Financial Crisis, Excessive Pay and Fat Cats.
Why Employment Scholars Should Start Reflecting on Regulation of Executive Remuneration

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Abstract

In the aftermath of the 2007-2008 financial crisis, flawed variable pay structures of executives were blamed by many for contributing to the build-up of the global financial turmoil, as they allegedly incentivized them to engage in excessive risk-taking. Legislators around the globe decided to regulate remuneration structures of the fat cats in the financial industry with a view to better align their compensation with effective risk management practices. Since 2010, several Directives have been adopted at EU level, imposing on financial institutions a combination of mandatory norms regarding how the variable part of remuneration is to be paid out. Although this topic has been widely investigated by corporate governance researchers, it has been largely neglected by labour law scholars. This article tries to fill this gap, analysing the issues of mandatory pay structure in the financial industry through the lenses of employment law.

> *Heads, you become richer than Croesus; tails, you get no bonus, receive instead about four times the national average salary, and may (or may not) have to look for another job … Faced with such skewed incentives, they place lots of big bets. If heads come up, they acquire dynastic wealth, if tails come up, OPM [other people money] absorbs almost all losses.*
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> A.S. Blinder, *After the Music Stopped. The Financial Crisis, the Response, and the Work Ahead* (London: Penguin 2013), 82

I. The Regulation of Executive Remuneration in the Financial Industry in the Aftermath of the Financial Crisis – Adding an Employment Law Perspective

Regulation of executive remuneration is on the rise. In the aftermath of the

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2007-2008 financial crisis, media and the public opinion started to pressure legislators, both in the US and in the EU, to regulate pay of the fat cats[1] in the financial industry in order to align their remuneration with prudent risk-taking.[2] The reasons behind this political pressure are not difficult to understand, after all. On the one hand, financial institutions registered disastrous performance throughout the crisis. On the other, high-ranked executives, as well as traders and brokers, were granted, immediately before the financial breakdown of 2007-2008, astonishing bonuses and lavish severance payments.[3] Remuneration plans rewarded risk-taking for high returns, but they did not punish for losses. This created perverse incentives because there was no personal downside to risk-taking.[4] As a result, flawed, variable pay structures of certain individuals at financial institutions were blamed for contributing to the build-up of this global financial turmoil, as they allegedly incentivized these workers to focus on short-termism and excessive risk-taking.[5] Although it is still controversial whether there was an actual causal link between reckless risk-taking and the crisis,[6] regulating the remuneration structure in the financial sector became a key topic in the agenda of many politicians in search for consensus.[7]

The first result of this political pressure was the adoption, at the international level, of the 2009 Financial Stability Board (FSB) principles for sound

[1] This expression, originally used to describe rich political donors, it is also commonly used to indicate people with a lot of money, especially someone in charge in a company who has the power to increase her/his own pay – among many, see B. Wedderburn, *The Future of Company Law: Fat Cats, Corporate Governance and Workers* (London: Institute of Employment Rights, 2004).

[2] K.J. Murphy, 'Regulating Banking Bonuses in the European Union: A Case Study of Unintended Consequences' 19 *European Financial Management*, 631, 635 (2013).

[3] G. Ferrarini, 'CRD IV and the Mandatory Structure of Bankers' Pay' 289 *ECGI Working Paper*, 3, 20 (2015).

[4] K. Berman and K. Knight, 'Lehman's Three Big Mistakes' *Harvard Business Review*, 16 September 2009, available at https://tinyurl.com/y232qaqv (last visited 27 December 2020) and A.S. Blinder, *After the Music Stopped. The Financial Crisis, the Response, and the Work Ahead* (London: Penguin, 2013), 82.

[5] D.W. Diamond and R. Rajan, 'The Credit Crisis: Conjectures about Causes and Remedies' 99 *American Economic Review*, 606, 607-608; L.A. Bebchuk and H. Spamann, 'Regulating Bankers' Pay' 98 *Georgetown Law Journal*, 247, 255-259 (2010); and, above all, the empirical analysis conducted by L.A. Bebchuk, A. Cohen and H. Spamann, 'The Wages of Failure: Executive Compensation at Bear Stearns and Lehman 2000-2008' 27 *Yale Journal of Regulation*, 27, 257 (2010).

[6] While certain scholars argue that flawed bonuses incentivized executives to take excessive risks, D.W. Diamond and R. Rajan, n 5 above, 607-608; L.A. Bebchuk and H. Spamann, n 5 above, 255-259; and, above all, L.A. Bebchuk et al, n 5 above, 257, others remain sceptical, K.J. Murphy, 'Pay, Politics and the Financial Crisis' 16 February 2012, available at https://tinyurl.com/yb50ec9p (last visited 27 December 2020); K.J. Murphy, n 3 above, 635-636, and argue that arguments for regulating executives' pay were rather weak in absence of a clear empirical evidence of a relation between excessive pay and the financial crisis, G. Ferrarini, n 3 above, 5-9 and 17-18, and P. de Andrés, R. Reig and E. Vallelado, 'European banks' executive remuneration under the new European Union regulation' 22 *Journal of Economic Policy Reform*, 208 (2019).

[7] G. Ferrarini, n 3 above, 20.

compensation practices.[8] The FSB principles set out international standards, to be implemented by financial institutions, aimed at better aligning compensation with effective risk management practices. In addition, they provide that pay-out schedules shall be sensitive to the time horizons of risks, in order to avoid short-termism and create incentives to produce value in the long run. The FSB principles have been implemented in different jurisdictions along different routes. While the US, especially at the beginning, has preferred the use of standards rather than rules, the EU has immediately adopted a stricter approach in regulating compensation in financial institutions, implementing the FSB principles through a series of mandatory rules on pay structure of both top executives and other risk-taking or high earning staff at various hierarchy levels of the relevant institution.[9]

Since 2010, several Directives have been adopted at EU level, applying to a wide spectrum of financial institutions such as banks, investment firms and insurance companies,[10] with the aim of promoting sound and effective risk management and avoiding excessive risk-taking. In particular, these Directives impose a combination of mandatory rules regarding how the variable part of remuneration – the one subject to an individual or institution's performance – is to be paid out. More specifically, financial institutions have to adopt remuneration

[8] K.J. Murphy, n 6 above; K.J. Murphy, n 3 above, 642-643, and G. Ferrarini and M.C. Ungureanu, 'Executive Remuneration', in J.N. Gordon and W.G. Ringe eds, *The Oxford Handbook of Corporate Law and Governance* (Oxford: OUP, 2018), 334, 357-358.

[9] G. Ferrarini and M.C. Ungureanu, n 8 above, 358-362.

[10] For the banking industry, the first rules were contained in 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 (2010) OJ L 329 (CRD III) and then in 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 (2013) OJ L 176 (CRD IV), as amended by 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 (2019) OJ L 150 (CRD V): in particular, Arts 92-94 of CRD IV as amended by CRD V.

For investment firms, these rules are provided by Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010 (2011) OJ L 174 (AIFM) and Directive 2014/91/EU of the European Parliament and of the Council of 23 July 2014 amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions (2014) OJ L 257 (UCITS V).

For insurance companies, see Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) (2009) OJ L 335 (Solvency II), as supplemented by the Commission Delegated Regulation (EU) 2015/35 of 10 October 2014 supplementing Directive 2009/138/EC of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) [2015] OJ L 12.

policies that provide the following rules:[11]

- the pay-out of variable remuneration must be balanced between cash and share or share-linked financial instruments;
- awards in shares or share-linked financial instruments must be subject to an appropriate retention policy;
- a substantial portion of variable remuneration must be deferred over a multiyear period;
- *ex post* risk adjustments mechanisms have to be implemented, in order to enable institutions to reduce or reclaim variable remuneration – which has not already been vested/paid ('malus') or has already been vested/paid ('claw-back') – when it becomes clear that the individual or the institution's performance upon which the award was calculated has been misstated.

In addition, although this last mandatory rule has been introduced only in the banking sector, a cap on variable remuneration has been imposed, so that banks have to set a maximum ratio between fixed and variable remuneration components.[12]

As a result, these mandatory rules have strongly limited the private autonomy in determining the structure of remuneration packages agreed in the individual contracts of executives in the financial industry. However, although the EU or national regulators can impose administrative sanctions on institutions and/or individuals responsible for the violation of mandatory provisions regarding pay structure,[13] there are no indications as to the contractual remedies that may be triggered in case of infringement of these regulations. In other words, there are no specific provisions governing possible antinomies between the mandatory rules contained in these Directives and the terms of an employment contract which, although freely bargained between an employing financial institution and one of its executives, have been agreed in violation of these regulations.

[11] For an overview on the mandatory rules regarding pay structure in the banking sector, although this is not updated to the latest amendments provided by CRD V, G. Ferrarini, n 3 above, 22-23.

[12] On the possible shortcomings of such a rule, K.J. Murphy, n 3 above, 642; G. Ferrarini, n 3 above, 31-38; P. de Andrés, R. Reig and E. Vallelado, n 6 above.

[13] For example, the powers of the European Central Bank (ECB) and national regulators to impose sanctions in case of violation of CRD. The power of the ECB to impose sanctions for the infringement of the mandatory rules regarding pay structure lies on: Art 9 of Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (2013) OJ L 287, Arts 25-35 and Art 129 of Regulation (EU) No 468/2014 of the European Central Bank of 16 April 2014 establishing the framework for cooperation within the Single Supervisory Mechanism between the European Central Bank and national competent authorities and with national designated authorities (SSM Framework Regulation) (2014) OJ L 141 and, more generally, Council Regulation (EC) No 2532/98 of 23 November 1998 concerning the powers of the European Central Bank to impose sanctions (1998) OJ L 318. Also, national regulators are entitled to impose sanctions: for instance, the power of Bank of Italy to proceed in this respect lies on Art 144 and following of decreto legislativo 1 September 1993 no 385.

This article, thus, tries to understand which rules govern such an antinomy. In absence of any contractual remedy provided at EU level, this answer has to be necessarily searched in the domestic laws of the Member States under the obligation of transposing into national legislation the abovementioned Directives. In investigating this issue, it is to be further considered that this discipline intersects the legislation in the field of employment law,[14] which provides an apparatus of mandatory norms protecting people at work, including those employed by financial institutions. This is a fundamental point of attention in analysing the issues of mandatory pay structures in the financial industry. Employment law, in continental European legal systems mainly, has traditionally evolved as a distinctive and autonomous legal subject to the extent that it widely provides special mandatory rules partially departing from general contract law in limiting the principle of freedom of contract, as the parties to a contract of employment cannot normally derogate from a worker-protective floor of mandatory rights.[15] The topic of executive remuneration has been extensively investigated by corporate governance researchers,[16] but it has been largely neglected by labour law scholars.[17] This is surprising also in light of the fact that employment legal practitioners have often been the ones engaged by financial firms to advise them in adapting to the latest regulatory interventions the remuneration packages of those individuals employed by financial institutions.[18]

Therefore, this article tries to contribute to the academic debate on the issues of mandatory pay structure in the financial industry analysing them through the lenses of employment law. In other words, it aims to add an original perspective to the broader discussion on this topic that has so far involved

[14] For the purposes of this article, the expressions 'employment law' and 'labour law' will be used interchangeably.

[15] For this comparative remark, M. Freedland and N. Kountouris, *The Legal Construction of Personal Work Relations* (Oxford: OUP, 2011), 58-74. This fundamental point will be extensively discussed at Section IV below.

[16] The debate among corporate governance scholars substantially started in the US after the 2001 Enron scandal and produced extensive research on this topic, as the influential book written by L. Bebchuk and J. Fried, *The Unfulfilled Promise of Executive Compensation* (Cambridge, MA: HUP, 2004), and it has restarted after the 2007-2008 financial crisis, as can be seen from the academic articles cited in the fns above.

[17] With the important exception, in Italy, of L. Nogler, 'La Direttiva "CRD III" e i "paracadute d'oro"' *Rivista Italiana di Diritto del Lavoro*, 2, 143 (2012) and, more recently, G. Sigillò Massara, 'Politiche di remunerazione e severance payment nel settore bancario: disciplina italiana e profili di costituzionalità' *Massimario di Giurisprudenza del Lavoro*, 1, 161 (2019).

Having said that, it has to be pointed out that this topic has been investigated by employment scholars, which have only focused on the possible roles for employees in company law: B. Wedderburn, n 1 above and, more recently, W. Njoya, 'The Problem of Income Inequality: Lord Wedderburn on Fat Cats, Corporate Governance and Workers' 44 *Industrial Law Journal*, 394 (2015). Nevertheless, these scholars have not focused on the implications of mandatory norms regarding pay structure under a purely employment law perspective.

[18] As an example, among many, see Freshfields Bruckhaus Deringer LLP, 'Executive reward. Handling the pressures on pay', December 2017, available at https://tinyurl.com/yc37wwzs (last visited 27 December 2020).

corporate scholars only. Conversely and at the same time, this article tries to understand whether these peculiar legislative interventions may add a new analytical dimension for labour scholars to the study of both the functions of remuneration and the role of inderogable norms in employment law, with any conclusion being clearly narrowed down solely to the financial sector.

The scope of the following analysis is limited by a twofold extent. First, although these issues arise in all the Member States, this article analyses them using Italian law as a case study. Nevertheless, it is assumed that the proposed solutions can be adapted also in other legal systems, because the terms of the problem seem to be the same at least in continental European countries.[19] Second, although the mandatory rules on pay structure are contained in several Directives applying to firms in the financial industry in a wider sense, this research will mainly deal with the ones provided by the latest version of the Capital Requirement Directive (CRD) in the banking industry,[20] as this is the specific sub-domain, among those regulated at EU level, where private autonomy have been more limited by stricter mandatory norms.[21] However, the general results of this research can be relevant to the financial sector in its broadest sense, as rules regarding executive remuneration are not only provided by EU law for banks, investment firms and insurance companies, but also by corporate governance codes mostly applied by listed companies throughout Europe.

The rest of the article is structured as follows. Section 2 clarifies the different meanings, functions, and legal implications that certain legal terms may have in regulations on pay structure in the financial industry as opposed to employment laws. Section 3 reflects on the structural participative nexus that regulation on variable pay establishes between employers in the financial industry and their executives due to the pivotal role played by the concept of risk in the normative structure of CRD and other related Directives. The analysis of this concept is instrumental, in Section 4, to deal with one of the main issues of this article, that is how to solve the possible antinomies between the mandatory rules regarding pay structure and the terms of an employment contract agreed in violation of these regulations. While addressing this legal problem, Section 4 extensively examines the peculiar features of regulatory interventions on pay structure from an employment law perspective in terms of reverse inderogability. Section 5 concludes.

[19] The nature of the norms at EU level regarding pay structure in the financial industry are mandatory in character and, as such, they have to be implemented in each Member State. In addition, similarly to Italy, also in other continental European Member States, employment laws provide for an inderogable floor or rights and generally forbid downwards derogation to mandatory law by way of an individual agreement between the parties to a contract of employment, M. Freedland and N. Kountouris, n 15 above, 62-66.

[20] See n 10 above.

[21] M. Cera and R. Lener, 'Remunerazioni e manager. Uomini (d'oro) e no. Editoriale' *Analisi Giuridica dell'Economia*, 2, 241, 245 (2014).

II. The Intersection Between Regulation of Executive Remuneration in the Financial Industry and Employment Law – Handling with Care the 'False Friend' Issue

The intersection of legislations regulating pay structure in the financial industry and employment laws raises an issue that is first terminological and then conceptual. There are several similar or even identical terms used both in the financial and in the employment legal jargon which can be labelled as 'false friends'. They seem to refer to the same legal concepts, but rather they have different meanings and legal implications.

This false friend issue is highly dependent on two variables. The first one can be classified as the domain specificity variable, which operates along a horizontal level. The similar or even identical terms are used in discrete legal domains, where legal definitions have been crafted by lawmakers along distinct policy rationales to face different legal problems. Therefore, these terms do not always have the same meaning within these two discrete legal domains. On the contrary, they will have to be interpreted in line with the idiosyncratic features and aims characterising the specific legal context at stake. The second variable can be labelled as the multi-layered integration variable, which conversely operates on a vertical level.[22] Both regulatory interventions on pay structures and employment laws are composed of two discrete though inter-related levels, namely an EU law layer and a domestic or Member State layer. Obviously, these two levels of regulation are mutually interactive. However, the

> 'effective normative outcomes … necessarily occur at the national level and are inevitably distinctive or specific to each Member State in their fine texture',

although they all are to conform to the mandatory norms formulated at the EU level.[23] Therefore, several terms used at EU level are shaped in a distinctive form when Directives are transposed at national level, because they have to be filtered through path-dependent, jurisdiction-specific and pre-existing legal concepts as they evolved within each Member State's legal tradition.[24]

For all these reasons, the exegetic process of ascribing a specific legal meaning to several similar or even identical terms is a rather complex exercise. This shall be cautiously conducted bearing in mind the abovementioned twofold intersection. Therefore, in order to avoid terminological and taxonomical confusion, this Section analyses two core terms used by CRD to regulate pay structure, and then

[22] The idea of multi-layered regulation has been developed by M. Freedland and N. Kountouris, n 15 above, 410-420 in the different context of personal work relations. However, it can be easily used to build an analytical framework regarding the intersections between the EU and national regulatory layers relevant to the topic of this article.

[23] M. Freedland and N. Kountouris, n 15 above, 418.

[24] ibid, 418.

compares them with similar or even identical terms used in employment law. First, the EU layer of regulation will be considered and, then, the domestic legislation, using Italy as a case study. This comparative exercise will then implicate a further limitation of scope of this article, as there are certain rules in the regulation of pay structure in the financial industry that do not necessarily intersect employment laws. This happens because the relevant personal and objective scopes have been framed around discrete concepts.

The first term to be analysed is 'staff', which is used by CRD to identify the individuals whose pay structure is regulated by the mandatory rules set by this Directive. According to the latest version of this Directive, Member States have an obligation to ensure that regulated institutions comply with the strict mandatory requirements set by CRD in terms of pay structure of those 'categories of staff whose professional activities have a material impact on the institution's risk profile'. These shall at least include: a) 'all members of the management body and senior management'; b) 'staff members with managerial responsibility over the institution's control functions or material business units'; and c) 'staff members entitled to significant remuneration in the preceding financial year', provided that certain specific conditions are met (the so-called 'material risk takers' or MRTs).[25] Italian regulation transposing CRD has duly followed the same pattern, specifying that the notion of MRTs includes board members, employees and other categories of workers engaged by the institution through a various range of agreements.[26]

The criteria to identify the individuals falling within the scope of CRD are both over-inclusive and under-inclusive compared to the ones generally used to frame the personal scope of application of labour laws. Both at EU and at national level, employment laws can be considered as largely rooted around the traditional binary between employment and self-employment, where only employees, as performing their services under the direction of an employer, are entitled with a full range of employment rights.[27] On the one hand, they are

[25] Art 92, para 3, CRD.

[26] Bank of Italy Circular 17 December 2013, no 285, 'New prudential supervisory instructions for banks', 25th update published on 23 October 2018, part 1, title IV, chapter 2, section I, para 3.

[27] The framing concept of employment law at EU level is the one of 'worker' that, although partially fragmented among several sub-domains of EU employment law, mainly 'reproduces the traditionally binary divide between subordinate employment and autonomous self-employment embedded in the labour law systems of the original founding member state' as noted by N. Kountouris, 'The Concept of 'Worker' in European Labour Law: Fragmentation, Autonomy and Scope' 47 *Industrial Law Journal*, 192, 199 (2018). For a very recent European comparative perspective on similarities and differences between Member States on setting the boundaries between subordinate employment and autonomous self-employment, which is far more complex than the one presented in this article, see N. Kountouris and V. De Stefano, *New trade union strategies for new forms of employment* (ETUC, 2019), 19-21, available at https://tinyurl.com/ybyhexz7 (last visited 27 December 2020). On the same topic, with reference to the Italian legal system, E. Gramano and G. Gaudio, 'New trade union strategies for new forms of employment': Focus on Italy', 10 *European Labour Law Journal*, 240, 241-242 (2019).

over-inclusive because they explicitly take into account, among others, board members and commercial agents that, at least under Italian law, are considered self-employed workers and, as such, fall outside the scope of employment law. On the other hand, they are under-inclusive because not all employees working for an employer in the banking industry have a material impact on the institution's risk profile. Thus, those employees not classified as MRTs are mostly falling outside the scope of CRD and national legislation transposing it, because the stricter mandatory norms regarding pay structure apply only to MRTs.

The second term to be analysed is 'remuneration', which is used by CRD to determine the objective scope of the regulation and refers to the amounts received by those categories of staff falling within the scope of CRD. This notion is practically all-encompassing and includes any benefit, monetary or non-monetary, awarded to staff on behalf of the employing institution, both during and upon termination of the employment relationship, including the so-called golden parachutes. The most important distinction for the purposes of CRD regulation is the one between fixed and variable remuneration, as only the latter is subject to mandatory norms regarding pay structure. In particular, remuneration is considered fixed when it is based on predetermined criteria that substantially do not depend on performance and do not provide any incentive for risk assumption. Conversely, all remuneration that is not fixed is considered variable. In this respect, with a view to avoid potential circumventions of CRD, the European Banking Authority Guidelines on sound remuneration policies (EBA Guidelines)[28] provides that a number of remuneration components, such as role-based allowances or severance payments, shall be considered variable remuneration for the purposes of CRD also when they do not clearly depend on performance and do not apparently provide any incentive for risk assumption. Italian regulation transposing CRD has duly followed the same pattern. The Italian regulation specifies that remuneration shall be considered as variable where it is not unequivocally characterized as fixed. In addition, it provides that several remuneration components shall be considered variable also when they do not clearly depend on performance and do not apparently provide any incentive for risk assumption.[29] Moreover, along the same route followed by the EBA Guidelines, it provides so not only with reference to role-based allowances and severance payments, including those sums agreed in a settlement agreement to avoid a labour dispute, but also with regard to the sums paid in consideration of non-compete covenants or other similar side agreements, generally adopting a more prudent approach compared to the minimum requirements imposed

[28] EBA/GL/2015/22 Guidelines on sound remuneration policies under Arts 74(3) and 75(2) of Directive 2013/36/EU and disclosures under Art 450 of Regulation (EU) No 575/2013 published on 21 December 2015.

[29] Bank of Italy Circular 17 December 2013, No. 285, 'New prudential supervisory instructions for banks', 25th update published on 23 October 2018, part 1, title IV, chapter 2, section I, para 3.

under CRD and EBA Guidelines.[30]

The term 'remuneration' – together with others like 'salary', 'wage' or 'pay' – is also widely used in employment legislation, both at EU[31] but above all at the national[32] level, to indicate the sums paid by an employer to an employee within an employment relationship. The concept of remuneration under Italian regulation transposing CRD can be deemed as generally over-inclusive than the one under Italian employment laws, above all because it does not include neither as fixed nor as variable remuneration certain kind of sums paid to an employee such as, *inter alia*, those agreed in a settlement agreement to avoid a labour dispute or the ones paid in consideration of non-compete covenants or other similar side agreements.

This terminological introduction is functional to show the existence of a false friend issue that will have to be handled with care during this investigation. Similar or identical terms in the two discrete legal domains at stake have different meanings that refer to discrete concepts, also in relation to the criteria to frame the scope of each regulation. Nonetheless, these distinct concepts partially overlap. This thus justifies the opportunity of analysing this topic from an employment law perspective.

III. The Participative Function of Variable Remuneration – Unveiling the Structural Participative Nexus Between Employers and Their Executives in the Financial Industry

The first point of attention for labour scholars is that regulatory interventions on pay structure may add an important analytical dimension to the study of the functions of remuneration.

Italian employment lawyers have underlined that remuneration has at least a twofold function. On the one hand, it has a social function with reference to those components known as minimum wage[33] and those related to income

[30] R. Lener, L. Capone and G. Gaudio, 'Il 25° aggiornamento delle disposizioni di vigilanza di Banca d'Italia in materia di politiche e prassi di remunerazione' *dirittobancario.it*, 27 December 2018, 4-7 and 23-25, available at https://tinyurl.com/y84hr7x5 (last visited 27 December 2020).

[31] Note that the EU has no competence in matter of pay, as provided by Art 153, para 5, of the Consolidated version of the Treaty on the Functioning of the European Union [2012] OJ C 326 and, thus, there is no secondary legislations in the field of employment law directly regulating pay. However, remuneration has been constantly used by the European Union Court of Justice as one of the main criteria to characterize the notion of worker in the free movement of workers context and then in other related employment law EU regulatory domains: N. Kountouris, n 27 above, 198-199.

[32] For sake of completeness, it must be pointed out that, under Italian employment laws, there are multiple notions of remuneration depending on a specific subdomain at stake: for a complete review of this topic, *see* E. Gragnoli and S. Palladini eds, *La retribuzione* (Milano: UTET, 2012).

[33] Note that in Italy there is not primary legislation setting a minimum wage, which has conversely been guaranteed by Courts combining Art 36 of the Constitution setting out the right to a fair wage and salary provisions included in sectoral collective agreements: for a recent article in English, see E. Menegatti, 'Wage-setting in Italy: The Central Role Played by Case Law' *Italian*

support payments made by an employer when the employee's performance is suspended in time of particular need because she/he is, for example, on sick or parental leave.[34] On the other, it has a contractual function with reference to almost all its components, as the salary is paid by an employer in consideration of the performance of an employee's tasks.[35] Having said that, it is interesting to further investigate, within the legal domain of labour law, the functions of variable pay, which can be defined as those sums paid or financial instruments awarded by an employer to its employees, provided that certain objectives related to the individual or employing institution's performance are met, operating with the mechanics of a condition precedent to the employment contract.[36] Therefore, variable pay cannot have a social function as defined above, because it can be awarded only above the minimum wage.[37] Accordingly, variable remuneration may have, at a first sight, a purely contractual function.

However, even this classification may be not analytically accurate. Not all variable remuneration is specifically awarded in consideration of the employee's obligation to work for her/his employer. This is true for those variable payments made once an employee has met individual targets strictly based on her/his working performance. But it would be inaccurate to ascribe a purely contractual function to those sums or financial instruments awarded to an employee when it is the employing institution – and not specifically the individual – to meet certain performance targets. Therefore, the latter variable payments have a different and more nuanced function, namely a participative one, as the workforce shares, to a certain extent, the business risk with its employing institution.[38] In other words, those variable payments establish a participative nexus between employers and employees beside the traditional one set up by the contract of employment.

This participative nexus is even more tangible when an employer decides to award part of the variable remuneration not in cash but in financial instruments, above all when these are equity of the employing institution. In the latter case, the participative nexus is indeed structural under a purely legal standpoint, because an employee becomes a shareholder of her/his employing institution. Awarding equity as compensation means that employees are also legally entitled to exercise their voice, provided that there are no or limited deviations from the general default corporate law rule that each share carries one vote in the shareholders' meetings.[39] Therefore, using shares as variable remuneration further

Labour Law e-Journal, 2, 53, 61-63 (2019).

[34] R. Del Punta, *Diritto del lavoro* (Milano: Giuffrè, 2018), 561-562.

[35] G. Zilio Grandi, *La retribuzione. Fonti, struttura, funzioni* (Napoli: Jovene, 1996), 399-437.

[36] E. Villa, 'La retribuzione di risultato nel lavoro privato e pubblico: regolazione ed esigibilità' *Rivista Italiana di Diritto del Lavoro*, 2, 451, 470-475 (2013).

[37] F. Pantano, 'Azionariato dei lavoratori', in E. Gragnoli and S. Palladini eds, *La retribuzione* (Milano: UTET, 2012), 754, 784.

[38] G. Zilio Grandi, n 35 above, 432.

[39] On the general default rule one-share–one-vote and its deviations, see L. Enriques et al, 'The Basic Governance Structure: Minority Shareholders and Non-Shareholders Constituencies', in

reinforces the abovementioned participative bond between an employer and its employees, making it structural under a corporate law perspective.

Before the enactment of various Directives like CRD in 2010, there were no specific mandatory norms regulating variable remuneration. Thus, the decision of implementing pay structures having a participative function was left to an optional business decision of an employer to be then agreed by the parties to a contract of employment. Since 2010, the legal landscape in the financial industry has changed starkly. CRD and other Directives provide that the pay-out of variable remuneration, related to a blend of individual and company targets to be met, must be balanced between cash and shares or share-linked financial instruments and that the latter must be subject to an appropriate retention policy – ie, the employee cannot sell them for a specific period – spreading over time and thus reinforcing the participative nexus between executives and financial institutions. Therefore, there are mandatory norms that expressly ascribe a participative function to variable remuneration and make it stable over time. Due to these developments, the law overrides the will of the parties to a contract of employment establishing a structural participative nexus between them. Furthermore, these regulations can contribute in setting up a novel form of industrial[40] – or, more correctly, managerial – democracy. In this respect, above all if executives manage to take advantage of corporate law collective action mechanisms such as proxy votes,[41] they may exercise even greater influence in deliberations through forming voting blocs. Consequently, they may play a significant role in the governance structure of financial institutions, above all in those with dispersed ownership.

This structural participative nexus between employers in the financial industry and their executives constitute the inevitable corollary of the rationale behind these legislative interventions, which aim at better aligning the interests of material

Kraakman et al eds, *The Anatomy of Corporate Law* (Oxford: OUP, 2017), 80-83.

[40] The expression 'industrial democracy' has been firstly used to indicate a form of worker participation mainly referred to union activity through collective bargaining. This weak form of worker participation is different from employee involvement in management through the co-determination of certain company decisions. Although financial participation has not been traditionally considered as an authentic form of workers participation as it has mainly pursued aims that are individual in nature – additional income in the interest of employees and higher productivity in the interest of employers – it can be claimed that this is not the case with regulation of executive remuneration in the financial industry. This is why financial participation in the employing institutions become structural: not for all individuals employed by them, but only for their executives, thus establishing a form of managerial democracy. On the intrinsic and even polysemic nature of expressions as 'worker participation' and 'industrial democracy', see M. Biasi, 'On the Uses and Misuses of Worker Participation: Different Forms for Different Aims of Employee Involvement' 30 *International Journal of Comparative Labour Law and Industrial Relations*, 459 (2014).

[41] On shareholders' coordination mechanisms, see J. Armour et al, 'The Basic Governance Structure: The Interests of Shareholders as a Class', in Kraakman et al eds, *The Anatomy of Corporate Law* (Oxford: OUP, 2017), 58-62.

risk takers with the ones of their employing institution to create value in the long run. This implies a strong correlation between variable remuneration awarded to executives and the risks which are assumed by the employing institution. The concept of risk is pivotal in the normative structure of CRD and other related Directives. On the one hand, it contributes to establish the abovementioned participative nexus between executives and their employers. On the other hand, the strong correlation between variable remuneration and risk is to be adjusted to the time horizons of risk to achieve the legislative aim of promoting sound risk management and avoiding short-termism. This is the policy reasons behind the introduction of certain limits to an unconditional correlation between variable pay and risk, such as the need of applying retention policies, deferral strategies and *ex post* risk adjustments mechanisms. This is instrumental to safeguard two interests. First and foremost, the immediate and individual interest of the regulated institution to be protected from potential excessive risk-taking of their executives. Second, the broader and superindividual interest to safeguard the stability and soundness of the financial system as a whole.

IV. The Unidirectional Structure of Employment Norms' Inderogability Reversed – Liberating Employers in the Financial Industry from Private Autonomy

The fact that mandatory norms regarding pay structure in the financial industry are protecting both an individual and a superindividual interest is instrumental to deal with the most important technical issue arising from the introduction of CRD and other related Directives. Namely, how to solve possible antinomies between the mandatory rules contained in the relevant Directives, as transposed in the Member States, and the terms of an employment contract which, although freely bargained between an employer operating in the financial industry and one of his executives, have been agreed in violation of these regulations. Before trying to offer an answer to this question, it is necessary to better understand the nature of the mandatory norms regarding pay structure that, as it will be argued below, can be defined as characterized by inherent inderogability. This Section thus begins by offering an overview of the notion of inderogability and then examines the role that this doctrine, with regard to hierarchy of sources in labour law and the relationship between mandatory rules and contractual autonomy, has traditionally played in the emancipation process of employment law from general contract law. Then, it continues analysing the peculiarities of the inderogability of rules regarding pay structure and concludes trying to understand how to solve a possible antinomy between them and the terms of an employment contract.

It has been traditionally well known among Italian employment scholars that mandatory rules[42] can be characterized as inderogable when the legal system is providing certain remedies, such as nullity and partial nullity, which can trigger the automatic substitution/insertion mechanism, according to which the nullity of a single clause does not cause the invalidity of the entire contract as mandatory rules automatically replace, by virtue of law, the void clauses.[43] In other words, the classification of a mandatory norm as inderogable is to be made looking at the consequences that the legal system provides when they are violated.[44]

The legislator usually provides such consequences when the interest safeguarded by a certain mandatory norm is not purely individual, but rather superindividual, so that it can be described as a public interest. In this respect, the fact that the law provides not only private but also public law sanctions, such as criminal or administrative ones, in case of violation of a certain mandatory norm can be regarded as an index of the fact that it safeguards a public interest and, as such, can be characterized as inderogable. Therefore, the inquiry on the inderogable nature of a mandatory norm, also when the law does not explicitly provide nullity or partial nullity as remedies, is a teleological exercise, because it essentially depends on searching the purpose behind a certain rule and on assessing whether it protects a public interest.[45]

Employment scholars have pointed out that inderogability is an essential

[42] Mandatory rules are different from default rules because only the latter are susceptible to disapplication, modification, or limitation. Therefore, mandatory rules can be defined as the ones that cannot be contracted out by the parties to an agreement. However, while all inderogable norms are mandatory, the opposite is not true. The concept of inderogable norms is more nuanced than the one of mandatory norms because, as it will be seen below, it constitutes a subcategory of mandatory norms for which the legislator provides peculiar consequences in case of their violation.

At least for the purposes of this article, the concept of inderogability shall also be distinguished from the one of nonwaivability, that are often used as interchangeable terms: on this topic, see recently G. Davidov, 'Nonwaivability in Labour Law' 40 *Oxford Journal of Legal Studies*, 3, 482 (2020). On the one hand, the term inderogability refers to the hierarchical relationships between different sources of employment rights, namely law, collective bargaining agreements and individual contracts of employment. On the other, nonwaivability refers to the power of an employee to waive a specific right, unilaterally or through a settlement agreement with her/his employer. The main difference is that inderogability refers to both accrued and future rights, while nonwaivability strictly refers to those rights already accrued by a certain employee: on this point, M. Novella, *L'inderogabilità nel diritto del lavoro. Norme imperative e autonomia individuale* (Milano: Giuffrè, 2009), 246-349 and R. Del Punta, n 34 above, 341-366.

[43] The relevant Italian provisions are Arts 1418 and 1419 of the Civil Code for nullity and partial nullity respectively, and Arts 1419, para 2, and 1339 of the Civil Code for the automatic substitution/insertion mechanism that can be triggered in case of partial nullity.

[44]The following paras mainly relies on M. Novella, n 42 above, 106-108. The need to look at the consequences of the violation of a mandatory norm to characterize it as inderogable is also stressed by C. Cester, 'La norma inderogabile: fondamento e problema del diritto del lavoro', *Giornale di Diritto del Lavoro e di Relazioni Industriali*, 119, 341, 344-346 (2008).

[45] M. Novella, n 42 above, 130-139; A. Albanese, 'La norma inderogabile nel diritto civile e nel diritto del lavoro tra efficienza del mercato e tutela della persona', *Rivista Giuridica del Lavoro e della Previdenza Sociale*, 2, 165, 171-173 (2008); C. Cester, n 44 above, 347-348.

feature of most part of labour mandatory norms. Employment law, mainly in continental European legal systems like Italy,[46] has traditionally evolved as a distinctive and autonomous legal subject to the extent that it widely provides special mandatory rules partially departing from general contract law in limiting the principle of freedom of contract, as the parties to a contract of employment cannot normally derogate from a worker-protective floor of mandatory rights.[47] Although the role of inderogability in labour law has become more porous and has been partially revisited in the last decades,[48] it characterizes so many employment norms that the majority of Italian scholars claim that it can be still regarded as the genetic heritage of employment law when comparing it to general contract law.[49]

This happens due to the asymmetric nature of the relationship behind the contract of employment, where one party, the employee, is subordinated to the managerial powers of the other party, the employer. Employment law provides

[46] For this comparative remark, M. Freedland and N. Kountouris, n 15 above, 58-74, that also point out how this general trend has not regarded common law systems. This is also the reason why the English term inderogability has been coined relatively few years ago, when Lord Wedderburn borrowed it from the Italian term '*inderogabilità*', although for the slightly different purpose of investigating the relationship between collective and individual agreements under English law, see B. Wedderburn, 'Inderogability, Collective Agreements, and Community Law' 21 *Industrial Law Journal*, 245, 250-251 (1992) and, more recently, S. Deakin, 'Labour Standards, Social Rights and the Market: "Inderogability" Reconsidered' *Giornale di Diritto del Lavoro e di Relazioni Industriali*, 140, 549 (2013).

[47] M. Freedland and N. Kountouris, n 15 above, 58-74 and, more recently, G. Davidov, n 42 above.

Note that inderogability of employment norms can also be observed, although in a slightly different fashion, at international and supranational level. The idea of inderogability is coherent, for example, with core labour concepts developed within the context of private international law, eg Art 6 of the 1980 Rome Convention on the law applicable to contractual obligations: see S. Sciarra, 'Norme imperative nazionali ed europee: le finalità del diritto del lavoro' *Giornale di Diritto del Lavoro e di Relazioni Industriali*, 109, 39, 40 (2006). The same idea of a bedrock of employment rights that cannot be derogated *in peius* is also a common feature of non-regression clauses contained in the majority of employment law Directives at EU level, ie, those making clear that Member States are not precluded from adopting higher levels of protection compared to the minimum standards imposed by EU secondary legislation: see, among many, C. Cester, n 44 above, 398 and 410.

[48] This point has been constantly raised in all the research conducted on this topic by Italian scholars in the last decades: for a summary of the debate, M. Novella, n 42 above, 382-440. For a stronger position, according to which inderogability cannot be regarded anymore as an essential feature of employment norms, M. Tiraboschi, 'Persona e lavoro tra tutele e mercato. Mercati, regole, valori', AIDLaSS Conference, 13-14 June 2019, 23-27, available at https://tinyurl.com/ybq5nqkl (last visited 5 October 2020).

With regard the academic debate outside Italy, the same point has been stressed, with specific reference to the evolution that has characterized EU law in the last thirty years, by S. Deakin, n 46 above.

[49] C. Cester, n 44 above, and R. De Luca Tamajo, 'Il problema dell'inderogabilità delle regole a tutela del lavoro: passato e presente' *Giornale di Diritto del Lavoro e di Relazioni Industriali*, 140, 715, 723-724. For a critical view, M. Tiraboschi, n 48 above, 23-27. In general, for the first comprehensive theorization of inderogability among Italian scholars, R. De Luca Tamajo, *La norma inderogabile nel diritto del lavoro* (Napoli: Morano, 1976).

a series of mandatory norms limiting these powers and thus protecting employees that these cannot even decide to contract out because, if they agree otherwise, such an agreement will be null. Therefore, due to the asymmetric nature of the employment contract, the individual interest of the employee often turns into a superindividual interest to be protected.[50] This is why employment laws often protect goods that have been recognized by legislators as having an overriding public and societal value, so that this justifies a departure from the principle of freedom of contract. In this respect, labour law can be described as a legal subject that turns against the principles of free market embedded in most part of general contract law.[51] Employment law in its classical dimension is, thus, based on the denial of employees' private autonomy on the assumption that any space granted to freedom of contract can allow employers to regain a complete and undesirable domination of the employment relationship.[52] As a result, employment law has been often described as generally characterized by a protective afflatus towards employees, a principle that has been constructed by scholars through inductive reasoning after having observed that many employment norms have a prominent protective dimension under a teleological point of view.[53]

In light of the above, employment law norms have been regarded as unidirectional, because inderogability is a technique used by the legislator in favour of only one of the parties to an employment contract, namely the employee.[54] Therefore, downwards derogation from employees' rights by way of individual agreement is not permitted (the so-called 'prohibition of derogation *in peius*'). Conversely, upwards derogation is permitted by individual bargaining as employment norms generally establish a protective bedrock or floor of rights (the so-called 'admissibility of derogation *in melius*'). As a result, in case of antinomy between a mandatory employment norm and the terms of a contract of employment, the latter prevails over the former only in case of derogation *in melius*, due to the protective purposes, safeguarding public interests, behind most part of employment norms.

That being said, it is necessary to understand whether mandatory norms regarding pay structure provided by CRD and other related Directives in the financial industry can be regarded as inderogable. There are various elements that confirm this hypothesis. It has already been noted how these mandatory norms have been enacted to safeguard two interests. Obviously, they protect the individual interest of the employing institution to not engage in excessive risk-

50 R. De Luca Tamajo, n 49 above, 733.

51 R. Del Punta, 'Ragioni economiche, tutela dei lavori e libertà del soggetto' *Rivista Italiana di Diritto del Lavoro*, 4, 401, 413-414 (2002).

52 R. Del Punta, n 34 above, 356. For a recent overview on the several justifications behind inderogability/nonwaivability of employment laws that goes beyond the Italian context, G. Davidov, n 42 above.

53 M. Novella, n 42 above, 139-142 and 146-149, and R. De Luca Tamajo, n 49 above, 733-734.

54 M. Novella, n 42 above, 142-143.

taking in the short term. However, this individual interest is instrumental to defend the superindividual interest of safeguarding the financial system as a whole. In this respect, it can be thus claimed that the EU legislator, in the aftermath of the financial crisis, has enacted CRD and other related Directives in order to clarify that the stability and soundness of the financial system is a good to be given public and societal value. This is further confirmed by the fact that the ECB and national regulators, such as the Bank of Italy, are entitled to impose administrative sanctions on institutions and/or individuals responsible for the infringement of mandatory provisions regarding pay structure.[55]

These are strong arguments to claim that mandatory norms regarding pay structure in the financial industry are characterized by inherent, albeit reverse, inderogability. As a consequence, the parties to a contract of employment may trigger the automatic substitution/insertion mechanism according to which the nullity of a single clause of the contract regarding variable remuneration does not cause the invalidity of the entire contract as norms regarding pay structure automatically replace, by virtue of law, the void clauses. However, in absence of an explicit indication of the legislator in this respect, this conclusion would be the product of a teleological exercise, which would essentially depend on searching the purpose behind the regulation of executive remuneration and characterising it as protecting not only a private but also a public interest. In other words, it would be a matter of interpretation and this could inevitably raise issues in terms of legal certainty.[56]

Having said that, it has to be pointed out that, since 2015, there are no doubts that nullity and partial nullity are the remedies to be triggered if private parties violate mandatory rules regarding pay structure. Since then, the Italian legislator has expressly provided the nullity of any contract or clause agreed in violation of the norms regarding pay structure, also clarifying that the invalidity of a single clause does not cause the nullity of the entire contract because the provisions contained in the null clauses are substituted with the mandatory norms regarding pay structure.[57] In other words, also with a view to guarantee legal certainty, the remedies of nullity and partially nullity have been explicitly extended to the infringement of mandatory norms regarding pay structure, definitely confirming their inderogable nature. This has recently been confirmed by the Court of Appeal in Milan.[58]

[55] See n 13 above.

[56] In this respect, note that the scholar that analysed this issue before 2015 concluded that the automatic substitution/insertion mechanism was only one of the possible technical tool to solve the possible antinomy between the individual contracts of employment and the mandatory provisions regarding pay structure contained in CRD III: see L. Nogler, n. 17 above, 147-152.

[57] Art 53, para 4-*sexies*, of decreto legislativo 1 September 1993 no 385, amended by Art 1, para 19, letter f), of decreto legislativo 12 May 2015 no. 72.

[58] Corte d'Appello di Milano 5 November 2020, a summary of the decision is available at https://tinyurl.com/y7fu49r8 (last visited 27 December 2020).

The characterization of mandatory norms regarding executive remuneration as inderogable is interesting for labour lawyers for the following two reasons.

The first reason is one of practical nature. This classification offers employment lawyers the technical tools to solve an antinomy between mandatory rules regarding pay structure and the terms of an employment contract agreed in violation of these regulations. In this respect, it can be claimed that an employer does not need to collect employees' consent to modify the clauses of a contract of employment when they are in breach of inderogable norms regulating their variable remuneration. The adjustment is automatic. This is justified by the fact that the change in the contractual terms regarding variable pay constitutes a mere acknowledgement of the partial nullity of these specific clauses contained in the contract of employment. In other words, there is no need for an employer to bargain with the employee new terms and conditions regarding pay when they are in conflict with mandatory regulatory provisions: a situation that may happen, for example, because the relevant EU or national regulations have been updated providing for stricter norms, a member of the staff becomes a MRT or, more simply, the parties of the contract of employment agreed to certain clauses in violation of mandatory norms regarding pay structure.

However, this conclusion suffers from an important limitation. It has been already said that many employment norms are characterized by inherent inderogability in favour of employees and that, conversely, rules regarding executive remuneration are structured as inderogable norms in favour of employers. This means that there may also be antinomies between conflicting inderogable norms. EU Directives do not provide any specific criteria to solve such an antinomy, except for a general provision contained in CRD that is quite vague and cannot be generalized because it is specifically referred to *ex post* risk adjustment mechanisms and not to all the norms regarding executive remuneration thereby provided.[59] Likewise, Italian regulation transposing CRD and other related EU Directives do not offer any indication on how to solve such an antinomy. In lack of any specific provision setting the criteria to solve possible antinomies between those clashing inderogable norms, it thus seems necessary to assess each conflict on a case-by-case basis to decide which norm shall prevail by recurring to a proportional balancing to clear the tension between the two public interests or values at stake.

The second reason is one of a more theoretical nature. The characterization of norms regarding executive remuneration as inderogable seems to add an

[59] The reference is to Art 94, para 1, letter (n), CRD, according to which: '*without prejudice to the general principles of national contract and labour law* (emphasis added), the total variable remuneration shall generally be considerably contracted where subdued or negative financial performance of the institution occurs…'. Similar indications are provided by paras 148, 154, 244 and 269 of the EBA Guidelines, but only with reference to *ex post* risk adjustments mechanisms and severance payments.

analytical dimension to the study of inderogability in employment law. It has been already pointed out how mandatory norms regulating pay structure share with employment mandatory norms the feature of safeguarding both an individual interest and a superindividual or public interest. It has also been reported how employment norms' inderogability has always been regarded as unidirectional in favour of the employee. The peculiar feature of executive remuneration norms' inderogability is that their unidirectional structure seems to be reversed. This is why they safeguard the individual interest of the employing institution to not take excessive risks in the short term which, conversely, undermines the conflicting interest of an executive to obtain her/his variable remuneration immediately and in cash only, without being subject to any retention policy, deferral mechanism, *ex post* risk adjustments mechanism or cap. Therefore, the overriding public interest of protecting the financial system through the implementation of sound remuneration practices prevails over the one of protecting people at work and justifies a limitation of the private autonomy of the parties to a contract of employment.

Notwithstanding the above, it needs to be understood whether the twofold mechanism of prohibition of derogation *in peius* and admissibility of derogation *in melius* characterising employment inderogable norms can be automatically used in relation to executive remuneration inderogable norms or whether it is necessary to implement some adjustments. In other words, the issue here consists in understanding if the parties to a contract of employment can agree on terms and conditions regarding variable remuneration that would end up in a downwards or upwards derogation from the parameter set by inderogable norms regarding pay structure.

In order to try to offer a solution to this technical dilemma, it may be useful to go back in time and analyse the so-called emergency employment legislation in force between the 1970s and the 1980s in Italy.[60] In the aftermath of the 1973 oil crisis, the Italian legislator enacted a series of legislative interventions to stem wages, aimed, in turn, at pursuing the wider, albeit temporary and contingent, economic policy objective to combat spiralling inflation. These mandatory norms substantially imposed quantitative restrictions on pay increases, in most cases indicating a specific parameter to be respected, so that private autonomy of industrial relations actors in setting the level of wages in collective bargaining agreements was resolutely limited.[61] The Italian Constitutional Court acknowledged the inderogable nature of these mandatory norms as they were functional to safeguard the public interest behind the legislative intervention.[62] However, in

[60] The expression 'emergency employment legislation' was coined by Italian employment scholars after the first measures had been enacted in the aftermath of the 1973 oil crisis: see R. De Luca Tamajo and L. Ventura eds, *Il diritto del lavoro dell'emergenza* (Napoli: Jovene, 1979).

[61] The reference is above all to Art 2 of decreto legge 1 February 1977 no 12. Other examples of these provisions are contained in legge 29 May 1982 no 297 and legge 12 June 1984 no 219.

[62] Corte costituzionale 23 June 1988 no 697, available at www.dejure.it.

light of its temporary and contingent nature, the Court also held that these measures were legitimate but just for the period during which the need of combating spiralling inflation actually persisted.[63] Nevertheless, the most interesting point for the purposes of this investigation is that the Italian Constitutional Court also pointed out that the inderogability of these mandatory rules showed a distinctive structure if compared with traditional employment inderogable norms because they actually established an equilibrium point between conflicting interests that could not be derogated neither *in peius* nor *in melius*.[64] Accordingly, inderogable norms enacted in the aftermath of the 1973 oil crisis could not be categorized as genuinely unilateral. On the one hand, it is clear they were not enacted to benefit employees. On the other, their structure was not authentically reversed compared to traditional employment norms. Although they introduced a prohibition of downwards derogation in the interests of employers, they actually did not implement the very distinctive mechanism of employment norms' unidirectional inderogability, because upwards derogation, in this case in the interest of employers, was not permitted. For this reason, they have been categorized as absolute because the legislator set a fixed parameter that could never be modified by private autonomy.[65]

This normative and judicial saga has one important element in common with inderogable norms regarding executive remuneration. Both legislative measures are breaking the traditional structure of employment inderogability to the extent they are not benefiting employees but rather employers due to overriding public interests that justified their adoption. Consequently, it might be thought that this important similarity would allow us to conclude that also mandatory norms on pay structure can be characterized as absolute inderogable norms and that they thus cannot be modified by private autonomy neither *in peius* nor *in melius*.

However, such an analogical reasoning would be superficial and fallacious. There are two paramount elements that starkly distinguish inderogable norms adopted in the aftermath of the oil crisis and those enacted after the more recent financial crisis. First, inderogable norms adopted during the oil crisis were temporary and contingent to the need of combating a persisting side-effect of the economic downturn, namely spiralling inflation. Conversely, the ones enacted more recently have been adopted to contrast one of the alleged causes of the financial crisis, namely reckless risk-taking by certain individuals at financial institutions that, in absence of such regulations, had perverse incentives to focus on the short term. Therefore, in the latter case, there is still – and most likely there always will be – a persistent public interest which still needs to be

[63] Corte costituzionale 26 March 1991 no 124, *Massimario di Giurisprudenza del Lavoro*, 175 (1991).

[64] See n 62 above.

[65] M. Novella, n 42 above, 143.

safeguarded to avoid the same mistakes that led to the financial crisis. Second, inderogable provisions contained in executive remuneration regulations do not establish any equilibrium point between conflicting interests. They rather provide a minimum floor that cannot be derogated *in peius* but can be derogated *in melius* from an employers interests' perspective. The letter of CRD is clear when, for example, it provides that a substantial portion of variable remuneration shall be paid in financial instruments and deferred over a multiyear period, further specifying that the relevant quota is to be in any event equal to at least 50% and 40% of the variable components of executive pay respectively.[66] Therefore, the legislator has not predetermined a fixed parameter to be respected. Rather, it has established a normative floor, thus admitting upwards derogations that may more incisively benefit employers' interests.

It has been seen how employment norms' unidirectional structure depend on their protective purpose towards employees. Likewise, the characterization of executive remuneration norms in terms of reverse inderogability is the product of a teleological exercise recognising that these legislative interventions have a prominent protective dimension towards the stability and soundness of the financial system, which in turn necessarily implies safeguarding the immediate interests of employers over the ones of their executives. Therefore, it can be concluded that these norms can be authentically described in terms of reverse inderogability. In other words, the regulation of variable remuneration in the financial industry is aimed at liberating employers – rather than employees – from private autonomy.

V. Conclusion – Employment Norms' Inderogability in Evolution

The analysis conducted in the previous Sections has tried to add an employment law perspective to the study of regulation of executive remuneration in the financial industry.

Preliminarily, it has been shown how there is a false friend issue to be handled with care when comparing several terms used by executive remuneration regulation, on the one hand, and employment law, on the other. These terms, despite being very similar or even identical, refer to different concepts within these discrete but intersected legal domains, also in relation to the criteria to frame the scope of each regulation. In addition, it has been observed how these concepts partially overlap with reference to certain categories of employees, ie, executives having a material impact on the institution risk profile, and to certain components of their total compensation, ie, variable remuneration, that can be generally defined as the one depending on performance criteria and that does

[66] Art 94, para 1, letters (l) and (m), CRD and Bank of Italy Circular 17 December 2013, no 285, 'New prudential supervisory instructions for banks', 25th update published on 23 October 2018, part 1, title IV, chapter 2, section III, paras 3 and 4.

provide for risk assumption. Accordingly, the normative overlap is limited both to the employers operating in the financial sections, and to the executives employed by the same (that have a material impact on the institution risk profile), with specific reference to the variable part of their compensation packages.

This finding has thus confirmed the insight that can be fruitful, from employment lawyers, to further investigate this topic, bearing in mind the above limitations in scope. In particular, the analysis has shown how this normative intersection can be interesting for at least two reasons.

The first reason is that variable remuneration in the financial industry, due to mandatory norms regarding pay structure, is characterized by a participative function. There are specific norms that force financial institutions and their executives to set up pay structures that allow to award variable remuneration only provided that the relevant institution has met certain performance targets. Moreover, it is mandatory to award a substantial part of variable remuneration in financial instruments and a part of them cannot be sold by each beneficiary before the end of a retention period. Therefore, the law overrides the will of the parties to a contract of employment establishing a structural participative nexus between them, beside the traditional one set up by the contract of employment, in order to better align the interests of executives with the ones of their employing institution to create value in the long run. While this choice used to be left to private autonomy, this is now mandatory in the financial industry. This may have increased the role of executives as a constituency with greater voice, that may in turn lead to novel forms of managerial democracy in financial institutions.

The second and more important reason is that these norms, like most part of employment ones, are characterized by inderogability. Labour lawyers are used to regard employment inderogable norms as unidirectional in favour of employees, as they operate through a twofold mechanism, that consists, on the one hand, in the prohibition of downwards derogation and, on the other, in the admissibility of upwards derogation. Conversely, it has been observed how executive remuneration norms in the financial industry are characterized by the same structure of employment norms, although it has been reversed. Rather than being unidirectional in favour of employees, they protect the immediate interests of employers in light of the predominant public interest of safeguarding the stability and soundness of the financial system as a whole. Therefore, in case of an antinomy between the inderogable norms regarding pay structure and the terms of an employment contract entered into by a financial institution and one of its executives, it is possible to trigger the automatic substitution/insertion mechanism when private autonomy has illegitimately derogated to the mandatory normative floor established by the law to protect the interests of financial institutions, as well as the financial system as a whole, to promote sound risk management and avoid short-termism.

Two useful conclusions may be drawn from these findings. First, the debate among employment scholars over inderogability can offer, to a more general legal audience, precious insights on the technical tools to solve the potential antinomies between the terms of a contract of employment and the mandatory norms regarding pay structure. There rules also establish a structural participative nexus between financial institutions and certain executives, who may end up being a constituency with greater voice in their corporate governance structure. Second, this analysis can be of help to labour lawyers, because it may add an original dimension, albeit limited to employers and top-ranked executives in the financial industry, to a pattern already well-known to those employment scholars that have scrutinized the evolution of the inderogability concept in labour law.

It is undisputed that the classical conception of employment norms' inderogability is increasingly under pressure and subject to a downward trend started immediately after it reached its peak. The golden age of inderogability in continental European countries as Italy ended at the dawn of cyclical economic downturns that started to slow down the economic boom registered after World War II. The persisting crisis of inderogability has followed different paths. First, many inderogable norms have become more porous with reference to several legislative interventions that have increasingly admitted controlled downwards derogations through collective bargaining agreements or even through individual contracts of employment. Thus, it can be said that these norms are still in favour of employees, although their inderogability rate is weakened as the law increases the space for collective or individual private autonomy to freely bargain terms and conditions of employment. Second, labour laws have remained loyal to inderogability as a technical legal tool, but they have sometimes bent its classical pro-labour structure to other policy objectives different from the ones of unconditionally protecting employees.

This second path can be in turn described as a biphasic evolutionary process. Initially, legislators have reassessed the structure of inderogable employment norms establishing an equilibrium point between labour rights and other policy objectives. This happened in Italy in the aftermath of the 1973 oil crisis, when the legislator decided to adopt inderogable norms, that have been described as absolute, because they could not be subject to neither downwards nor upwards derogation. This research has shown how, more recently, this trend, although limited to certain sectors, has gone even further. The analysis of the regulation of executive remuneration in the financial industry has revealed how the structure of inderogable norms has been reversed in presence of a public interest that has been considered prevailing over the ones of certain employees, due to the overriding policy objectives that have characterised the legislative interventions in the financial sector after the 2007-2008 crisis. Therefore, these regulations can be interesting for labour lawyers, as they show how legislatures, even in legal domains that are only partially intersecting employment laws, have been loyal to a classical labour law technique, traditionally used to protect workers, that has yet been employed, upside-down, in the immediate interest of the other party to the employment contract.

Nevertheless, this structural inversion, in any case applicable to financial institutions and their top-ranked executives only, does not seem to represent a real danger for the social afflatus behind the teleological justification of several employment norms, especially when considering that one of the classical theoretical bases for their inderogability has been the imbalance of bargaining power between an employer and its employees. After all, this change in inderogability direction is evidently less problematic when an employer negotiates a remuneration package not with the archetypical blue-collar worker in assembly-line production, but rather with a fat cat at the top of the corporate food chain.