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New supervisory law requirements for remuneration systems in banks and insurance companies

This client information refers to the following sources:

- Act on the supervisory law requirements for remuneration schemes in (banking) institutions and insurance companies, BGBl. I/2010, S. 950 and draft, published in BT-Drs. 17/1291 of March 31, 2010.
- Regulation on the supervisory law requirements for remuneration schemes in (banking) institutions („**InstitutsVergV**“), BGBl. I/2010, S. 1374.
- Regulation on the supervisory law requirements for remuneration schemes in the insurance sector („**VersVergV**“), BGBl. I/2010, S. 1379..
- BaFin circular 22/2009, requirements for remuneration schemes of (banking) institutions
- BaFin circular 23/2009, requirements for remuneration schemes in the insurance sector.
- Commission recommendation of April 30, 2009 on the regulation of remuneration of members of the executive of publicly listed companies, 2009/385/EG („**EU-recommendation for publicly listed companies**“)
- Commission recommendation of April 30, 2009 on remuneration policy in the financial services sector, 2009/384/EG („**EU-recommendation for the financial services sector**“).
- Draft European Union directive of July 7, 2010 on the amendment of the directives 2006/48/EG and 2006/49/EG with regard to equity capital requirements for the trading book and for re-securitisations and the supervisory review of remuneration policies („**draft directive**“), Kom(2009)0363 – C7-0096/2009 – 2009/0099(COD).

A.

Developments on the national and international level

Since the financial markets crisis, remuneration provisions of listed companies in general and in particular of financial and banking institutions have been a focus of politics. First, the legislative introduced rules on the remuneration of executive board members of stock companies independent from the business concerned in the Act on the Appropriateness of Management Board Compensation (VorstAG, cf. our client information of August 2009). These provisions are now being tightened up with regard to remuneration systems in banks and insurance companies.

Before, particular provisions concerning executive remuneration in the financial services sector were already contained in the principles for the stabilization of financial markets, the so called "Principles for Sound Compensation Practices – Implementation Standards" ("**FSB-Standards**"). These standards were developed by the "Financial Stability Board" ("**FSB**") which had been called together by the G20-countries as a reaction to the financial markets crisis. The implementation of these standards into German law was undertaken in several steps:

- Some of the German banks and insurance companies already submitted to a voluntary obligation to adhere to the FSB-Standards in December 2009.
- In late December 2009, the German Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht, "**BaFin**") substantiated the principles laid out in the FSB-Standards for German law and published requirements for remuneration systems in banks and insurance companies in its circulars 22/2009 (BA) and 23/2009 (VA).

- On July 27, 2010, the law on the supervisory requirements for remuneration systems in banks and insurance companies came into force. The latter is being supplemented by regulations of the German Ministry of Finance ("**BMF**") on the supervisory requirements for remuneration systems in banks (InstitutsVergV) and insurance companies (VersVergV) since October 12, 2010.

On the European level, the commission published in April 2009 two recommendations; one on the remuneration of business leaders of publicly listed companies and another on the remuneration policies in the financial services sector. In the very near future, a supplement to the banking- (2006/48/EG) and equity capital (2006/49/EG) directives is expected concerning the supervisory requirements for remuneration policies in financial services companies. In parts, these shall already apply starting on January 1, 2011.

B.

The act on the supervisory requirements for remuneration systems

I. Parameters for remuneration structure

The requirements for remuneration systems set forth in the statute are rather general: Sec. 25a para. 1 no. 4 KWG and Sec. 64b VAG require remuneration systems to be *transparent* and *directed at a sustainable development (long term value creation) of the institution*. The definition of more detailed requirements is left to executive branch directives.

This expands the material and personal applicability of the existing (stock corporation law) standards: The special rules for banks and insurance companies apply to all types of companies without regard to legal form which fall within the scope of the KWG resp. the VAG. In addition, these requirements not only apply to executive level personnel but to all employees, in particular so called „risk takers“ (cf. infra). In insurance companies, the requirements extend to supervisory board members (Sec. 64b para. 1 VAG).

II. Sanctions

The law includes a central denouement with regard to sanctions: Pursuant to Sec. 45 para. 1 s. 1 no. 4 KWG resp. Sec. 81b para. 1a VAG, the BaFin can now interdict the payment of variable remuneration portions or reduce such to a portion of the yearly result. Such requires that the company would no

longer fulfill the supervisory requirements in case of payment of the remuneration due to a lack of capital resources or in case it is to be expected that the company will no longer fulfill these requirements in the future.

This authority of the BaFin must be taken into account in agreements with executives and employees. Pursuant to Sec. 34 para. 1 s. 1 nr. 4 KWG resp. Sec. 81b para. 1a VAG, no rights or claims can be derived from contractual agreements containing variable remuneration provisions without a reservation concerning an intervention by the BaFin.

III. Temporal Scope of the Revisions

The provisions of the law are applicable to remuneration systems of companies as of its entering into force (July 27, 2010). The legislative history shows that the revised version of the law shall also apply to contracts which were concluded before the effective date of the law. According to the government's statements, conservation of the status quo shall only apply to remuneration portions already paid; these shall not be affected retroactively.

C.

The directives of the BMF

Since October 12, 2010, both the regulation on supervisory requirements for remuneration systems of banking and financial services institutions (**InstitutsVergV**) and the regulation on the supervisory requirements for remunerations systems in the insurance industry (**VersVergV**) have been in force. The BMF had submitted drafts of both regulations to the affected industry associations in late May; the InstitutsVergV in particular has been amended considerably compared to the draft. While the regulations are based on their predecessors, the BaFin circulars 22/2009 (BA) and 23/2009 (VA), at least in part they extend beyond these considerably.

I. InstitutsVergV

As was already the case in BaFin circular 22/2009 (BA), the InstitutsVergV differentiates between general requirements for remuneration systems (Sec. 3 InstitutsVergV) to be complied with by all banking and financial services institutions within the meaning of Sec. 1 para. 1b KWG and special requirements for remuneration systems of so called important institutions (Sec. 5, 6 and 8 InstitutsVergV).

In Sec. 2, the InstitutsVergV contains a catalog of definitions. Aside from the term "remuneration" the terms "remuneration systems", "remuneration parameters" and "profit contribution" are now defined in the regulation. This is equally true for the terms "variable" and "fixed remuneration". Variable remuneration is defined as that part of remuneration the grant or amount of which is within the discretion of the institution or dependent on the fulfillment of agreed upon conditions. The variable remuneration within the meaning of the InstitutsVergV also includes any contributions to pension schemes within the institutions discretion.

1. General Requirements

a) Reasonableness of Remuneration Systems

The core of the general requirements for remuneration systems is that they be reasonable. Pursuant to Sec. 3 para. 3 InstitutsVergV, remuneration systems are, in particular, reasonable if incentives to take unreasonably high risks are prevented and the remuneration systems do not counteract the supervisory functions of controlling units.

aa) Prohibited incentives for taking unreasonable risks

The InstitutsVergV defines two cases in particular in which there is a prohibited incentive to take an unreasonably high risk.

For one, this is the case if the executive or employee concerned is significantly dependent on the variable remuneration (Sec.3 para. 4 s. 1 nr. 1). In this context, Sec. 3 para. 5 InstitutsVergV also provides that variable and fixed remuneration portions must be reasonably balanced. This, according to the regulation, is the case if there is (1) no significant dependency on the variable remuneration and (2) the variable remuneration can nevertheless create an effective incentive. However, the InstitutsVergV does not further specify when an employee may be dependent on the variable remuneration. EU-recommendation 4.2 for the financial services sector (and EU-recommendation 3.1 for publicly listed companies) substantiates a reasonable balance to mean that the fixed remuneration portion shall constitute a sufficiently high part of the total remuneration so that the financial institution may exercise a bonus policy that is flexible in all aspects. In particular, the institution shall remain capable of completely or partially retaining a bonus without exposing the employees to existential risks. The reasoning behind

the draft of the InstitutsVergV also recurs on this aspect.

In comparison to the requirements to date, Sec. 3 para. 5 InstitutsVergV contains an extensive new provision obliging every institution to determine a reasonable upper threshold or cap for the balance between fixed and variable remuneration. This provision had not been contained in the initial draft of the InstitutsVergV and has its basis in the corresponding provision in the draft directive (Annex V, Nr. 23 lit. I).

The InstitutsVergV does not contain an explicit provision regarding who determines the cap applicable to the institution. The allocation of responsibilities under stock corporation law requires that the supervisory board is responsible for the remuneration of the executive board members and accordingly also for the determination of the reasonable balance between fixed and variable remuneration pursuant to Sec. 3 para. 5 InstitutsVergV. On the other hand, as also clarified in Sec. 3 para. 1 s. 1 InstitutsVergV, the management is responsible for the remuneration system for employees. From a legal standpoint, supervisory board and management must decide upon the applicable thresholds separately. These can but need not be the same. The same responsibility issues arise regarding the "principles of remuneration systems" to be set out in the organizational guidelines of the institution pursuant to Sec. 3 para. 11 InstitutsVergV.

Furthermore, pursuant to Sec. 3 para. 4 s. 1 nr. 2 InstitutsVergV, claims for benefits upon termination of employment/service which are fully enforceable even in case of negative individual contributions are prohibited. This provision was included before the backdrop of some considerable severance packages that retired executives and employees attempted to enforce in court against their former employers which has been rescued only by governmental aid. According to its wording, the provision, however, covers any and all benefits granted in case of the termination of the respective service/employ and thereby has a clearly overreaching tendency. Therefore, before the provision was passed, the central credit committee recommended to limit this provision to "existing claims". This raises the question whether severance claims that are justified in both amount and legal grounds fall within the scope of this provision and to what extent the provision allows interventions with regard to pension claims under individual agreements.

The InstitutsVergV only contains further requirements for the reasonable design of remuneration schemes concerning the remuneration of managers. Sec. 3 para. 4 s. 2 and 3 InstitutsVergV repeats the requirements of Sec. 87 German Corporation Act (AktG) concerning reasonableness and habitualness of executive remuneration as provided therein since the VorstAG. Therefore, these requirements apply to financial services institutions within the meaning of the KWG irrespective of legal form and public listing.

bb) Significance of supervisory function

Pursuant to Sec. 3 para. 3 InstitutsVergV, a reasonable design of remuneration schemes also requires that these "do not counteract the supervisory functions of controlling units". This requirement is further specified in Sec. 3 para. 6 InstitutsVergV. The legislative assumes that the intra-company supervisory control of a company is factually disabled if the remuneration of supervisory entities is *significantly* based on the same parameters as that of the entities or persons to be supervised. Hence, the variable remuneration for members of supervisory entities must be based on other remuneration parameters than those applicable to the persons supervised to a significant extent. However, a partial concurrence of parameters should be permissible.

b) No abolishment of risk orientation

Pursuant to Sec. 3 para. 7 InstitutsVergV, guaranteed variable remuneration is now only permissible at the time of beginning an employment or service relationship and may not exceed one year. This is in line with the provisions in Nr. 4.3 of BaFin circular 22/2009 and Nr. 11 of the FSB Principles. Furthermore, measures which limit or exclude the risk-orientation of the remuneration are prohibited. This obligation under Sec. 3 para. 8 InstitutsVergV is based upon Nr. 14 of the FSB Principles and had already been included in Nr. 5 of BaFin circular 22/2009. In this context, Sec. 3 para. 8 InstitutsVergV obligates institutions to introduce appropriate compliance structures.

c) Written form/information obligations

Sec. 3 para. 2 InstitutsVergV provides that the executive remuneration must be finally set forth in the respective service agreement. The service agreement and amendments thereto must be in the written form. In addition, all executives and employees must be informed in writing about the design of the remuneration systems applicable to them (Sec. 3 para. 9

InstitutsVergV). Furthermore, Sec. 3 para. 10 InstitutsVergV provides that the management, the administrative or supervisory board must be informed about the design of remuneration systems at least once per year.

d) Capital Resources

Sec. 4 InstitutsVergV provides that the total amount of variable remuneration may not negatively impact the institution's ability to maintain or reestablish sufficient capital resources in the long term. If such negative impact is to be feared, the intervention rights of the BaFin pursuant to Sec. 45 para. 1 s. 1 no. 4 KWG apply.

2. Special requirements for remuneration schemes in important institutions

There are additional requirements for remuneration schemes in so called "important institutions". Pursuant to Sec. 1 para. 2 InstitutsVergV, important institutions are such whose average balance sheet total over the last three years exceeded EUR 10 billion *and* which, in their risk analysis determine for themselves that they are important. BaFin circular 22/2009 had already called for such a self-assessment. The InstitutsVergV exceeds this somewhat. Institutions whose average balance sheet total over the last three years exceeds EUR 40 billion are generally regarded as important.

Regarding natural persons, the special requirements of Sec. 5 InstitutsVergV only apply to managers and such employees of an institution who can create considerable risks („**Risk Taker**“). Who this may be is to be determined by the institution itself by way of self-assessment under the InstitutsVergV. The decisive factors shall be the size of the institution, the type of business, the business volume, the type of risks, the revenues of the organizational unit and the activities of the person concerned as well as his/her position and remuneration to date. This assessment must be documented in writing in plausible form comprehensible to third parties, just like the self-assessment of the institution. Furthermore, the draft directive contains leads as to when an employee may be classified as a „**Risk Taker**“. The latter equates all employees whose total remuneration is generally equivalent to that of managers and "Risk Takers" to managers and "Risk Takers".

a) Special requirements for the determination of variable remuneration

aa) Remuneration Parameters

Sec. 5 para. 2 nos. 1-3 InstitutsVergV define parameters to be particularly taken into account in determining the variable remuneration for executives and risk takers in important institutions. Aside from the overall success of the institution, these include the organizational unit's and the individual's contribution to success. This is in line with the prior provisions in Nr. 4.3 lit. a of BaFin circular 22/2009 resp. follows from Sec. 87 para. 1 s. 1 AktG as far as the executives are at the same time executive board members of a stock corporation.

In addition, the personal profit contribution is to be measured against non-financial parameters such as the compliance with internal rules and strategies, customer satisfaction and qualifications (Sec. 5 para. 2 nr. 2 InstitutsVergV). Furthermore, Sec. 5 para. 2 nr. 3 InstitutsVergV provides that the company-oriented and – as far as possible – individual remuneration parameters must be oriented towards sustainable success/long term value creation.

bb) Deferral of variable remuneration

The special requirements set forth in BaFin circular 22/2009 already contained an obligation to retain a part of variable remuneration. The InstitutsVergV further exacerbates these requirements:

Depending on an employee's position and tasks, the amount of the variable remuneration and the risks which an employee may cause, at least 40% of the variable remuneration must not be paid out immediately. For managers and employees on the leadership level immediately below them, this portion of deferred variable remuneration increases to 60%. This is an accentuation of the previous provisions in the BaFin circular but is in line with nos. 6 and 7 of the FSB Principles. The latter required that the portion of the variable remuneration to be deferred and the duration of the deferral period are to be fixed subject to the seniority and responsibility of the respective employee.

The InstitutsVergV in the form it entered into force (the initial draft was different) now takes up both aspects: Not only was the part of the variable remuneration for managers to be deferred increased to 60% but the withholding duration was also lengthened. Payment must now be extended over a **with-**

holding period of at least three to five years. Previously, there was only talk of three years. Pursuant to Sec. 5 para. 2 no. 4 s. 3 InstitutsVergV, the deferral period shall be oriented towards the business cycle, the type and risk of the business activities and the activities of the employees or managers concerned.

Furthermore, Sec. 5 para. 4 no. 4 InstitutsVergV provides that the variable remuneration *withheld* may not be paid out any faster than proportionally to time and that during the withholding period there is only a claim for correct determination of the variable remuneration but not for the variable remuneration itself. This is in line with the previous provisions in BaFin circular 22/2009 (Nr. 4.4 lit. d) and in the FSB Principles (Nr. 6 und 7).

cc) Dependency of variable remuneration on sustainability factors, whether deferred or not deferred

Nr. 4.4 lit. d) of BaFin circular 22/2009 provided that the withheld portion of the variable remuneration should be adjusted "according to sustainability". In practice, this was often handled by making the payment of the variable remuneration subject to achieving the remuneration parameters in the following years, thereby, in case these were not achieved, allowing the variable remuneration to be omitted in whole or in part.

The InstitutsVergV in its form now having come into effect (again the initial draft was different), differentiates between the provision on deferral (Sec. 5 para. 4 nr. 4) and that on taking into account sustainable value development/long term value creation (Sec. 5 para. 4 nr. 5 InstitutsVergV). This results in an exceedingly complex set of provisions: At least 50% of **both the deferred part of the variable remuneration as well as of the variable remuneration not deferred** are to be made dependent on the sustainable/long term development of the institution and be subject to a reasonable retention period after which these blocked parts of the variable remuneration may become available. This new concept in the InstitutsVergV leads to numerous new legal questions:

Regarding the deferred part of the variable remuneration, at least 50% of which now is to be dependent on the sustainable value development/long term value creation of the institution, the relationship between Sec. 5 para. 4 no. 4 and no. 5 is to be determined. Is it still sufficient to make the payment of the deferred remuneration portions subject to the

achievement of remuneration parameters for the following years and to pay out in case of their fulfillment taking into account the chosen withholding period and the temporal steps of Sec. 5 para. 4 no. 4 lit. a) InstitutsVergV? Or must there be an additional reasonable period after the deferral period, Sec. 5 para. 4 no. 5 InstitutsVergV during which payment is blocked? Regarding the part of the remuneration not withheld at least 50% of which must now also be dependent on the sustainable value development/long term value creation of the institution, there are questions as to how this can be practically implemented.

dd) Significance of negative profit contributions

Sec. 5 para. 4 no. 6 InstitutsVergV requires that negative profit contributions of the manager resp. the employees or their organizational units and the institution as a whole must diminish the variable remuneration. Insofar, the question arises which parts of the variable remuneration these „clawback“-provisions must apply to. Sec. 5 para. 4 nr. 6 InstitutsVergV speaks of the "variable remuneration *including the amounts withheld pursuant to nr. 4, also in connection with no. 5 lit. a*". Despite this broad wording, it is to be assumed that the provision only covers encroachments of the withheld portion of the variable remuneration which can be decreased in case of negative profit contributions. Repayment of amounts already paid out should not be possible based on Sec. 5 para. 4 no. 6 InstitutsVergV.

b) Special provisions regarding discretionary contributions to pension schemes

Sec. 5 para. 3 and 4 InstitutsVergV contain specific provisions concerning *discretionary contributions to pension schemes* which are granted either due to a termination of the employment of managers or employees for reasons of retirement (para. 4) or for other reasons (para. 3). Pursuant to the definitions in Sec. 2 no. 4 InstitutsVergV, such are parts of variable remuneration which are agreed for purposes of old age pension in light of an impending termination of employ with the institution. These must then be dependent on the sustainable value development/long term value creation of the institution and payment must be drawn out over **at least five years**. In cases in which the employment is not terminated as a consequence of retirement, § 5 Abs. 3 Nr. 3 InstitutsVergV provides that additional forfeitures provisions shall apply if the contributions to the profit are not to be regarded as sustainable.

c) Obligation to establish a Remuneration Committee

Pursuant to Sec. 6 InstitutsVergV, Important institutions must also establish an advisory committee (so called remuneration committee) that supervises the reasonableness of remuneration. Pursuant to Sec. 5 para. 3 InstitutsVergV, this remuneration committee has to provide a remuneration report to the management and the administrative or supervisory board of the company at least once per year. In addition, the chairman of the administrative or supervisory board must be granted a direct right to be informed by the remuneration committee. In case the institution in question is a stock corporation, such a right to information is somewhat problematic in light of the intra-company order of competences.

3. Publication obligations

In addition, the publication obligations in Sec. 6 InstitutsVergV for all institutions and in even broader form under Sec 7 InstitutsVergV for important institutions are a major regulatory revision. According to these provisions, information about the design of remuneration schemes, the composition of remuneration and the form and manner in which such is granted as well as the total amount of all remuneration and the number of recipients of variable remuneration must be published on the institutions' website and brought up to date at least once per year. This information shall be sufficiently detailed to allow for understanding and reproducing the compliance of the remuneration schemes with the requirements under the regulation

Important institutions must also publish additional information on their websites. This information includes such about the composition, responsibilities and organizational integration of the remuneration committee. In addition, the grant of guaranteed variable remuneration within the meaning of Sec. 3 para. 7 InstitutsVergV, the total amount of withheld variable remuneration in accordance with Sec. 5 para. 2 no. 4 InstitutsVergV or the total amount of the remuneration dependent on the sustainable value development/long term value creation of the institution (Sec. 5 para. 2 nr. 5 InstitutsVergV) must be reported (enumeration is only exemplary), differentiating between managers and risk takers.

4. Applicability of the InstitutsVergV to existing agreements

The InstitutsVergV came into effect on October 12, 2010. Sec. 10 InstitutsVergV concerns an obligation to amend agreements which were already concluded before it came into effect. Institutions are required to procure that „*existing agreements with executives and employees as well as binding obligations to provide benefits on the basis of intra-company customs and provisions (betriebliche Übung) that are not in line with this regulation must be amended based on a comprehensible legal evaluation as far as legally permissible and taking into account the concrete chances of success*“.

For the most part, this is in line with Nr. 6 of BaFin circular 22/2009. This results in a **two-tiered obligation to control** remuneration for both the executive board as far as employees are concerned and for the supervisory board as far as executives are concerned. On the first tier, it must be checked whether the existing "contracts or intra-company customs and provisions (*betriebliche Übung*) can be brought in line with the requirements of the InstitutsVergV. In case the result is that this is not possible, it must be checked on the second tier whether an amendment is legally permissible and can be enforced with sufficient chances of success.

II. VersVergV

Also on October 12, 2010, the regulation on the supervisory law requirements for remuneration schemes in the insurance sector („VersVergV“) came into effect. The requirements for remuneration schemes are partially the same as those in the InstitutsVergV so that in the following, we only address differing provisions.

In principle, the VersVergV shall be applicable to all insurance companies for which the Law on the Supervision of Insurance Undertakings (VAG) is applicable. Just like the InstitutsVergV, the VersVergV differentiates between general requirements which must be met by remuneration systems of the aforementioned insurance companies on the one hand and special requirements which must be fulfilled only by important companies.

1. General Requirements

The general requirements for remuneration systems under the VersVergV correspond to those for financial institutions. Insurance companies must establish

reasonable remuneration schemes. These are reasonable, in particular, if they avoid negative incentives (Sec. 3 para. 1 nr. 2 VersVergV).

Regarding managers, the variable part of their remuneration shall be a consideration for the sustainable success of the business/long term value creation resulting from the manager's activities (Sec. 3 para. 1 nr. 3 VersVergV). The variable remuneration may not significantly depend on the total of premiums collected, new business of the brokerage of individual insurance agreements. In addition, the requirements of Sec. 87 AktG were also included in the VersVergV so that these apply to the managers of insurance companies irrespective of the latter's legal form.

Furthermore, Sec. 3 para. 6 VersVergV provides that managers and supervisory board members of insurance companies may not be granted remuneration in connection with the brokerage of insurance agreements. The same applies to insurance brokerage enterprises which broker insurance agreements for the company on a large scale. The BMF perceived a risk that managers would be tempted to build large volume business instead of sustainable business/long term value creation if they were granted variable remuneration on this basis.

2. Special Requirements

The VersVergV also contains a special chapter concerning requirements for remuneration schemes in important companies. Sec. 1 para. 2 VersVergV defines an important company as insurance companies, insurance groups or financial conglomerates with total assets of at least EUR 45 billion and which based on a risk analysis determine their special relevance themselves. A special importance of an institution is assumed if it has total assets of EUR 90 billion or more. Below the threshold of total assets of EUR 45 billion, companies are not considered of special importance (Sec. 1 para. 2 s. 8 VersVergV).

As regards natural persons, the special requirements of the VersVergV again apply to managers and such employees who – according to self-assessment by the company – have substantial influence on the risk profile as a whole (Sec. 4 para. 1 s. 1 VersVergV).

The special requirements of the VersVergV, on the whole, are equivalent to those of the InstitutsVergV but are less stringent in part. E.g., the VersVergV

also requires that fixed and variable remuneration portions must be in a reasonable balance but the VersVergV does not establish an obligation to determine a reasonable upper threshold or cap. The provisions regarding the withholding of parts of the variable remuneration are also more lenient: It is sufficient if at least 40% of the variable remuneration is not paid out before the end of a *reasonable* withholding period. In general, a period of three years is regarded as reasonable. Again, 50% of this withheld part of the variable remuneration shall be dependent on the long term value creation of the company (Sec. 4 para. 3 nr. 3 VersVergV). Negative profit contributions again are covered as in the InstitutsVergV and pursuant to Sec. 4 para. 3 no. 4 VersVergV decrease the amount of the variable remuneration including the withheld portions. The provisions regarding discretionary contributions to pension schemes are also largely equivalent (Sec. 4 para. 5 and 6 VersVergV).

Important insurance companies within the meaning of the VersVergV, just like important institutions under the InstitutsVergV, must establish a remuneration committee and report about their remuneration systems once per year. The VersVergV does not contain further requirements regarding these publication obligations and other than in the InstitutsVergV, the reporting obligation only applies to important companies within the scope of the VersVergV.

3. Applicability

The VersVergV also came into effect on October 12, 2010 and, in principle, is directly applicable. Pursuant to Sec. 6 VersVergV, existing agreements must be amended under the same prerequisites as pursuant to Sec. 10 InstitutsVergV. The provisions are almost identical.

D.

Developments on the European level

On the European level, there will be a supplement to the banking directive (2006/48/EG) and the equity capital directive (2006/49/EG) regarding supervisory requirements for remuneration policies of financial services companies. Major changes result from an amendment of the existing directive concerning banking of June 14, 2006 (2006/48/EG) and the inclusion of a separate Annex regarding remuneration policy. The amendment directive shall be ratified and come into effect this year.

In a large part, the InstitutsVergV has already taken into account and reflected the draft directive. This is true, e.g., with regard to the provisions concerning the retention of a major portion of variable remuneration 4: 40-60 % pursuant to the directive), the general prohibition of guaranteed variable remuneration or the obligation to establish a remuneration committee in important financial services companies. Therefore, we only address additional aspects of the draft directive in the following.

I. Parts of variable remuneration

Annex V no. 23 lit. o) of the draft directive provides that "a considerable part which makes up at least 50% of the variable remuneration" shall consist of "stock or equivalent interests depending on the legal form of the financial institutions concerned or of instruments connected to shares or equivalent non-cash instruments". This provision has its basis in the concepts of the FSB which was mainly concerned with shares or stock price based remuneration (cf. nr. 8 FSB Principles: „*shares or share-linked instruments or, where appropriate, other non-cash instruments*“). These should be designed in a manner that they create incentives for long-term value creation.

The InstitutsVergV does not contain respective requirements for the individual parts of variable remuneration. Just like the preceding provision in BaFin circular 22/2009 nr. 4.4 lit. e), it only recurs to the dependency on long term value creation for the institution.

II. Remuneration in case of governmental support for a financial institution

The InstitutsVergV does not include specific remuneration provisions for financial institutions receiving governmental support (in Germany: from SoFFin). So far, such restrictions, e.g. capping of executive remuneration at a fixed maximum of EUR 500.000, resulted from contractual agreements under which governmental support was granted. A statutory cap on the variable remuneration of executives and employees is the subject of great controversy on a national level.

In case financial institutions benefit from governmental support, the draft directive provides the following:

- The variable remuneration is strictly limited to a percentage of the net revenues if it cannot be brought in line with the maintenance

of sound capital resources and early termination of governmental support.

- The competent authorities require financial institutions to redesign their remuneration structures to be in line with sound risk management and long term growth and, inter alia, if necessary encompass upper thresholds for executive remuneration.
- The executives of such a financial institution do not receive any variable remuneration unless it is justified.

III. Responsibility of the CEBS for creating guidelines for sustainable remuneration policy

With regard to future developments it is furthermore decisive that the draft directive in its Art. 22 para. 4 Banking Directive (2006/48/EG) grants to the *Committee of European Banking Supervisors – CEBS* the responsibility and jurisdiction to create "guidelines for sustainable remuneration policy". On October 8, 2010, CEBS presented a first draft of „Guidelines on

Remuneration Policies and Practices“ (CP 42); the consultation deadline runs out on November 8, 2010.

According to Annex V no. 23 lit. I s. 3 of the draft directive, the guidelines shall also include criteria for the determination of a reasonable balance between variable and fixed remuneration components (cf. Sec. 3 para. 5 s. 3 InstitutsVergV). The aforementioned draft does so in nr. 78-84 but remains rather general.

E. Perspective

With the InstitutsVergV, the legislative has again considerably intensified regulation of remuneration systems in the banking and insurance industry. Further regulation, in particular on the European level, is to be expected. It remains to be hoped that solutions can be found which do not exacerbate the already increased time, effort and expense required for the institutions concerned to comply with new regulatory requirements.

This client information only contains a broad overview on its subject matter. It does not and is not intended to replace legal advice. Regarding this client information and for further advice, the following persons are available:

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