The Commission's Evaluation of the Financial Executives' Remuneration Policy and the Amendments of Directive No 2019/878

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Abstract

The Commission evaluation of EU policies has become an important practice for the review of EU rules. This article is a case study of the 2016 evaluation of the remuneration rules applicable to financial executives (Directive No 2013/36 – CRD IV), which led to their amendments made by Directive 2019/878. These amendments have been negligible and despite the efforts of private interest groups operating in the financial sector, the so-called bonus cap has been maintained.

This article explores the dynamics amongst the actors involved in the evaluation of the remuneration policy (Commission, European Banking Authority, and stakeholders) and provides an account of the factors that shaped such evaluation. This paper argues that the influence of private interest groups was limited. Although the bonus cap is a contested policy, and the evidence of its impact ambiguous, it still enjoys legitimacy.

Keywords

Financial executives' remuneration policy, CRD IV Bonus Cap, Commission evaluation, Amendments of Directive No 2019/878.

1. Introduction

After the financial crisis of 2008, it was claimed that one of the contributing factors was the structure of remuneration packages paid to financial executives.[1] In particular, the variable component of remuneration was dependent on the achievement of targets, which created the incentive to trade risky financial instruments and focus on short-term performance. Therefore, the EU's response to the financial crisis also

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[1] For the present purposes, financial executives refer to staff working in financial institutions regulated by Directive No 2013/36 (CRD IV) which include any staff whose professional activities have a material impact on the risk profile of the institutions they work for. See Article 92(2), CRD IV.

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included mandatory rules on the structure of financial executives' pay (hereinafter 'remuneration policy', 'remuneration rules' or 'remuneration provisions'). The policy goal was to align remuneration structures with medium and long-term stability of institutions operating in the financial sector.

The first rules on financial executive remuneration were laid down in a 2009 Recommendation.[2] In 2010, CRD III (Capital requirements directive) introduced mandatory rules,[3] which were subsequently amended in 2013 by CRD IV (Directive 2013/36).[4] Finally, Directive 2019/878 further amended some remuneration provisions (hereinafter the '2019 amendments').[5] Although Directive 2019/878 was adopted by co-decision procedure (approval of the European Parliament and the Council), the underpinning evidence and the rationale of the 2019 amendments can be traced back to the Commission's evaluation of the remuneration policy, which was prescribed by CRD IV[6] and completed in 2016 (the '2016 Evaluation').[7]

The 2016 Evaluation recommended minor changes, which were adopted by the 2019 amendments. These consisted primarily in exempting small and non-complex financial institutions from the application of some remuneration rules.[8] However, the 2016 Evaluation did not recommend changes to the bonus cap rule (also: maximum ratio rule), which was left unaltered by Directive 2019/878. This rule provides a ratio between fixed and variable remuneration whereby the latter cannot exceed 100% of the former.[9]

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[2] Commission Recommendation of 30 April 2009 on remuneration policies in the financial services sector (2009/384/EC). OJ [2009] L120/22.

[3] Directive 2010/76/EU of the European Parliament and of the Council of 24 November 2010 amending Directives 2006/48/EC and 2006/49/EC as regards capital requirements for the trading book and for re-securitisations, and the supervisory review of remuneration policies. OJ [2010] L329/3.

[4] Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC. OJ [2013] L176/338 (CRD IV).

[5] Directive (EU) 2019/878 of the European Parliament and of the Council of 20 May 2019 amending Directive 2013/36/EU as regards exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers and capital conservation measures. OJ [2019] L150/253.

[6] Article 161, CRD IV.

[7] Report from the Commission to the European Parliament and the Council. Assessment of the remuneration rules under Directive 2013/36/EU and Regulation (EU) No 575/2013. COM(2016) 510 final.

[8] An analysis of the 2019 amendments will be made later.

[9] CRD IV Article 94(1)(g)(i). Member States can set the ratio at 200% with shareholders' approval. This was introduced upon the input of the European Parliament: See the Report on the proposal for a directive of the European Parliament and of the Council on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms and amending Directive 2002/87/EC of the European Parliament and of the Council on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate (A7-0170/2012) of 30 May 2012, in particular, Article 90(1)(f) 'institutions shall set the appropriate ratios between the fixed and the variable component of the total remuneration where the variable component shall not exceed one time the fixed component of the total remuneration'.

As in any other stage of policy-making, a number of stakeholders participated in the Commission's evaluation by providing evidence and information about the impact of the remuneration rules; most of these stakeholders were interest groups operating in the financial sector. These interest groups raised concerns, *inter alia*, about the adverse effects of some remuneration rules. However, while the Commission accepted some of their concerns, which led to the 2019 amendments, financial interest groups failed to convince the Commission to repeal the maximum ratio rule. Against this background, this article investigates the factors that shaped the evaluation process and in particular why the Commission kept the maximum ratio rule. It does so by examining the actors involved in this evaluation, their dynamics, and how the Commission strategically used the evaluation findings.

This article argues that the influence of economic interest groups was limited to minor aspects that are reflected in the 2019 amendments. By contrast, given the legitimacy of the maximum ratio rule amongst the public and the lack of conclusive evidence of its impact, the Commission did not propose any amendment. This article brings an original contribution to the scholarships of corporate law and of the Commission's policy-making.

Some corporate law scholars criticised the bonus cap rule because *inter alia* they argued that performance-related remunerations did not contribute to the financial crisis and because the bonus cap adversely affects the competitiveness of banks. However, with respect to the competitiveness of banks, the 2016 Evaluation shows there is no conclusive evidence substantiating this claim. In general, while the 2016 Evaluation was supposed to be an opportunity to verify the criticisms to the remuneration provisions, serious epistemic challenges undermined its findings.

With regard to the Commission's policy-making, the 2015 Better Regulation Agenda emphasises evaluation as a starting point for new regulatory interventions.[10] However, it has been argued that the Commission's approach to evaluation could disguise a programme of deregulation.[11] Although this article is a case-study, and therefore its findings cannot be generalised, it shows that this is not always the case, as testified by the bonus cap rule. This research also contributes to the topic of participation of stakeholders and independent agencies in European policy-making. In particular it covers the problem of undue influence of the former over the legislative process.

This article is structured as follows:

Section 2 explains the methodology followed in this research. Section 3 offers an overview of the Commission's evaluation as set out in the Better Regulation Agenda. Section 4 summarises the specific aspects of the remuneration rules to be evaluated as set out in CRD IV. Section 5 gives an overview of the main characteristics of

[10] For the purposes of this article, evaluation refers to a retrospective assessment of the performance of a policy, which is the same meaning given by the Commission in the 'Better Regulation Agenda', SWD(2015) 111 final.

[11] Stijn Smismans, *Policy Evaluation in the EU: The Challenges of Linking Ex Ante and Ex Post Appraisal* 6 European Journal of Risk Regulation 6 (2015).

evaluation of the remuneration rules. Section 6 examines the actors involved in the 2016 evaluation: the Commission, the European Banking Authority, and stakeholders. Section 7 looks into the problems that affected the 2016 Evaluation. Section 8 reports the main findings of the 2016 Evaluation and the relevant amendments made by Directive 2019/878. Section 9 provides an assessment of the 2016 Evaluation. Section 10 draws some conclusions.

2. Methodology

Since this article investigates the factors that accounted for the 2016 Evaluation, it is a case-study on a policy output (the 2016 Evaluation), which can be explained by examining the interactions of the Commission with the European Banking Authority (EBA) and with stakeholders. Put differently, a policy evaluation may be considered as an 'event' resulting from a 'process'. The understanding of social processes and how events happen is achieved through qualitative methods,[12] which generate knowledge through the use of, *inter alia*, in-depth interviews and text analysis. Indeed, this research primarily relied on legal and policy documents of the Commission and the EBA and on semi-structured elite interviews with two Commission policy officers and two EBA policy officers.

The legal documents were the CRD IV and Directive 2019/878. The policy documents were those published by the Commission and EBA throughout the evaluation from its inception to the Commission Report evaluating the remuneration rules (the 2016 Evaluation).[13] They were downloaded from the Commission and EBA websites and consisted of opinions, impact assessments, staff working papers and the relevant legislative proposals. Other important documents included some financial interest groups' contributions submitted during a public consultation that the Commission launched in 2016 to acquire information on the impact of these rules.[14] Such stakeholders' submissions were then summarised in the Commission feedback statement.[15]

The analysis of the policy documents was made because they expressed the institutional stance of the Commission and EBA, and because they showed the interactions between these two institutions. Similarly, interest groups' submissions were examined because they expressed their policy preferences. The analysis of all these documents showed a number of factors such as the EBA's assistance to the Commission and the influence of interest groups, which could account for the 2016 Evaluation.

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[12] Ariadne Wromen, *Debating Methods: Rediscovering Qualitative Approaches* in David Marsh and Gerry Stoker (eds.), *Theory and Methods in Political Science,* 249-250 (Palgrave, 3rd ed. 2010).

[13] Report from the Commission to the European Parliament and the Council. Assessment of the remuneration rules under Directive 2013/36/EU and Regulation (EU) No 575/2013. COM(2016) 510 final.

[14] The stakeholders contributions are also no longer available on the Commission website and are on file with the author.

[15] 'Commission Feedback Statement, Summary of responses to the public consultation on the CRD IV remuneration rules' (2016). No longer available on the Commission website, on file with the author.

In particular analysis of stakeholders' contributions was carried out to determine whether, and if so, the extent to which, stakeholders' preferences corresponded to the position adopted by the Commission as expressed in the 2016 Evaluation. If they corresponded, then it could be inferred that their lobbying was successful, although it must be remembered that the reason for the adoption of a policy may be due to alternative explanatory factors unrelated to interest groups lobbying.[16]

The role of the Commission and EBA in the evaluation and the participation of stakeholders informed the questions, which were subsequently discussed in two separate semi-structured elite interviews with the Commission and EBA policy officers who were involved in, or had close knowledge of, the evaluation of the remuneration policy. The first interview was with two Commission officers and took place in January 2018 in Brussels. The second interview was with two EBA officers and took place in May 2019 in London. The questions to the Commission and EBA officers were structured into two groups. The first group was concerned with the relationship with each other: the Commission officers were asked how they saw their relationship with EBA, and the EBA officers were asked how they saw their relationship with the Commission. The second group of questions concerned the lobbying of interest groups: the Commission officers were asked how interest groups lobbied the Commission, and equally the EBA officers were asked how interest groups lobbied the EBA.

The reason for the interviews with the Commission and EBA officers was that they had in-depth knowledge of the implementation of the remuneration policy, of the involvement of financial interest groups, and of the problems encountered during the evaluation, thus could provide valuable insights into the evaluation process. Here a note of caution is necessary: elite interviews present limitations in assessing interest groups' influence. Lobbying takes place also behind closed doors and in several venues, which means that this activity is not directly observable.[17] Similarly, the interviewed officers may not be aware of all lobbying initiatives that took place to influence the evaluation of the remuneration rules. Finally, they may be reluctant to acknowledge the influence exerted by interest groups. Nonetheless, the Commission and EBA officers provided inside knowledge which does not transpire in the policy documents produced during the 2016 Evaluation.

3. The Commission Evaluation in the 2015 Better Regulation Agenda

A summary of the general characteristics of the Commission's evaluation system is desirable to better understand the evaluation of the remuneration policy. The Commission undertook to carry out a regular and systematic evaluation of the EU policies

[16] Ascertainment of interest groups influence is notoriously difficult. This technique of comparison is still advocated by some political scientists, but they also warn that other variables may explain a certain event. See Heike Klüver, *Lobbying in the European Union*, 63 (OUP 2013).

[17] Heike Klüver, *Lobbying in the European Union*, 61 (OUP 2013).

in the 2015 Better Regulation Agenda (BRA), which was part of a broader commitment to evidence-based policy-making. Evaluation is a retrospective assessment of the effects of a policy (outcome evaluation), of the causal mechanisms between policy and effects (impact evaluation), and whether a policy has achieved its goal(s).[18] The most important goals of evaluation are policy learning (the evaluation findings are used to improve the policy)[19] and accountability (holding the Commission accountable to the European Parliament, Member States).[20] Indeed, an evaluation informed to evidence also contributes to the quality of democracy as it allows citizens to be informed and debate on a policy.[21]

The Better Regulation Agenda states that the assessment should cover whether the EU measures have been effective, efficient, relevant, coherent, and have achieved EU added value.[22] Effectiveness refers to whether, why and how the measure under evaluation has achieved its goal. Efficiency refers to the costs (including the regulatory burden) and benefits generated by the measure under evaluation. Relevance assesses whether the goal(s) of the EU measure are still justified in the light of the current needs and problems. Coherence looks at whether the components of a policy are still suitable to achieve its goal (internal coherence) and whether the policy is coherent with other EU interventions (external coherence). Finally, evaluation investigates whether a measure has been more effective at EU level rather than regional or national level (added value or also subsidiarity check). The BRA emphasis on efficiency, effectiveness, and policy improvements based on evaluation findings fits the rationalistic approach to evaluation, which is designed to produce objective assessments to be used for policy improvements. (It is also referred to as 'instrumental use'). The opposite approach is called 'argumentative', which rejects the claim that evaluation is neutral and instead understands it as part of a political process where political actors have a stake in the evaluation findings according to their preferences. On this latter view, political actors may use evaluation findings also for purposes other than policy improvement.[23] Political science scholarship has recently devoted attention to the Commission's policy evaluation and seems to confirm the argumentative approach.[24] Overall, that scholarship casts doubt on the Commission's ability and

[18] Christoph Knill and Jale Tosun, *Public Policy,* 175 (Palgrave 2012).

[19] This is sometimes referred to as 'evaluate first' principle. Commission 'Better Regulation Agenda', SWD(2015) 111 final, at p 51.

[20] BRA, at p 51. See also, Steven Højlund, *Evaluation in the European Commission* 6 European Journal of Risk Regulation 35 (2015).

[21] Robert Picciotto, *Democratic Evaluation for the 21st Century* 21 Evaluation 150.

[22] Commission 'Better Regulation Agenda', SWD(2015) 111 final. Pages 57-60.

[23] Mark Bovens, Paul't Hart & Sanneke Kuipers, *The Politics of Policy Evaluation* in Michael Moran, Martin Rein & Robert Goodin (eds), *The Oxford Handbook of Public Policy,* ch15, 319, 324 (OUP 2006).

[24] Steven Højlund, *Evaluation Use in Evaluation Systems – The Case of the European Commission* 20 Evaluation 428 (2014); Stijn Smismans, *Policy Evaluation in the EU: The Challenges of Linking Ex Ante and Ex Post Appraisal* 6 European Journal of Risk Regulation 6 (2015); Thomas van Golen & Stijn van Voorst, *Towards a Regulatory Cycle? The Use of Evaluative Information in Impact Assessments and Ex-post Evaluations in the European Union* 7 European Journal of Risk Regulation 388 (2016); Ellen

commitment to using evaluation findings for policy improvements. Among other things, it has been argued that evaluation could disguise a programme of deregulation,[25] and that the Commission has failed to make proper use of evaluation findings.[26]

4. The Aspects of the Remuneration Policy to be Evaluated

Even before the Commission committed to systematic policy evaluation in the BRA, some EU legislation provided that it had to be assessed after its implementation. This is the case with CRD IV: it required the Commission to review the remuneration rules by June 2016,[27] which was done by the 2016 Evaluation. This section provides an overview of what aspects of the remuneration provisions had, therefore, to be evaluated.

The first one was the domestic implementation, enforcement, and identification of lacunae resulting from the application of the principle of proportionality. Here the goal of the evaluation was to ensure a level playing field among financial institutions.[28] This refers to the problem of Member States implementing differently the remuneration policy, which created wide-ranging differences at national level. It also reflects the concern of regulatory arbitrage and competitive disadvantage of those Member States that implemented the CRD IV requirements strictly.[29]

The second one is the efficiency of the remuneration rule.[30] CRD IV does not define the meaning of efficiency of these rules. However, the 2015 BRA refers to efficiency

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Mastenbroek & Stijn van Voorst, *Enforcement Tool or Strategic Instrument? The Initiation of Ex-Post Legislative Evaluations by the European Commission* 18 European Union Politics 640 (2017); Stijn van Voorst, *Evaluation Capacity in the European Commission* 23 Evaluation 24 (2017); Stijn van Voorst & Pieter Zwaan, *The (Non-) Use of Ex Post Legislative Evaluations by the European Commission* 26 Journal of European Public Policy 366 (2018); John Turnpenny, Claudio Radaelli, Andrew Jordan & Klaus Jacob, *The Policy and Politics of Policy Appraisal: Emerging Trends and New Directions* 16 Journal of European Public Policy 640 (2009); Ellen Mastenbroek, Stijn van Voorst & Anne Meuwese, *Closing the Regulatory Cycle? A Meta Evaluation of Ex-Post Legislative Evaluations by the European Commission* 23 Journal of European Public Policy 1329 (2016); Ellen Mastenbroek, Stijn van Voorst & Pieter Zwaan, *Ex Post Legislative Evaluation in the European Union: Questioning the Usage of Evaluations As Instruments for Accountability* 82 International Review of Administrative Sciences 674 (2016).

25 Stijn Smismans, *Policy Evaluation in the EU: The Challenges of Linking Ex Ante and Ex Post Appraisal* 6 European Journal of Risk Regulation 6 (2015).

26 Thomas van Golen & Stijn van Voorst, *Towards a Regulatory Cycle? The Use of Evaluative Information in Impact Assessments and Ex-post Evaluations in the European Union* 7 European Journal of Risk Regulation 388 (2016) and Stijn van Voorst & Pieter Zwaan, *The (Non-)Use of Ex Post Legislative Evaluations by the European Commission* 26 Journal of European Public Policy 366 (2018).

27 CRD IV, Article 161.

28 CRD IV, Article 161(1).

29 See for example, Recital 65 of Directive 2013/36, which with regard to the rule prescribing a maximum ratio between variable and fixed component of the total remuneration, it requires the EBA to provide guidelines that ensures a level playing field.

30 CRD IV, Article 161(2)(a).

as an assessment of costs and benefits of EU interventions.[31] In the context of regulatory policies, which is the case of CRD IV, any analysis of efficiency shall take into account administrative and regulatory burden.[32] A particular inquiry into the efficiency of remuneration rules is the impact of the bonus cap rule on competitiveness and on staff working in subsidiaries located outside the EEA.[33]

Promoting financial stability[34] is the overarching aim of this directive. Given that the rationale of the remuneration rules is to discourage excessive risk-taking, which was thought to be a contributor factor to the financial crisis,[35] CRD IV also required an assessment of the impact of the bonus cap rule on financial stability.[36]

Overall, evaluation of the remuneration rules reflects various concerns (efficiency, effectiveness, and level playing field), which also underlie conflicting goals. For example, financial stability is achieved by increasing regulatory requirements, which may adversely affect the competitiveness of financial institutions.

5. Compulsory and Periodic Evaluation of the Remuneration Policy

The 2015 BRA provides that only major initiatives should be evaluated, in particular directives and complex legislation.[37] By contrast, CRD IV provides that the Commission shall conduct periodic reviews,[38] which means that its evaluation is compulsory. Mandatory evaluation is not a novelty of CRD IV. Directive 2010/76 entrusted the

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[31] Commission 'Better Regulation Agenda', SWD(2015) 111 final, at p 57.

[32] *Ibid*.

[33] CRD IV, Article 161(2)(b)(i) and (ii).

[34] There is no fixed definition of financial stability, it has been described as an elusive and evolving concept. Rosa Lastra, in *Systemic Risk and Macro-Prudential Supervision* in Niamh Moloney, Eilís Ferran & Jennifer Payne (eds.), *The Oxford Handbook of Financial Regulation,* ch11 (OUP 2015).

[35] See for example, recital 62 which states that 'excessive risk-taking behaviour can undermine sound and effective risk management of credit institutions and investment firms'. More explicit is Article 161(2)(b)(i) which requires the Commission to investigate the impact of the maximum ratio rule on the financial stability. In this context, excessive risk-taking behaviour is defined as a choice of 'an inefficient portfolio, i.e. on where the same expected return could be achieved with a lower level of risk at a given risk appetite.' in: Idlan Zakaria, Udo Reifner Doris Neuberger, Sebastian Clerc-Renaud, Paola Schwizer, Andreas Nastansky, Andreas Stephan, Maria Gaia Soana, Giovanni Ferri, Saul Schwartz, William Forbes, Christine Riefa, *Final Report: Study on the Remuneration Provisions Applicable to Credit Institutions and Investment Firms* (Prepared by the institute for financial services for European Commission's DG JUST, January 2016), p 62. <https://www.verantwortliche-kreditvergabe.net/index.php?id=1976&viewid=49046> Hereinafter: '2016 Final Report, Study on the remuneration provisions applicable to credit institutions and investment firms' or simply: '2016 Final Report'.

[36] CRD IV, Article 161(2)(b)(i).

[37] Commission in the 'Better Regulation Agenda', SWD(2015) 111 final, at pages 51 and 52. However, programmes and activities indicated by Financial Regulation have to be evaluated. With regard to the Commission's discretion on what programmes should be evaluated, see: Stijn van Voorst and Ellen Mastenbroek, *Enforcement Too or Strategic Instrument? The Initiation of Ex-Post Legislative Evaluations by the European Commission* 18 Evaluation 640 (2017).

[38] CRD IV, Article 161.

Commission with reviewing the provisions on remuneration.[39] The 2011 impact assessment of CRD IV confirmed the Commission's duty to evaluate these provisions,[40] now provided for in Article 161 of CRD IV. Finally, Directive 2019/878 has confirmed the Commission's duty to review some of the amended remuneration provisions by December 2023.[41] The Impact Assessment of CRD IV[42] does not state the reason why evaluation of CRD IV was made compulsory, rather, it refers to the duty of the Member States to implement it correctly.[43] A plausible hypothesis is that a mandatory evaluation enabled the Commission to overcome the objections to the remuneration rules, particularly the maximum ratio rule. It should be remembered that the remuneration rules, especially the maximum ratio rule, were opposed by the financial sector and one of the problems that the Commission had to address was the scarcity of evidence. Opponents to these rules argued that the impact of executives' remuneration packages was a marginal factor in the 2008 financial crisis. Even if remuneration packages had had a significant role, it would be difficult to design rules conducive to optimal risk-taking behaviour by executives. Facing these difficulties, the Commission proposed remuneration rules with a wide scope of application, but that at the same time it could use the statutory duty to evaluate this policy to make credible commitments to changing these rules in the light of evaluation findings. This way, the Commission addressed the objections to these rules by showing it was willing to revise them if appropriate.

A second reason for providing mandatory and periodic evaluation is that this directive introduced wide-ranging requirements and called for intense co-operation with national authorities. Given the complexity of some its requirements, EU policymakers may have been aware of the risks of incorrect implementation by the Member States. A compulsory and periodic system of evaluation enabled the Commission to know the working of this piece of legislation. An historical analysis of the remuneration rules preceding CRD IV is consistent with this reading. For example, the current principles underpinning the financial executives' remuneration policy were

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[39] Article 1(18). Directive 2010/76 was repealed by CRD IV.

[40] Commission Staff Working Paper, Impact Assessment accompanying the document Proposal for a Directive of the European Parliament and the Council on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms and amending Directive 2002/87/EC of the European Parliament and of the Council on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate. SEC(2011) 952 final at p 133.

[41] Section (27)(6), Directive (EU) 2019/878 of the European Parliament and of the Council of 20 May 2019 amending Directive 2013/36/EU as regards exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers and capital conservation measures. OJ [2019] L150/253.

[42] Commission Staff Working Paper, Impact Assessment accompanying the document Proposal for a Directive of the European Parliament and the Council on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms and amending Directive 2002/87/EC of the European Parliament and of the Council on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate. SEC(2011) 952 final.

[43] Commission Staff Working Paper, Impact Assessment, SEC(2011) 952 final, at p 133.

already set out in a Recommendation of 2009,[44] which also provided that the Commission monitor the situation and then consider whether to take further measures on the basis of how Member States implemented that recommendation.[45]

From a broader perspective, the periodic review of the remuneration policy is consistent with the experimentalist governance framework,[46] which understands EU policy-making of complex policies (e.g. environmental or financial regulation) as a recursive process with provisional goal-setting and revisions based on learning.[47] With regard to the learning aspect, experimentalist governance highlights a periodic revision of goals, metrics, and decision-making procedures by a wide group of actors, which is made in response to the problems revealed by the review process.[48]

6. The Evaluation of the Remuneration Rules: The Actors

A critical analysis of an evaluation system must include its actors, both public and private. The mandate of the institutions involved in policy evaluation, their powers, financial capabilities, expertise, and interaction with other institutions are all factors that affect the evaluation process. The three main actors who participated in the evaluation of the remuneration provisions were the Commission, the European Banking Authority (EBA), and stakeholders. Broadly speaking, the Commission makes policy choices whereas the EBA provides the Commission with expertise, which happened in the assessment of the remuneration rules. While the Commission and EBA are public authorities, 'stakeholders' refers to broad categories, and may include national authorities although they are predominantly private parties. In policy-making of the remuneration rules, the main category of stakeholders were interest groups representing financial institutions (financial businesses or associations representing financial businesses). The next sections provides an overview of the above-mentioned actors and the interactions between the Commission and interest groups on the one hand, and the EBA and interest groups on the other hand.

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[44] Commission Recommendation of 30 April 2009 on remuneration policies in the financial services sector (2009/384/EC). OJ [2009] L120/22.

[45] Article 13, Commission Recommendation of 30 April 2009 on remuneration policies in the financial services sector (2009/384/EC). OJ [2009] L120/22.

[46] Experimentalist governance is attributed to the work of Charles Sabel and Jonathan Zeitlin. See Charles Sabel & Jonathan Zeitlin, *Learning from Difference: The New Architecture of Experimentalist Governance in the EU* 14 European Law Journal 271 (2008).

[47] Charles Sabel & Jonathan Zeitlin, *Experimentalist Governance* in David Levi-Faur ed., *The Oxford Handbook of Governance,* ch12, 169-183 (OUP, 2012).

[48] Charles Sabel & Jonathan Zeitlin, *Experimentalist Governance* in David Levi-Faur ed., *The Oxford Handbook of Governance,* ch12, 169 (OUP 2012)

6.1. The Commission

As mentioned above, Article 161 CRD IV sets out the framework for evaluation of the policies of that directive. The Commission was the institution entrusted with the task of carrying it out, but was assisted by the EBA. The attribution to the Commission of such duty is consistent with the EU institutional architecture. The Commission is the agenda-setter as it proposes EU legislation.[49] It is often referred to as the 'Guardian of the Treaties' as it monitors Member States compliance with EU law.[50] With regard to evaluation, both the 2015 Better Regulation Agenda, which is the general framework of the Commission's policy-making, and Article 161 CRD IV, provide that evaluation findings should be the basis, if appropriate, for amendments or new regulatory interventions. Indeed, the recommendations contained in the 2016 Evaluation were adopted in the Commission's proposal for amendments of CRD IV,[51] which subsequently was the basis of the remuneration rules provided by Directive 2019/878. The evaluation was carried out by the Directorate General Justice and Consumers. It is out of the scope of this article to provide even an overview of the Commission's importance in EU policy-making. Here it is worth highlighting the point that although the Commission is the executive body of the EU, it does not always have expertise in all policy areas, which is the reason why the EBA assisted the Commission in the evaluation of the remuneration rules. This is a common pattern as often independent EU agencies provide the Commission with expertise. In addition, the Commission relied on a report containing research on remuneration rules, which had been commissioned to external academic experts (the 2016 Final Report).[52] This is also a common pattern when the Commission does not have in-house expertise and therefore it is assisted by external experts.[53]

6.2. The European Banking Authority (EBA)

The EBA was established in 2010[54] with the mandate to promote the stability and effectiveness of the financial system of the EU. It performs regulatory and supervisory

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[49] Art 17(1) TEU.

[50] Art 17(1) TEU. 'It [the Commission] shall oversee the application of Union law'.

[51] Commission Proposal for a Directive of the European Parliament and of the Council amending Directive 2013/36/EU as regards exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers and capital conservation measures. COM(2016) 854 final.

[52] Idlan Zakaria, Udo Reifner Doris Neuberger, Sebastian Clerc-Renaud, Paola Schwizer, Andreas Nastansky, Andreas Stephan, Maria Gaia Soana, Giovanni Ferri, Saul Schwartz, William Forbes, Christine Riefa, *Final Report: 2016 Final Report, Study on the Remuneration Provisions Applicable to Credit Institutions and Investment Firms*. <https://www.diva-portal.org/smash/get/diva2:934646/FULLTEXT01.pdf> (August 2020).

[53] In reality a great deal of expertise is provided by expert groups registered in the Register of Commission Expert Groups, For an overview of how the Commission organises external expertise: <https://ec.europa.eu/transparency/regexpert/index.cfm?do=faq.faq&aide=2> (August 2020).

[54] Regulation No 1093/2010.

functions to prevent regulatory arbitrage, promote transparency of the financial markets and equal conditions of competition, regulate and supervise credit and other risks, and enhance consumer protection.[55] It is an unelected (non-majoritarian) and independent agency.[56] Although non-majoritarian institutions' independence is bestowed by politically accountable bodies, these institution's powers, rules, and practices need to be legitimate, i.e. they need to rest upon social acceptance/consensus. Legitimacy is broken down into input, output, and procedural legitimacy.[57] In the context of independent regulatory agencies, output legitimacy refers to an institution's effectiveness to accomplish its mandate and includes aspects such as its powers and the use of expertise to underpin their decisions.[58] However, effectiveness and expertise are not sufficient to justify independent agencies because the rules and decisions they make may have distributional implications or a political dimension.[59] This is why output legitimacy (effectiveness) needs to be balanced with input and procedural legitimacy. Input legitimacy refers to the democratic credentials of an institution and it includes civil society's participation in the decision-making process. Procedural legitimacy refers to an institution's decision-making process and it includes aspects such as transparency and judicial review requirements.

A first element that broadens the EBA's input legitimacy is the composition of the Board of Supervisors, which includes the heads of the Member States supervisory authorities.[60] A second input legitimacy channel is the Banking Stakeholder Group, which was established to facilitate consultation with stakeholders and which includes representatives from credit and investment institutions, employees, and consumers.[61] Stakeholders also contribute by responding to the EBA public consultations.[62]

Output legitimacy of supervisory financial authorities rests on the achievement of regulatory goals and on their impact on financial markets. Given the difficulties in measuring the accomplishment of these goals, effectiveness can also be understood by looking at how the powers of a supervisory financial authority are exercised and the ability to inform its decisions by expertise, including the expertise provided by national authorities.[63] Here an important aspect of the EBA's powers is assisting national supervisory authorities thus ensuring consistent interpretation and application

[55] Regulation No 1093/2010, Article 1(5).

[56] Regulation No 1093/2010, Article 1(5).

[57] These terms have no fixed meaning, political science scholarship use them in a different manners.

[58] Niamh Moloney, *The Age of ESMA: Governing EU Financial Markets,* 46 (Hart Publishing, 2018).

[59] Niamh Moloney, *ibid.*

[60] Article 40(1), Regulation No 1093/2010. Moloney argues that involvement of national authorities is another legitimation channel, Niamh Moloney, *The Age of ESMA: Governing EU Financial Markets,* 52 (Hart Publishing, 2018).

[61] Regulation No 1093/2010, Article 37.

[62] Regulation No 1093/2010 provides that public consultations are launched on draft regulatory technical standards (Article 10), implementing technical standards (Article 15), guidelines and recommendations (Article 16).

[63] Niamh Moloney, *The Age of ESMA: Governing EU Financial Markets,* 46-48 and 114 (Hart Publishing, 2018).

of European Union rules relating to the stability of financial systems. It also serves as an independent advisory body to the European Parliament, the Council, and the Commission. With regard to its regulatory powers, EBA is empowered *inter alia* to adopt regulatory technical standards[64] and implementing technical standards[65] by means of delegated act (Article 290 TFEU) and implementing act (Article 291 TFEU).

It has been argued that the EBA's effectiveness has been limited. For example, it suffers from inadequate legal mandate and powers, and from an inefficient governance arrangements.[66] In particular, while the EBA is an independent agency, the Board of Supervisors is composed of representatives of national supervisors, which means that they may act to protect the national interest rather than expressing a European view.[67] The EBA supervisory activity operated to facilitate and co-ordinate national supervisors rather than asserting its authority.[68] One of the reasons that could explain the EBA's limited effectiveness is that it is a relatively young institution, which means that it still needs to develop its full capability. For example, it has been reported that banks preferred to establish a deeper relationship with some national supervisors (for example, the German authority), which have more experience in the regulation of financial markets.[69]

Finally, an important aspect of legitimacy is accountability. In this respect, the EBA is accountable to the European Parliament and the Council.[70] In addition, the Commission has to endorse EBA draft regulatory[71] and implementing[72] technical standards before being adopted.

6.3. Stakeholders (Interest Groups Representing the Financial Sector)

Stakeholders have long contributed to EU policy-making, which was already recognised in 2001.[73] The TFEU imposes a general duty on the Commission to carry out consultations with parties impacted by a policy.[74] The 2015 BRA provides their full involvement in the whole regulatory cycle,[75] from policy formulation to policy eval-

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64 Regulation No 1093/2010, Article 10.

65 Regulation No 1093/2010, Article 15.

66 Eilís Ferran, *The Existential Search of the European Banking Authority* 17 Eur Bus Org Law Rev 285, 290 (2016).

67 Eilís Ferran, *The Existential Search of the European Banking Authority* 17 Eur Bus Org Law Rev 285, 301 (2016).

68 Eilís Ferran, *The Existential Search of the European Banking Authority* 17 Eur Bus Org Law Rev 285, 303 (2016).

69 David Coen and John-Paul Salter, *Multilevel Regulatory Governance: Establishing Bank-Regulator Relationships at the European Banking Authority* 22 Business and Politics 113 (2020).

70 Regulation No 1093/2010, Article 3.

71 Regulation No 1093/2010, Article 10(1).

72 Regulation No 1093/2010, Article 15(1).

73 White Paper on European Governance COM(2001) 428 final.

74 Article 11 TEU.

75 2015 Better Regulation Agenda at p 66.

uation.[76] Historically, the main reason for their inclusion in the EU governance was to increase the democratic credentials of the EU.[77] While the debate about whether or not this has been achieved is still open,[78] it is acknowledged that interest groups provide important information relating to policies under discussion.[79] In fact, EU lobbying has been conceptualised as an exchange relationship where the European institutions ask for policy-relevant information, citizen support, and economic power, and interest groups ask for access to EU institutions and influence in their policy-making process.[80] Political science research on EU stakeholders, interest groups, and civil society is wide and touches many aspects,[81] but an important one is the unequal participation of classes of stakeholders. Ideally, stakeholders participating in EU policy-making should reflect the various societal interests (employees, non-profit organisations, local communities, businesses and associations of businesses, etc). The diversity of interest groups participating in the formation of a policy enhances the democratic credentials of the EU institutions (input legitimacy) and increases the chances of a better implementation of those who will be subject to a policy, thus enhancing its effectiveness (output legitimacy). However, such diversity has not been met since economic and business interests are predominant in EU policy-making.[82] In the financial sector this problem is particularly acute. For example, in a consultation on the EU regulatory framework for the financial sector launched in 2015, the Commission received 288 responses of which 218 came from the financial sector.[83] With regard to policy-making leading to CRD IV, in a consultation on remuneration policy held in 2010, 13% of respondents were public authorities, 4% citizens, and 83% private organisations of which 56% belonged to the financial service industry and investor community.[84] In the 2015 consultation on the impact of the remuneration

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[76] 2015 Better Regulation Agenda at p 52.

[77] Beate Kohler-Koch, Christine Quittkat, Vanessa Buth & Christina Altides, *De-Mistification of Participatory Democracy,* 1-16 (OUP, 2013).

[78] Beate Kohler-Koch, Christine Quittkat, Vanessa Buth & Christina Altides, *De-Mistification of Participatory Democracy* (OUP, 2013). The authors offer a mixed picture whether civil society's participation has met the expectations to improve the quality of the democratic system of the EU.

[79] Heike Klüver, *Lobbying in the European Union* (OUP 2013).

[80] Heike Klüver, *Lobbying in the European Union,* 1-23 (OUP 2013).

[81] These terms are used as synonyms although there are subtle differences that reflect various governance approaches. Stijn Smismans, *Regulating Interest Group Participation in the European Union: Changing Paradigms between Transparency and Representation* 39 E.L. Rev. 470 (2014).

[82] This is a broad statement, in reality the nature of interest groups may vary across policy fields, stages of policy-cycle, etc. Heike Klüver, *Lobbying in the European Union* (OUP 2013).

[83] Commission, Summary of contributions to the 'Call for Evidence' <https://ec.europa.eu/finance/consultations/2015/financial-regulatory-framework-review/docs/summary-of-responses_en.pdf> pages 3 and 4.

[84] Commission Staff Working Paper, Impact Assessment accompanying the document Proposal for a Directive of the European Parliament and the Council on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms and amending Directive 2002/87/EC of the European Parliament and of the Council on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate. SEC(2011) 952 final, at page 200.

rules, which was launched to undertake the 2016 Evaluation, only 35 stakeholders participated in it and more than 75% of respondents were industry representatives.[85] The concern arising from such a disproportionate presence of financial sector interest groups is that they provide a one-sided perspective of the effects of these rules, while information that could be provided by non-economic stakeholders has fewer chances of being considered. For example, in the above-mentioned 2015 public consultation on the remuneration rules there is no mention of consumer associations.[86] Yet the design of executives' remuneration packages has an indirect impact on consumers who may be misled by aggressive selling practices promoted or endorsed by executives who have a personal interest in maximising the sale of risky financial products in order to increase their bonuses. In fairness, the Commission relied on the above-mentioned academic report (the 2016 Final Report) to gain a more comprehensive knowledge, however the predominant category of interviewees in that report was staff working for financial institutions.

Empirical research on economic interest groups does not point to a systematic influence over the policy outcome. For example, during the discussion leading to the European Mortgage Credit directive (2014/17/EU), financial interests groups failed to undermine the Commission's proposal to enhance consumer protection. In fact some consumer groups were successful in their advocacy.[87] Yet the informational advantage of these stakeholders can hardly be denied. The following two sections (6.3.1 and 6.3.2) provide an overview of private stakeholders' inputs into the Commission and EBA respectively in the 2016 evaluation. This has been done by interviewing two Commission and two EBA officers. Section 6.3.3 draws some conclusions about stakeholders' involvement.

6.3.1. Stakeholders and the Commission

Stakeholders participated in the evaluation by making submissions to public consultations and by meeting directly with officers of the Commission. Stakeholders' submissions about remuneration policy have been considerable since 2009.[88] With regard

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[85] 'Commission Feedback Statement, Summary of responses to the public consultation on the CRD IV remuneration rules' (2016) page 2. No longer available online, on file with the author.

[86] 'Commission Feedback Statement, Summary of responses to the public consultation on the CRD IV remuneration rules' (2016). Also in the previous public consultations (2009 and 2010) organised by the Commission to discuss policy documents on remuneration of financial executives and on the revision of CRD, the great majority of stakeholders came from the financial sectors. Occasionally, EU and national public authorities or trade unions participated in such consultations, but sporadically. There is no mention of private non-economic stakeholders.

[87] Lisa Kastner, *From Outsiders to Insiders: A Civil Society Perspective on EU Financial Reforms* 57 Journal of Common Market Studies 223 (2019).

[88] In 2009 a consultation was run to gather views on the drafted remuneration policy that would be subsequently introduced in Directive 2010/76/EU (CRD III). A second round of consultation was launched in 2010 and 2011 with respect to the Commission's plan on corporate governance: Commission Green Paper, Corporate Governance in financial institutions and remuneration policies (COM(2010) 284 final); and Commission Green Paper, The EU corporate governance framework (COM(2011) 164 final). In particular, in a 2010 consultation, which concerned, *inter alia* the CRD III remuneration rules,

to the 2016 Evaluation, the impact of the maximum ratio rule on the competitiveness of financial institutions attracted most of the criticisms. Many stakeholders claimed there had been an increase of fixed remuneration, which meant higher fixed costs, and a reduction of the variable component of remuneration, which meant lower variable costs. With respect to deferral and the *malus* and clawback rules, most respondents agreed that they were effective to promote long-term performance of the firm and to deter excessive risk-taking behaviour. On the other hand, it was held that such rules were not necessary for small and non-complex institutions that normally pay out a small amount of variable remuneration.[89] This is precisely an aspect that was emerged during the consultations with stakeholders. In the national implementation of the remuneration policy, some Member States relied on the principle of proportionality (ie adoption of the least restrictive means to achieve the policy goal) to minimize at the national level the restrictions imposed by the EU remuneration provisions. Indeed, the exemption of the remuneration rules for small institutions, which created regulatory differences at national level, was justified on proportionality grounds. In this respect, an officer of the Commission said: 'The main problem is that often Member States go beyond what is prescribed by the directive when implementing it.' She/he said: 'stakeholders' meetings also serve the purpose to understand the source of the problem. Stakeholders complained about the regulatory burden resulting from the remuneration policy. However, after two-hour discussion everyone realised that the source of the problem was Member States' implementation.' To put this differently: 'the implementation phase seemed to be the wild west at Member States level.'

The key question is whether stakeholders influenced the 2016 Evaluation. As mentioned above, proving stakeholders' influence is not an easy task. A first methodology is to compare their submissions with the subsequent Commission's policy documents to see whether the latter reflect the former. In this respect, some conclusions of the 2016 Evaluation are consistent with some stakeholders' comments. For example, the Commission accepted that deferral and pay-out in instruments are not efficient for small and non-complex credit institutions and investment firms.[90] On the other hand, it rejected the claim that the maximum ratio rule had a negative impact on the competitiveness of financial institutions as it was noted that the financial industry did not show any evidence that such rule hindered the recruitment of talented

stakeholders opposed the introduction of additional remuneration provisions before the evaluation of the effects of the existing ones (ie those provided by CRD III). See, Commission Staff Working Paper, Impact Assessment accompanying the document Proposal for a Directive of the European Parliament and the Council on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms and amending Directive 2002/87/EC of the European Parliament and of the Council on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate. SEC(2011) 952 final, at p 217.

[89] These views are reported in Commission's Feedback Statement, Summary of responses to the public consultation on the CRD IV remuneration rules.

[90] Report from the Commission to the European Parliament and the Council. Assessment of the remuneration rules under Directive 2013/36/EU and Regulation (EU) No 575/2013. COM(2016) 510 final, at p 12.

staff.[91] Better insights into the role of stakeholders may be gained in an interview conducted with two Commission's officers who had close knowledge of the 2016 Evaluation. The two officers reported that the main concern raised by stakeholders throughout all consultations was that the restrictions put in place by the remuneration policy could result in a loss of competitiveness of credit institutions and in particular the difficulty in attracting talented staff. However, an officer was sceptical of this claim; anecdotally he/she recounted an episode where a bank representative complained of the difficulties in hiring a talented manager, but after a short time he/she learnt that the bank had employed a manager outside the EU.

In general, what surfaced from meetings with stakeholders was the quality of information submitted by credit institutions. An officer of the Commission raised the point that not all data they presented were necessarily complete/reliable. The officer said that they were reluctant to disclose data on their own remuneration structures. When consultancy firms acted on behalf of credit institutions, they were forbidden to disclose such information as they claimed that remuneration structures were a business secret. The officer concluded that stakeholders withheld evidence because they did not want to be challenged, with the consequence that it significantly inhibited the Commission from verifying the extent of the problem created by the remuneration policy. In relation to the problem of overwhelming participation of financial stakeholders, the Commission's officers said that they were aware of their agenda, which is why they broadened their sources of knowledge by working closely with the EBA and by commissioning the above-mentioned academic research.

6.3.2. Stakeholders and the EBA

As mentioned above, one of the EBA's tasks is to provide expertise in the banking sector to the European institutions. Its involvement in assisting the Commission in the review of the remuneration rules was provided by CRD IV. To carry out its tasks, also the EBA needs data from the financial sector. In this respect, stakeholders' consultations respond to this need though they are also seen as a tool to enhance its input legitimacy. The importance of stakeholders' consultations is attested by the EBA's statutory duty to launch them in respect of some rules.[92] With regard to the remuneration policy, the EBA held seven consultations.[93] Generally speaking, the consultations managed by the Commission were concerned with broad policy choices, whereas those run by the EBA regarded technical aspects developed in the guidelines issued to implement the remuneration policy. Like the consultations held by the Com-

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[91] Report from the Commission to the European Parliament and the Council. Assessment of the remuneration rules under Directive 2013/36/EU and Regulation (EU) No 575/2013. COM(2016) 510 final, at p 11.

[92] Regulation No 1093/2010 provides the EBA shall conduct open public consultation when preparing regulatory technical standards (Article 10), when implementing technical standards (Article 15), and guidelines and recommendation (Article 16). The EBA guidelines are important because, for example, they specified the general rules provided by CRD IV.

[93] The first consultation took place from October to November 2010 by the Committee of European Banking Supervisors, an authority that was later replaced by the EBA.

mission, also in those organised by the EBA, the majority of stakeholders were operating in the financial sector either as businesses or industry associations.[94] In a consultation running from April 2015 to June 2015, stakeholders made comments on the draft guidelines on remuneration policies,[95] which covered the most important rules of the remuneration policy. Although the EBA's consultation documents were concerned with technical matters, an officer of the Commission noted that there was no significant difference between the submissions made to the Commission and the EBA as in both cases they were primarily aimed at raising the issue of loss of competitiveness.

With regard to their strategy, an EBA officer confirmed that credit institutions lobbied at multiple levels. In particular, their pressure was effective with Member States in two respects. The first was when Member States sat on the Council, where their influence was significant. The second was when Member States implemented the remuneration policy. There, their lobbying strategy was directed both to national policy-makers and to the national regulatory authorities. That the implementation phase of the remuneration rules was particularly vulnerable to the action of lobbies was confirmed by an EBA officer who believed that this was due to a combination of factors. The first was that some countries, primarily the UK, have a short-term vision, which privileges competitiveness over long-term goals such as financial stability. The second was that Member States' banking systems are different, which seemed to justify regulatory diversity to accommodate the needs of each system. The third was the input from lobbies, which was always significant. In summary, the intense lobbying pressure was effective because some national policy-makers were receptive to the concerns raised by credit institutions.

A second aspect of the lobbying strategy was the time of their intervention. The EBA officers said there was a difference depending on the stage of the policy-cycle: at the beginning there was a great deal of opposition; however, once it had been implemented fewer complaints were raised and there was more engagement in the merit of the policy. Interestingly, once credit institutions realised that the implementation of the policy resulted in significant regulatory differences, during discussions with EBA, they asked for more harmonisation. Finally, with regard to their level of influence on the EBA, the EBA officers stated that it was ineffective. They said: 'it's not working with the EBA, we've got the expertise to vet the arguments we are presented. On the other hand, we're not always against their suggestions or inputs coming from interest groups.' This aspect is significant: the EBA officers felt that their technical expertise made them less susceptible to influence by the financial sector's

[94] For example, in the 2015 consultation, 127 responses were received of which 73 were published on the EBA website. 71 out of 73 of responses are businesses or business associations operating in the financial sector. https://eba.europa.eu/regulation-and-policy/remuneration/guidelines-on-sound-remuneration-policies/-/regulatory-activity/consultation-paper#responses_1002371

[95] Consultation Paper: 'Draft Guidelines on sound remuneration policies under Article 74(3) and 75(2) of Directive 2013/36/EU and disclosures under Article 450 of Regulation (EU) No 575/2013' EBA/CP/2015/03, 4 March 2015.

interest groups, but also more confident in accepting their suggestions when they felt that such interest groups raised a valid concern.

6.3.3. Conclusive Considerations on Stakeholders' Involvement in the 2016 Evaluation

Involving financial sector stakeholders in the evaluation has been important both to promote the legitimacy of this process and to obtain information about the application these rules. Arguably, this strategy was successful for the Commission because it forced stakeholders to engage in the merits of the alleged problems created by these rules. As an EBA officer reported, during the formulation of the policy, financial stakeholders presented ideological arguments against the remuneration rules. However, after its approval, they engaged in the process of evaluation by presenting their information in an attempt to support the claim that the remuneration policy was detrimental to banks' competitiveness. Yet this engagement turned out to be insidious for stakeholders: when relating to the EBA, they presented more concrete evidence relating to specific problems, whose credibility was sometimes challenged by the EBA thanks to its expertise. When relating to the Commission, they submitted inadequate or selective evidence about loss of competitiveness created by these rules, which strengthened the Commission's case for maintaining the remuneration provisions.

At the same time, stakeholders arguments and suggestions were sometimes accepted. For example, as the Commission found appropriate to exempt small and non-complex financial institutions from the application of some remuneration rules. The EBA was also open to consider stakeholders' technical suggestions, which would not entail policy choices. Precisely because the Commission and the EBA were aware of the predominance of financial stakeholders in providing information about the effects of the remuneration policy, they were also cautious in accepting their suggestions. In any case they did not capture the whole process of evaluation as the maintenance of the maximum ratio rule testifies. The above interviews with the Commission and EBA's officers have confirmed that they were able to engage in multiple venues, both at EU and national level. An important point about stakeholders' participation is the aspects of the remuneration policy to be evaluated, which were framed in terms of competitiveness, efficiency, and implementation at domestic level. Thus framed, financial stakeholders were the most suitable actors to provide this information. However, this is likely to have discouraged stakeholders with non-economic interests from giving their contributions, which perpetuated the problem of unequal participation of stakeholders.

7. The Critical Issues That Affected the 2016 Evaluation

In an ideal world policy-making and policy-evaluation are supported by robust and reliable evidence. However, that was not possible as a number of issues hampered the assessment of the remuneration policy.

The first was the evaluation timeframe. The remuneration policy evaluation had to be made by 30 June 2016.[96] Given that Member States had to transpose CRD IV by 31 December 2013, the assessment of these rules was limited to three years, which was not enough for a thorough appraisal.

The second was the impact of the remuneration rules on the staff's risk-taking behaviour. As the 2016 evaluation acknowledges, 'measuring concrete impact on individuals' behaviour is very complex',[97] a consideration that was made also with respect to the maximum ratio rule.[98] Put simply, a number of factors influence executives' decisions, which means that it is difficult to determine to what extent the remuneration policy has an impact on their decisions.

The third problem was assessing the extent to which the maximum ratio rule promoted the stability of the financial system, which had to be evaluated.[99] The causes of the 2008 financial crisis are still debated; the most recurrent ones are insufficient capital adequacy requirements, regulators' failures, poor corporate governance, a monetary policy that resulted in excessive liquidity, etc.[100] However, it has been disputed that the remuneration structures of bankers' remunerations played a significant role.[101] Here the problem is that financial stability depends on the interaction of multifarious factors, which makes it difficult to identify the extent to which the remuneration rules contributed to it.

Finally, the 2016 Evaluation was hindered by Member States' erroneous implementation of the remuneration policy through a misconceived application of the principle of proportionality. This was a significant problem because a correct implementation of a policy is the prerequisite to evaluating the effects. That was not the case, as Member States applied the principle of proportionality, in particular the adoption of the least restrictive means, to dilute the scope of the remuneration provisions.

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[96] CRD IV, Article 161.

[97] Report from the Commission to the European Parliament and the Council. Assessment of the remuneration rules under Directive 2013/36/EU and Regulation (EU) No 575/2013. COM(2016) 510 final, at p 3.

[98] Report from the Commission to the European Parliament and the Council. Assessment of the remuneration rules under Directive 2013/36/EU and Regulation (EU) No 575/2013. COM(2016) 510 final, at p 10.

[99] CRD IV, Article 161(2)(b)(i).

[100] The literature on the causes of the 2008 financial crisis is extensive. For a good overview, Jean Tirole, *Economics for the Common Good,* ch12 (Princeton University Press 2017). This book was originally published in 2016, *Économie du bien commun* (Presses Universitaires de France 2016).

[101] Guido Ferrarini & Maria Cristina Ungureanu, *Executive Remuneration* in Jeffrey Gordon & Wolf-Georg Ringe (eds.), *The Oxford Handbook of Corporate law and Governance,* ch13, 334-362 (OUP 2018). See also, Demetra Arsalidou, *The Regulation of Executive Pay and Economic Theory* 5 Journal of Business Law 431 (2011).

8. The 2016 Evaluation Findings

The following two sections present some of the findings of the 2016 Evaluation. Section 8.1 summarises the evaluation on the deferral and pay-out in instruments and the amendments provided by Directive 2019/878, amendments that reflect such evaluation. Given the prominence of the maximum ratio rule in the debate about the remuneration rules,[102] Section 8.2 summarises the criticisms of this rule and how the 2016 Evaluation responded to such criticisms.

8.1. The Evaluation of Deferral and Pay-Out in Instruments and the New Remuneration Rules of Directive 2019/878

After acknowledging the above-mentioned problems that hampered the review, the 2016 Evaluation reported a decrease severance pay.[103] Conversely, the use of deferral and pay-out in instruments increased following their introduction by CRD III. On the other hand, the regulatory burden created by deferral and pay-out in instruments was considered excessive in relation to small institutions and staff with low variable remuneration.[104] Accordingly, the Commission proposed exempting those rules for such small institutions.

Directive 2019/878 reflects the suggestions of the 2016 Evaluation. First, it now provides an exemption from the deferral, pay-out in instruments, and shared linked-instruments rules for staff whose variable remuneration does not exceed Euro 50,000.00 and does not represent more than one third of the staff's total annual remuneration.[105] Second, the exemption of deferral and pay-out in instruments has been provided for institutions whose value of assets is equal to or less than 5 billion Euros.[106] Finally, with regard to the deferral rule, the Directive has increased the minimum time of the deferral of the variable remuneration, from three to four years.[107]

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[102] CRD IV, Article 161(2)(a).

[103] Variable remuneration is regulated in CRD IV Article 94(1)(d) and (e).

[104] The estimated costs for small institutions were between Euro 100,000.00 and 500,000.00; Report from the Commission to the European Parliament and the Council. Assessment of the remuneration rules under Directive 2013/36/EU and Regulation (EU) No 575/2013. COM(2016) 510 final, at p 8.

[105] Directive (EU) 2019/878 of the European Parliament and of the Council of 20 May 2019 amending Directive 2013/36/EU as regards exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers and capital conservation measures. OJ [2019] L150/253. Article (1)(27) point (c) adds to Article 94 CRD IV a third paragraph, which provides exemption from Article 94 (l) and (m), to institutions whose (b) staff member whose annual variable remuneration does not exceed EUR 50,000 and does not represent more than one third of the staff's member's total annual remuneration.

[106] Directive 2019/878, Article (1)(27) point (c) adds to Article 94 CRD IV a third paragraph, which provides exemption from Article 94 (l) and (m), to non-large institutions whose values is equal or less than Euro 5 billion. However Member States may still decide to apply these rules also to small institutions – Article (1)(27)(c).

[107] Directive 2019/878, Article (1)(27)(a) amends Article 94(1)(m) of CRD IV, which now reads as follows: 'a substantial portion, and in any event at least 40 %, of the variable remuneration component

Overall, Directive 2019/878 has not introduced significant changes to the CRD IV remuneration provisions. Broadly speaking, these changes consist in a reduction of the scope of application of some remuneration rules for small institutions and some staff, which the Commission justified in terms of efficiency.

The European Parliament and Council[108] did not propose significant changes to the Commission's proposal save for the European Parliament proposal to add the principle that the remuneration policy is gender neutral, which has been accepted in Directive 2019/878.[109]

8.2. Quantitative Findings on the Impact of the Maximum Ratio Rule

Among the remuneration provisions, the maximum ratio rule has been the recipient of most of the criticisms, which, for the present purposes, can only be summarised.[110] First of all, it has been disputed that variable remunerations were a contributing factor to the financial crisis. Therefore, the rationale for the maximum ratio rule rests upon a false premise. Second, even if bonuses had contributed to the financial crisis, the design of incentives to avoid excessive risk-taking is a complex issue, which should be left to the board of directors rather than being set by ex-ante regulation. In addition, if the goal is to promote the financial stability, there are alternatives means, for example prudential regulation. Finally, the main criticism is that a bonus cap is detrimental to the efficiency of financial institutions. Not surprisingly, CRD IV specifically prescribes that this aspect be evaluated.[111] In this respect the 2016 Evaluation recognises that it was too early to assess the impact of that rule as it had been applied for just one year. Despite the limited data, which had been supplied by the EBA, the 2016 Evaluation reported that only 2.34% of staff of institutions subject to CRD IV were affected by this rule. It also reported an increase of average fixed remuneration and a decrease of variable remuneration, which was predicted by the critics of this rule. However, the 2016 Evaluation also showed that fixed remuneration represented

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is deferred over a period which is not less than **four to five** years and is correctly aligned with the nature of the business, its risks and the activities of the staff member concerned.'

108 The comparison between the Commission 'Proposal amending Directive 2013/36/EU as regards exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers and capital conservation measures'; COM(2016) 854 final, and the European Parliament 'Report on the proposal for a directive of the European Parliament and of the Council amending Directive 2013/36/EU as regards exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers and capital conservation measures.' A8-0243/2018, 28.06.2018. The Council text that reflects its position, before negotiation with the European Parliament, is the Council document 14776/16, dated 23 November 2016, Interinstitutional file: 2016/0364 (COD).

109 Following the amendment made by this Directive, now CRD IV, Article 92(2)(ii) provides that 'the remuneration policy is a gender neutral policy'.

110 For a summary of the debate: Guido Ferrarini & Maria Cristina Ungureanu, *Executive Remuneration* in Jeffrey Gordon & Wolf-Georg Ringe (eds.), *The Oxford Handbook of Corporate law and Governance,* ch13 (OUP 2018)..

111 CRD IV, Article 161(2)(a) and (b).

only 5% of the total administrative costs and 1% of its funds. Thus, this rule resulted only in as a small increase in fixed costs, due to the increase of fixed remuneration, from 2013 to 2014.[112] With regard to the impact of this rule on institutions' profitability, it was reported that in 2013 and 2014, such profitability had been largely stable.

8.3. Evaluation of the Inefficiencies of the Maximum Ratio Rule

Various arguments highlighted how the bonus cap impairs efficiency. First it was argued that the bonus cap rule would result in an increase of the amount of fixed remuneration, which is paid regardless of performance. Higher fixed remunerations increase fixed costs, which means an institution is less cost efficient.[113] In response, the 2016 Evaluation acknowledged there had been an increase of fixed remuneration and a decrease of average variable remuneration; however, it noted that this trend had started before the introduction of the maximum ratio rule.[114] Related to the point of high fixed remunerations, it has been argued that they would reduce the flexibility of financial institutions in lowering costs in case of economic difficulties.[115] However, the 2016 Final Report concluded that the impact of fixed costs was nominal and no evidence was found that this rule limited the firm's ability to respond to financial difficulties.[116]

Second, it has been argued that the maximum ratio rule would reduce efficiency because once staff have reached the maximum amount of variable remuneration, they no longer have any incentive to make risky but well-informed decisions. Thus the rule limiting variable remuneration does not encourage good performance.[117] Again, the 2016 Final Report, on the basis of interviews with a sample of bank staff, showed that 94% of respondents said that a higher fixed pay would not reduce the motivation to take risks. Cultural factors, rather than the amount of variable pay, play a role in staff's motivation to take risks.[118]

Finally, the bonus cap means that EU banks find it more difficult to attract talented staff because to compete with international banks not subject to this restriction, they will have to offer higher fixed remunerations. This, the argument goes, reduces the

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[112] Report COM(2016) 510 final, pages 10-11.

[113] Kevin Murphy, *Regulating Banking Bonuses in the European Union: A Case Study in the Unintended Consequence* 19 European Financial Management 631, 645 (2013).

[114] 2016 Evaluation, page 10.

[115] Andreas Kokkinis, *Exploring the Effects of the 'Bonus Cap' Rule: The Impact of Remuneration Structure on Risk-Taking By Bank Managers* 19 Journal of Corporate Law Studies 167, 191 (2019).

[116] *2016 Final Report, Study on the Remuneration Provisions Applicable to Credit Institutions and Investment Firms* at page 100 [above fn 35].

[117] Pablo de Andrés, Rodrigo Reig & Eleuterio Vallelado, *European Banks' Executive Remuneration Under the New European Union regulation* 22 Journal of Economic Policy Reform 208, 216 (2018).

[118] *2016 Final Report, Study on the Remuneration Provisions Applicable to Credit Institutions and Investment Firms* at pages 93-94.

competitiveness of the EU banking sector.[119] The 2016 Evaluation found no evidence that this occurred.[120] The responses to interviews of 36 staff working in the financial sector give a more complex picture: while bonuses are considered in the decision to accept employment for a certain financial institution, other factors such as employer, reputation, quality of life, and other personal choices affect such a decision.[121] Accordingly, the 2016 Evaluation concluded that this claim had been unsubstantiated. As a result, it proposed maintaining the maximum ratio rule, which was left unaltered by Directive 2019/878.[122]

9. Assessment

As already mentioned, evaluating the performance of financial regulation is difficult because financial markets are affected by many factors. This difficulty is compounded by two problems. The first is that a great deal of information on the impact of the remuneration rules is provided by stakeholders subject to these rules. In addition, the predominance of financial interest groups in the evaluation process creates a further risk of an assessment which takes into account their interests rather than those of society at large.

The second factor is the multi-level EU governance whereby regulatory interventions need to be implemented by Member States and national authorities, which is not always done correctly. The problem of Member States' incorrect implementation is a recurrent issue in EU law. An analysis of the experience of the 2015 Better Regulation Agenda shows that the Commission no longer intends to be blamed for inefficient regulatory outcomes created by Member States' poor implementation of EU measures.[123] Not surprisingly, CRD IV provides that the review of the remuneration rules needs to cover also the lacunae resulting from the application of the prin-

[119] Kevin Murphy, *Regulating Banking Bonuses in the European Union: A Case Study in the Unintended Consequence* 19 European Financial Management 631, 650 (2013).

[120] The 2016 Evaluation, page 11.

[121] For example, only 36% of respondents stated that the opportunity to earn large bonus was a factor affecting the decision to take up or leave employment. The 2016 Final Report, at page 102.

[122] While it was expected that the European Parliament would not propose its repeal as it proposed it in the first place, the voting record of the Council (Council of the European Union, Document 9253/19, dated 14 May 2019, Interinstitutional file 2016/0364 (COD)) shows that the proposal has been approved by all Member States, including the UK, which had previously started proceedings before the Court of Justice to challenge the legality of this rule: Case C-507/13 *UK v European Parliament and Council of the European Union*. EU:C:2014:2394. The case was withdrawn by the UK following the Opinion of the Advocate General Jääskinen delivered on 20 November 2014 in which he held that such rule was valid under EU law. The Council records do not show the Council debate; perhaps the reason why the UK voted in favour of Directive 2019/878 was because although it left unaltered the maximum ratio rule, overall it reduced CRD IV's scope of application.

[123] Claudio Radaelli, *Halfway Through the Better Regulation Strategy of the Junker Commission: What Does the Evidence Say* 56 Journal of Common Market Studies 85, 87 (2018).

ciple of proportionality.[124] Indeed, this issue had already been addressed in 2015 by the EBA and the Commission as they maintained that some Member States' waiver of the application of some remuneration rules to small and non-complex institutions, justified on proportionality grounds, was contrary to CRD IV.[125]

Here the Commission's response has been to introduce specific quantitative criteria to identify those institutions to which, due to their size or negligible amount of variable remuneration, it is unnecessary to apply the remuneration rules.[126] The objective of such quantification is twofold. First, it intends to introduce some level of uniformity, which stakeholders called for in order to establish a level playing field among institutions operating in different jurisdictions. Second, it aims to reduce the risk of wrong implementation of the remuneration rules at national level as has previously happened. Effectively, by laying down the threshold-rules when credit institutions do not need to apply the remuneration rules, the Commission pre-empted Member States from applying the principle of proportionality and set the regulatory intervention at EU level.

With regard to the maximum ratio rule, the Commission's response has been different. The context in which Commission undertook the evaluation included, on the one hand, the limited time in which this rule had been into force, the incorrect implementation of the Member States, and the inherent difficulty in assessing the impact of a bonus cap on banks' staff. On the other hand, the Commission was aware of the significance of this rule to the public and to the European Parliament. The bonus cap enjoys legitimacy among the public so presumably the Commission did not want to appear acquiescent to the complaints raised by bankers.[127] More importantly, it was the European Parliament that in 2012 proposed an amendment calling for the adoption of the maximum ratio rule.[128]

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[124] CRD IV, Article 161(2)(a).

[125] In this respect, see the correspondence between the EBA and the Commission in relation to how Member States interpreted the principle of proportionality. EBA letter of 08 January 2015 signed the Chairperson Andrea Enria to Paraskevi Michou, Acting Director-General, European Commission, Directorate-General for Justice and Consumers and the latter's reply, dated 23 February 2015. Available at: <https://eba.europa.eu/sites/default/documents/files/documents/10180/1073529/838642d8-6a1f-442f-8cb6-23eaf4ba9649/2015%2001%2008%20 (Letter%20to%20Ms%20Michou%20DG%20Justice%20on%20Proportionality).pdf> and <https://eba.europa.eu/sites/default/documents/files/documents/10180/1073529/14888706-e787-4efb-bf41-460cd0dd0f0e/2015%2002%2023%20(Response%20EU%20COM%20re%20proportionality).pdf> respectively (Accessed 22 July 2020).

[126] See above section 8.

[127] See for example, a poll conducted in 2014 by YouGov which showed public support for the bonus cap rule. <https://yougov.co.uk/topics/politics/articles-reports/2014/11/22/strong-public-support-banker-bonus-cap> An EBA's officer I interviewed subscribed to this view.

[128] Report on the proposal for a directive of the European Parliament and of the Council on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms and amending Directive 2002/87/EC of the European Parliament and of the Council on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate (A 7-0170/2012) of 30 May 2012. Article 90(1)(f): 'institutions shall set the appropriate ratios between the fixed and the variable component of the total remuneration where the variable component shall not exceed one time the fixed component of the total remuneration;'

Against this background, the Commission used the process of evaluation to shift the blame to the Member States for the incorrect implementation of these rules and to 'reverse' the burden of proof on stakeholders who complained about the maximum ratio rule: as they failed to produce convincing evidence, the Commission neutralised their opposition and confirmed this rule (see above 6.3.1 where one Commission officer complained about the lack of full disclosure of information from stakeholders).

Stakeholders' participation was a key aspect of the 2016 Evaluation. As mentioned above, the concern is that the predominance of financial interest groups could jeopardise a proper review of the remuneration policy. In this respect, the interviews with the EBA officers showed that they were not prepared to accept all stakeholders' arguments. Although problems with the EBA's effectiveness and credibility have been highlighted,[129] it played an important role in countering stakeholders' influence and providing assistance to the Commission. This leads to the question of whether regulatory capture occurred in the 2016 Evaluation. As mentioned above, political science scholars still debate how to measure interest groups' influence.[130] The amendments made by Directive 2019/878 closely reflect the stakeholders' contributions submitted in the public consultations for the evaluation of the remuneration rules. Thus, here it is reasonable to infer that stakeholders succeeded in influencing the Commission. However, this was not the case for the maximum ratio rule, which has always been strongly opposed by financial institutions. Arguably, the above-mentioned position taken by the European Parliament in 2012 played an important role in the Commission's decision not to amend this rule.[131] From a theoretical perspective, public policy scholarship advanced a hypothesis that explains interest groups' failure to have their preferences accepted by policy-makers: policy salience. Salience refers to the 'importance that citizens attach to a political issue'.[132] Citizens' attention to matters that have wide social and economic implications creates pressure upon policy-makers to adopt certain policies and not to align with interest groups advocating light-touch regulation. In addition, public attention to a 'salient' political issue means the issue is taken from the private to the public sphere,[133] which makes it more difficult for lobbyists to advance their preferences. Some research argues that the financial regulation

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[129] Eilís Ferran, *The Existential Search of the European Banking Authority* 17 Eur Bus Org Law Rev 285 (2016).

[130] Heike Klüver, *Lobbying in the European Union,* 60-65 (OUP 2013)

[131] Directive 2019/878 was passed through the co-decision procedure, thus the European Parliament's consensus was essential. Since 2012 the European Parliament has not explicitly reiterated its support for this rule, but in the debate leading to the adoption of Directive 2019/878 it did not propose any change thus confirming the *status quo*. See: European Parliament Report on the proposal for a directive of the European Parliament and of the Council amending Directive 2013/36 as regards exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers and capital conservation measures. Committee on Economic and Monetary Affairs, 28.06.2018. A8-0243/2018.

[132] Cornelia Woll, *Lobbying under Pressure: The Effects of Salience on European Union Hedge Funds Regulation* 51 Journal of Common Market Studies 555, 559 (2013).

[133] Cornelia Woll, *ibid.*

adopted after 2008 fits into this framework.[134] The adoption of the remuneration provisions is consistent with this explanation: the 2008 financial crisis had wide and serious economic consequences, and the behaviour of financial executives was blamed for playing a contributory role in the crisis and was subject to public scrutiny. This made the regulation of remuneration of financial executives a salient policy and consequently EU policy-makers adopted and later maintained the bonus cap despite the financial industry's opposition.

10. Conclusions

This paper has critically investigated the factors that shaped the evaluation process with a focus on the Commission's decision to maintain the maximum ratio rule. Ideally, policy evaluation is a rational retrospective analysis informed by full and reliable data of how a policy has performed in order to assess whether it achieved the intended goal(s). It should also set out suggestions on how the evaluated policy might be improved. Yet this research confirms that policy evaluation is not a neutral exercise, as it is affected by the nature of the actors involved in the process, the criteria against which the policy is evaluated, and the availability and reliability of data. In this case, the limited time in which such provisions had been in force and the wrong implementation of the policy undermined its assessment. In addition, the predominant presence of financial interest groups in the evaluation process was significant. In this latter respect, this research has shown that while financial interest groups succeeded in having some rules changed (see the amendments made by Directive 2019/878), they failed to have the maximum ratio rule repealed. This article has suggested that the legitimacy of this rule, which was justified by the conviction that financial executives' bonuses were a contributory factor to the financial crisis, and the political salience of this issue, account for the confirmation of the maximum ratio rule. Against this background, the Commission turned the problem of inconclusive evidence to its advantage by blaming the Member States for not correctly implementing the remuneration rules, and by pointing out to stakeholders that they failed to prove the alleged detrimental effects of the maximum ratio rule. A last consideration should be made on the approach to evaluation of the remuneration rules. Since the outset, this policy was designed on the premise of rational behaviour by financial executives responding to economic incentives (i.e. the amount of their bonuses). Consequently this approach also affected the terms of reference of evaluation, of which efficiency was an important benchmark. As a result, fairness and distributive issues of executives' bonuses were extraneous to the evaluation framework. A discussion of this topic would be

[134] Cornelia Woll, *ibid.* Also Lisa Kastner, *From Outsiders to Insiders: A Civil Society Perspective on EU Financial Reforms* 57 Journal of Common Market Studies 223 (2019). Andrew Baker, *Restraining Regulatory Capture? Anglo-America, Crisis Politics and Trajectories of Change in Global Financial Governance* 86 International Affairs 647 (2010).

outside the scope of this research;[135] however, there is no reason why future evaluations of remuneration policies in the financial sector should not include this aspect too.

[135] For a discussion of executives' pay from this perspective: Charlotte Villiers, *Executive Pay: A Socially-Oriented Distributive Justice Framework* 37 Company Lawyer 139 (2016).