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Consultation Paper | PRA CP15/14/FCA CP14/14

# Strengthening the alignment of risk and reward: new remuneration rules

July 2014

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Email: [cp15\\_14@bankofengland.co.uk](mailto:cp15_14@bankofengland.co.uk) by 31 October 2014.

The Financial Conduct Authority (FCA) also asks for comments on this consultation paper by 31 October 2014. Comments can be sent using the form on the FCA website at:  
[www.fca.org.uk/your-fca/documents/consultation-papers/cp14-14-response-form](http://www.fca.org.uk/your-fca/documents/consultation-papers/cp14-14-response-form).

Or in writing to:

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You can download this consultation paper from the FCA website: [www.fca.org.uk](http://www.fca.org.uk).



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## 1 Introduction

1.1 The behaviour and culture within banks played a major role in generating the conditions which led to the 2008–09 financial crisis and in conduct scandals such as payment protection insurance (PPI) mis-selling and the manipulation of London interbank offered rate (Libor). The key drivers of this behaviour included poor individual accountability within firms and incentives for excessive risk-taking or poor conduct which collectively gave rise to significant detriment.

1.2 The primary purpose of the Remuneration Code is to ensure greater alignment between risk and individual reward, to discourage excessive risk-taking and short-termism and encourage more effective risk management. This in turn supports the Prudential Regulation Authority's (PRA's) statutory objective to improve the safety and soundness of firms and the resilience of the financial system and the Financial Conduct Authority's (FCA's) statutory objectives. The compatibility statement which contains the different objectives of the PRA and FCA is at Appendix 1.

1.3 The United Kingdom's regulatory approach to remuneration derives from the requirements of the Principles and Standards on compensation of the Financial Stability Board (FSB)<sup>(1)</sup> and subsequent European legislation including the Capital Requirements Directive, on which much of the Remuneration Code is based.

1.4 This consultation paper (CP) sets out proposed changes to the Remuneration Code to address weaknesses in the alignment between risk and reward which were highlighted in the final report of the Parliamentary Commission on Banking Standards (PCBS), *Changing Banking For Good*, which was published in June 2013.<sup>(2)</sup>

1.5 These changes will affect all banks and building societies, as well as the PRA-designated investment firms, currently nine, which are dual regulated by the PRA and FCA.

1.6 Although the disciplines imposed by the Remuneration Code have had a substantial impact on firms' behaviours since the financial crisis, it was the view of the PCBS that many of the historical problems persisted due to continued misalignment in reward policies and structures. The remuneration recommendations in the PCBS report aimed to address this misalignment with the objective of ensuring that the rewards of banking flowed in accordance with the full long-term costs and benefits of the risks taken.

1.7 The PRA and FCA recognise that there is further scope to strengthen the alignment of risk and reward. The Bank of England's response of 7 October 2013 to *Changing Banking For Good*<sup>(3)</sup> welcomed the report and stated the Bank's intention to take forward the bulk of the PCBS recommendations in this

area. Similarly, the FCA also welcomed the report and set out in its response<sup>(4)</sup> that it intended to take forward most of the recommendations that related to the FCA.

1.8 These proposals complement those in a parallel consultation paper: *Strengthening accountability in banking: a new regulatory framework for individuals*, which also takes up a number of the PCBS's recommendations.

1.9 The existing Remuneration Code in SYSC 19A is maintained by both regulators. This is therefore a joint PRA/FCA consultation and this CP includes the proposed revised Remuneration Codes which will be incorporated in the PRA Rulebook and the FCA Handbook. These proposals are represented in Appendix 3 for the PRA Rulebook and Appendix 5 for the FCA Handbook.

1.10 The Remuneration Code applies to all material risk-takers (MRTs)<sup>(5)</sup> in firms that are within the scope of the Code, and is applied in a proportionate way according to a firm's size and internal organisation and the nature, scale and complexity of its activities.<sup>(6)</sup>

1.11 At Appendix 2 is a cost-benefit analysis which sets out information on the direct and indirect costs which the PRA and FCA assess will arise from the proposals in this CP. The analysis is drawn largely from a report which the FCA commissioned to assess the costs and benefits. There is a degree of uncertainty surrounding the indirect effects of the proposals which make it difficult to accurately predict at this stage the impact on international competitiveness, although labour market effects appear likely to impose the greater indirect impact on firms.

1.12 The CP also includes a section on buy-outs which discusses possible changes without proposing a specific rule at this stage. Views are invited on the relative merits of possible measures, but these are not currently proposed, and are not therefore covered by the cost-benefit analysis at Appendix 2. The views of respondents are invited on the advantages and disadvantages of pursuing any of the approaches discussed in that section, and this may be followed by a further consultation on specific rule changes in light of respondents' views.

(1) [www.financialstabilityboard.org/activities/compensation/](http://www.financialstabilityboard.org/activities/compensation/).

(2) [www.parliament.uk/business/committees/committees-a-z/joint-select/professional-standards-in-the-banking-industry/news/changing-banking-for-good-report/](http://www.parliament.uk/business/committees/committees-a-z/joint-select/professional-standards-in-the-banking-industry/news/changing-banking-for-good-report/).

(3) [www.bankofengland.co.uk/publications/Documents/news/2013/pcbsresponse.pdf](http://www.bankofengland.co.uk/publications/Documents/news/2013/pcbsresponse.pdf).

(4) [www.fca.org.uk/your-fca/documents/pcbs-response](http://www.fca.org.uk/your-fca/documents/pcbs-response).

(5) Recital 4; <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0604&from=EN>.

(6) The MRTs Regulation 604/2014, which was published by the European Banking Authority (EBA) on 6 June 2014 and came into force on 26 June 2014, defines how MRTs should be identified for European Economic Area (EEA) firms. The remuneration rules also apply to employees and officers on non-EEA firms who would fall within the EBA definition if the firms were EEA firms.

## Role of variable remuneration

1.13 Since first coming into force at the beginning of 2010, the Remuneration Code has included a requirement for firms to maintain an appropriate balance of fixed and variable pay. In assessing what is appropriate, firms should note that this provision is intended to enshrine Implementation Standard 6 from the FSB Principles and Standards, which provides that 'a substantial proportion of compensation should be variable'. It is the view of the PRA and the FCA that, notwithstanding the thrust of recent European Union legislation in this area, it continues to be appropriate for a substantial proportion of firms' remuneration to be variable as this is critical to the positive incentive effects of the deferral,<sup>(1)</sup> malus,<sup>(2)</sup> risk adjustment and other provisions of the Code, as well as ensuring a degree of flexibility over costs which can contribute to firms' resilience in times of business stress.

## The PRA Rulebook

1.14 In line with the intention set out in its approach to banking supervision<sup>(3)</sup> the PRA has begun a process to replace the PRA Handbook with a PRA Rulebook, with supervisory statements being used to clarify its expectations of firms. A supervisory statement on remuneration will be finalised following the outcome of the consultation and published alongside the Policy Statement and final rules. These rules would apply to banks, building societies, investment firms and non-EEA headquartered firms.

1.15 The proposed Remuneration Part of the PRA Rulebook is at Appendix 3.1, together with a related instrument making consequential amendments to the PRA Handbook at Appendix 3.2 (and repealing SYSC 19A as a PRA Handbook chapter). The proposed supervisory statement which sets out the PRA's expectations is at Appendix 4.

1.16 These documents should be read in conjunction with existing supervisory statements on the proportionality framework<sup>(4)</sup> and on the application of malus.<sup>(5)</sup> The proportionality framework divides firms into the following three levels:

- Level 1 — total assets exceeding £50 billion (averaged over three years) to which all the Code's rules apply and which are subject to an annual supervisory process;
- Level 2 — total assets exceeding £15 billion, but not exceeding £50 billion, which must also apply all the rules, but are reviewed at supervisory discretion; and
- Level 3 — firms with total assets not exceeding £15 billion, which may disapply certain rules.

## The FCA Handbook

1.17 As this is a shared policy which has been developed jointly by the PRA and FCA, in most areas the FCA's changes mirror

the PRA's. This aims to ensure consistency between the FCA's Handbook and the PRA's Rulebook, to help firms implement the proposed changes efficiently and effectively. In other parts of this CP it has not been relevant for the FCA to change its rules to mirror changes being consulted on by the PRA — and *vice versa* — given our different statutory objectives. The FCA has deleted certain areas of guidance where those areas are no longer considered necessary. In a few areas retained guidance has been amended to enhance clarity. The draft section of the FCA Handbook is at Appendix 5.

1.18 The FCA has issued General Guidance on Proportionality and is consulting separately on new General Guidance on Proportionality for dual regulated firms (SYSC 19D) and amendments to the existing General Guidance on Proportionality for SYSC 19A and SYSC 19C. The three proportionality levels are set out in paragraph 1.16.

## Responses and next steps

1.19 This consultation closes on 31 October 2014. Views are welcomed on the issues raised in the consultation paper including the detailed questions on the specific proposals. Please send your responses to either:

cp15\_14@bankofengland.co.uk  
cp14-14@fca.org.uk

1.20 The FCA and PRA will consider and discuss the responses to all joint questions. In addition, each regulator will separately consider the responses to its individual questions, and responses will be aggregated and published later this year. It is anticipated that the PRA and FCA will each publish separate policy statements containing their respective final rules at a later date.

1.21 It is intended that all the new rules will come into force for awards made for performance periods starting on or after 1 January 2015.

## 2 Deferral

2.1 Deferral is an important feature of variable remuneration structures which helps ensure greater alignment between the interests of risk-takers within the firm and the longer-term interests of the firm itself. It allows for an opportunity to

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(1) Paragraphs 120–140; [www.eba.europa.eu/documents/10180/106961/Guidelines.pdf/a3ab77c9-980f-4994-b2cd-397413b77084?version=1.0](http://www.eba.europa.eu/documents/10180/106961/Guidelines.pdf/a3ab77c9-980f-4994-b2cd-397413b77084?version=1.0).  
(2) Paragraph 136; [www.eba.europa.eu/documents/10180/106961/Guidelines.pdf/a3ab77c9-980f-4994-b2cd-397413b77084?version=1.0](http://www.eba.europa.eu/documents/10180/106961/Guidelines.pdf/a3ab77c9-980f-4994-b2cd-397413b77084?version=1.0).  
(3) The Prudential Regulation Authority's approach to banking supervision, June 2014; available at [www.bankofengland.co.uk/publications/Documents/prapproach/bankingappr1406.pdf](http://www.bankofengland.co.uk/publications/Documents/prapproach/bankingappr1406.pdf).  
(4) *PRA Supervisory Statement LSS8/13*, 'Remuneration standards: the application of proportionality', April 2013; [www.bankofengland.co.uk/publications/Documents/other/prapolicy/2013/remunerationstandardslss8-13.pdf](http://www.bankofengland.co.uk/publications/Documents/other/prapolicy/2013/remunerationstandardslss8-13.pdf).  
(5) *PRA Supervisory Statement SS2/13*, 'PRA expectations regarding the application of malus to variable remuneration', October 2013; [www.bankofengland.co.uk/prapages/publications/appofmalus.aspx](http://www.bankofengland.co.uk/prapages/publications/appofmalus.aspx).

reassess the nature and scale of risks undertaken in order to produce the performance for which remuneration has been awarded, taking account of any risks that have subsequently crystallised, instances of individual misconduct uncovered, the quality of the risk management and management oversight employed and the subsequent performance of the firm. Deferral therefore allows for the application of malus where appropriate, ie a reduction in variable remuneration between initial award and payment or vesting.

2.2 The current requirements on firms in respect of deferred remuneration are:

- (i) Firms must defer at least 40% of awards for MRTs and at least 60% of awards for directors and other high-earners<sup>(1)</sup> (total variable remuneration of £500,000 or more) for a minimum of 3–5 years, with awards vesting no faster than on a *pro rata* basis.
- (ii) In practice firms often apply three year deferral, although firms are increasingly requiring longer deferral for senior executives. For the majority of MRTs this means that only a relatively small proportion of any year's award remains unvested for the full three years.
- (iii) A minimum of 50% of the deferred remuneration must be paid in the form of shares or other instruments, such as bail-in debt, the value of which will reflect the firm's performance.

The above deferral requirements are mandatory for all firms in proportionality levels 1 and 2 (see paragraph 1.15 above). Level 3 firms are required to have appropriate deferral policies in light of the size and the nature, scope and complexity of their business activities.

2.3 The PCBS report noted the importance of deferral as a feature of remuneration schemes that apply to those with senior decision-making responsibility and risk-taking roles in banks. The PCBS took the view that deferral over two or three years was insufficient to take account of the timescales over which material business issues can come to light and concluded there should be a presumption that all staff to whom the new Code applies should be subject to greater and longer deferral than has been customary to date. Furthermore, the PCBS suggested that the regulators should have a power to require that a substantial part of remuneration be deferred for up to ten years, where necessary, for effective long-term risk management.

2.4 The PRA and FCA note that increasing the overall length of deferral is not the only way in which the typical present pattern of deferrals might be altered to improve risk alignment. There is scope to increase the proportion of awards that are held for longer within the overall deferral period,

either by requiring a greater proportion of awards to be deferred, or by delaying the start of vesting, which typically starts a year following the initial award. Over time this would generally lead to a larger proportion of variable remuneration unvested at any point in time and therefore potentially subject to the application of malus. Some firms already use a more back-end loaded pattern of vesting for more senior executives, including five year 'cliff-vesting' (where all the deferred awards vest at the end of the deferral period).

## PRA and FCA proposals

2.5 It is the view of the PRA and FCA that deferral periods should generally be longer than current minima to align the risk horizons of key individuals further with the longer-term safety and soundness of the firms for which they work. This is particularly important for those senior executives who collectively help to determine or are responsible for implementing the overall business strategy of a firm and who are ultimately responsible for risk management. For those staff the risk horizon should reflect the timescales over which the risks associated with those strategic decisions are likely to manifest themselves. This means setting deferral periods that are closer in length to the typical period over which major business risks tend to play out, a point recognised by the interim Financial Policy Committee in the *Financial Stability Report* in November 2012.<sup>(2)</sup>

2.6 There is no single measure of how long this period should be. One aim would be to ensure that there was at least some exposure across the typical business cycles which underpin the performance of the financial sector. One measure of the cycle would be the standard business cycle based on fluctuations in real economy or economic activity. Post-war estimates for the United Kingdom would suggest the length of the average business cycle is around 5–7 years depending on how the cycle is estimated.<sup>(3)</sup> But within that average some post-war cycles have lasted up to 9–11 years.

2.7 Another measure for gauging the cycle in financial earnings would be based on cycles in credit and financial variables. Many studies have estimated these to be longer than the standard business cycle with the estimates ranging from eight to as much as 20 years.<sup>(4)</sup> On this basis a range of

(1) <http://eur-lex.europa.eu/legal-content/EN/TXT/?url=CELEX:32013L0036>.

(2) [www.bankofengland.co.uk/publications/pages/fsr/2012/fsr32.aspx](http://www.bankofengland.co.uk/publications/pages/fsr/2012/fsr32.aspx).

(3) The US National Bureau of Economic Research's paper (based on data from fourteen major countries including the United States and United Kingdom) suggests an average business cycle of around 5.5 years. This is in line with published Bank estimates that post-war UK business cycle averaged 5.7 years. See Hills, S, Thomas, R and Dimsdale, N (2010), 'The UK recession in context — what do three centuries of data tell us?', *Bank of England Quarterly Bulletin*, Vol. 50, No. 4, pages 277–91, available at [www.bankofengland.co.uk/publications/Documents/quarterlybulletin/qb100403.pdf](http://www.bankofengland.co.uk/publications/Documents/quarterlybulletin/qb100403.pdf).

(4) Aikman, D, Haldane, A and Nelson, B (2014), 'Curbing the credit cycle', *The Economic Journal*, estimate for the UK a cycle of around thirteen years. Drehman, M, Borio, C and Tsatsaronis K (2012), 'Characterising the financial cycle: don't lose sight of the medium term!', *BIS Working Paper No. 380*, estimate the credit cycle at up to 18 years, using data from seven countries including the United States and United Kingdom.

8–11 years would span the upper range of standard business cycle estimates and the lower range of credit cycle estimates.

2.8 We have also considered evidence from recent banking failures and scandals. Here the picture is mixed, with key decisions having been taken a few months or many years before the eventual failure of a firm. However, the fact that particularly important decisions were taken a certain period before a failure, particularly in the context of a widespread financial crisis, does not necessarily indicate what would be an appropriate timescale to allow for the risk inherent in strategic choices to become manifest. Some conduct failings suggest that lead times in the order of ten to 20 years could even be appropriate.

2.9 Against this must be set a number of other considerations. Principal among these is the time-discounted value of deferred remuneration to the recipient. One recent study<sup>(1)</sup> has suggested that financial executives may discount at a rate of around 30% per annum, which has implications for the effectiveness of long-deferred awards as risk incentives, positive or negative, and consequently for the cost-benefit balance of deferred awards for firms.

2.10 Taking account of these factors, the PRA and FCA propose the following two-level minimum deferral and vesting periods:

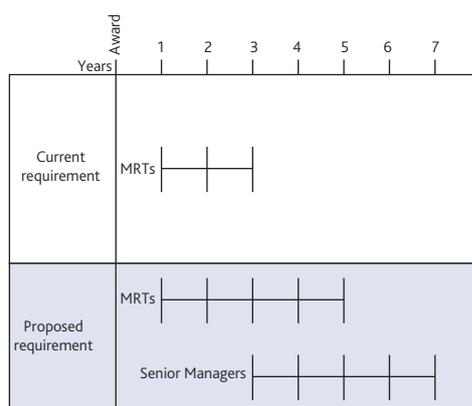
- (i) For Senior Managers:
  - (a) deferral for no less than seven years;
  - (b) first vesting of deferred remuneration no earlier than the third anniversary of award; and
  - (c) vesting no faster than *pro rata* between years three and seven.
- (ii) For all other MRTs:
  - (a) deferral for no less than five years;
  - (b) first vesting of deferred remuneration no earlier than the first anniversary of award; and
  - (c) vesting no faster than *pro rata*.

For these purposes, the definition of Senior Managers for both PRA and FCA would comprise those individuals performing a Senior Management Function as defined in Section 59ZA of the Financial Services and Markets Act 2000 (FSMA) and which the PRA is proposing to specify as a function requiring PRA approval in its CP14/14.

2.11 Figure 1 illustrates the proposed minimum vesting periods for the deferred part of variable remuneration. As now, these proposals would be mandatory for all level 1 and 2 firms.

2.12 The PCBS also referred to the possibility of a power for the regulator to direct firms to defer a substantial part of remuneration for longer, up to ten years, where necessary for

Figure 1 Current and proposed vesting periods



effective long-term risk management. The PRA and FCA agree with the PCBS that requiring longer and/or more deferral should be an option where we have concerns that the management or MRTs of a particular firm were subject to inadequate incentives to consider the long-term safety and soundness of the business. The PRA and FCA are satisfied that this would be an option that could be applied by supervisors as appropriate using existing powers under section 55M of the FSMA and so we do not propose to introduce any new rules to meet this recommendation. The proposals below on clawback<sup>(2)</sup> are also relevant here.

**Question 1** Do you agree with the principle of introducing a two-level approach for deferral, with longer deferral for senior managers?

**Question 2** Do you agree with extending the deferral period to seven years for senior managers?

**Question 3** Do you agree with introducing an additional requirement that no deferred variable remuneration should vest earlier than the third anniversary of award for senior managers?

**Question 4** Do you agree that five years is an appropriate minimum requirement to apply to all other MRTs, bearing in mind the range of roles covered?

### 3 Clawback

3.1 The Remuneration Code requires firms to reduce unvested variable remuneration where there has been employee misbehaviour, a material downturn in the firm's performance, or a material risk management failure. This requirement, known as *malus*, applies to variable remuneration which has

(1) Pepper, A and Gore, J(2013), 'The economic psychology of incentives: an international study of top managers', *Journal of World Business*. ISSN 1090-9516 (In Press). The UK figure was 27.4%, but the international mean was 33%.  
 (2) Paragraphs 134–139; <http://www.eba.europa.eu/documents/10180/106961/Guidelines.pdf/a3ab77c9-980f-4994-b2cd-397413b77084?version=1.0>.

been awarded but not yet paid, and consequently is only effective over the period of deferral.

3.2 As noted above, risks may materialise over a longer timescale, especially given that a typical credit cycle may extend over a significantly longer period than the average period of deferral, even after the changes to minimum deferral periods proposed above. In CP6/14 (March 2014),<sup>(1)</sup> the PRA consulted on a requirement for firms to amend employment contracts to enable them to apply clawback — by which it meant a requirement to pay back the value of vested awards — to all variable remuneration, thus extending the total period of potential *ex-post* risk adjustment. The outcome of that consultation (PS7/14) is being published simultaneously with this CP.

3.3 The new rule in PS7/14 requires variable remuneration, both deferred and undeferred, to be subject to clawback for a period of at least seven years from the date of award. This rule, which is to apply to awards made from 1 January 2015, applies to all MRTs at PRA-regulated firms. The FCA has not yet consulted on this rule and is therefore doing so as part of this consultation.

3.4 At the same time, the role of senior executives in overseeing long-term decision-making and effective risk management has come under closer scrutiny. It is clear that decisions made by these senior executives may have a greater impact on the firm over a longer period than those of other MRTs. It would be consistent therefore to ensure that the overall period over which their remuneration may be subject to adjustment is longer than that of other MRTs.

### PRA and FCA proposals

3.5 The PRA and FCA therefore propose that firms should provide for an option to extend the clawback period for Senior Managers of up to a further three years at the end of the normal seven year clawback period (ie to ten years) in the following circumstances:

- (a) where a firm has commenced its own internal inquiry into a potential material failure, which could potentially lead to the application of clawback; or
- (b) where a firm has been clearly notified by a regulatory authority (including an overseas authority) that an investigation has been commenced which the firm considers could potentially lead to the application of clawback.

The decision on whether the circumstances for extending the clawback period had been met would be a matter for the firm. The firm would, however, be expected to discuss the circumstances giving rise to a possible extension with the regulators. In taking this decision, the firm would need to take

account of all relevant factors, including the degree of proximity and/or responsibility of individual Senior Managers for the potential failure in question, and the period of extension would lapse once the relevant investigations were concluded and the degree of responsibility of individuals had been established.

**Question 5** Do you agree with the FCA's proposal to introduce a requirement for a minimum clawback period of seven years for all MRTs, in line with the PRA rule?

**Question 6** Do you agree with the proposal to introduce a requirement to provide for a possible extension of the clawback period of up to three years for Senior Managers if there are outstanding investigations underway at the end of seven years?

## 4 Bailed-out banks

4.1 The PCBS drew attention to the lack of negative consequences in the recent past for the previously awarded remuneration of senior staff of firms that have required taxpayer support. It recommended that where banks are in receipt of such support, the regulator should have discretion to render void or cancel deferred compensation, entitlements to payments for loss of office or change of control or unvested pension rights.

4.2 Under principle 7 of the existing Code, firms are already expected to restrict or stop the payment or vesting of variable remuneration, which may include discretionary pension payments, for MRTs where payment or vesting would be inconsistent with ensuring a sound capital base or a timely exit from government support. There is a stronger presumption against payments to the 'management body', which are prohibited unless they can be justified. Such justification needs to be in terms of the long-term interests or safety and soundness of the firm. The Capital Requirements Regulation (CRR) will place limitations on distributions for firms that fail to meet their capital buffer.

### PRA and FCA proposals

4.3 There is clearly an important public policy interest, as well as a regulatory interest, in ensuring that bank management are subject to adequate financial incentives to avoid bank failures that require official intervention. The PRA and FCA propose to reinforce this incentive by making explicit in the remuneration rules that the presumption against payment or vesting extends to all discretionary payments, including payment for loss of office and discretionary pension benefits. The same justifications as now would continue to apply for deciding to pay or vest in respect of staff and the management body.

(1) [www.bankofengland.co.uk/pr/Pages/publications/clawbackcp614.aspx](http://www.bankofengland.co.uk/pr/Pages/publications/clawbackcp614.aspx).

**Question 7** Do you agree with the proposal to make explicit in the remuneration rules the presumption against payment or vesting of any discretionary payments, including entitlements to payment for loss of office and discretionary pension benefits?

## 5 Buy-outs

5.1 In its report the PCBS noted the widespread practice whereby firms cancel the unvested bonus awards of staff who are leaving one firm to join a competitor and the competitor 'buys-out' the forfeited awards. The PCBS drew particular attention to the way this practice has the effect of wiping the slate clean for the purposes of malus for individuals who change employers, effectively insulating them against the risk of downward adjustment in their past awards as risks crystallise or the consequences of poor risk management emerge.

5.2 This is a complex area, not least because properly addressing buy-outs would require international agreement, which (as the PCBS noted) is desirable, but unlikely. The PCBS nonetheless recommended that the regulators should come forward with proposals for domestic reform, suggesting that they look at the option of requiring banks to leave deferred awards in place when an employee leaves, or the possibility of a new, discretionary power for the regulator to recover buy-out awards where malus would otherwise have been applied by the previous employer.

5.3 The PRA and FCA recognise the complexities in this area as well as the potential impacts on firm behaviour and competition, which cannot be easily quantified.

5.4 **The PRA and FCA therefore outline below four broad potential approaches to this issue on which views are invited.** In particular, respondents may wish to offer views on the potential behavioural impacts of the different approaches and the impact they might have on labour mobility and competition in the sector. Respondents may also wish to identify possible alternative ways to meet the objective of maintaining the link between risk and reward that malus and clawback are intended to achieve.

### Approach 1: banning buy-outs

5.5 The most straightforward approach could be to ban firms from buying out unvested awards. This is likely to have major adverse impacts on competitiveness, putting firms subject to the UK ban (and therefore prohibited from using buy-outs) at a significant disadvantage when hiring staff versus overseas and other firms which would remain free to offer buy-outs to new staff. It would be likely to drive up levels of fixed pay in UK firms as they fought to attract staff.

### Approach 2: maintaining unvested awards

5.6 This approach would not involve a constraint on the discretion of firms to offer buy-outs, but would instead require firms covered by the PRA/FCA remuneration rules to continue to honour unvested awards when staff leave, whether or not this was to join a rival, unless there were grounds for making reductions in accordance with the rules on malus. The unvested awards would therefore continue to be potentially subject to malus until vesting, and clawback thereafter. Similar to Approach 1, this could have an impact on competitiveness as firms subject to the UK rule would be less able to use deferred pay as a means of retaining employees. It may also therefore drive up fixed pay.

5.7 Another potential downside of maintaining unvested awards after a person leaves a firm is the potential for conflicts of interest arising from an ongoing interest in the performance of their former employer, particularly because at least half of the unvested awards would be in the form of equity or an alternative instrument, like a bail-in bond. In general it is considered that such potential conflicts of interest could be handled the way that similar conflicts are already, but there might be a need to permit unvested awards to be converted to cash where this was justified by concerns over conflicts at the recruiting firm.

5.8 A variant of this option would involve requiring firms to maintain a minimum proportion of unvested awards, rather than the total, again in the absence of grounds for applying malus. Under this variant the regulators could, for example, require maintenance of the cash portion or a specified percentage, whichever was the greater. This could be adopted as a transitional measure, or as a permanent rule. The purpose of this approach would be to moderate the impact on the labour market and reduce the extent to which conflicts of interest might arise. The PRA and FCA do, however, note that encouraging the use of cash is not aligned with the underlying principles of the Remuneration Code.

### Approach 3: applying malus to bought-out awards

5.9 The PCBS suggested a discretionary power for the regulator to recover buy-outs in cases where the former employer would have had grounds to apply malus. This would preserve the existing character of variable remuneration as a means of retaining staff. However, it could in effect substitute the regulator for the former employer in deciding on the application of malus and therefore fundamentally alter the character of malus. It could transform malus into a regulatory disciplinary procedure, rather than a contractual matter between employer and employee designed to risk adjust the employee's remuneration incentives.

5.10 Alternatively, it has been suggested that the buy-outs, which in any case should vest no more rapidly than the original awards under the existing Code, could be held in trust on

behalf of the previous employer, with the implication that if any grounds for malus emerged the buy-outs might be reduced.

5.11 This might address the role of the regulator, but there would remain a concern that in practice such an approach might still require the regulator to assume a role in determining when and how malus should be applied.

#### Approach 4: reliance on clawback

5.12 Given the uncertainties surrounding the impact of the approaches outlined above, another approach would be to make no changes to the rules to deal with buy-outs, but to rely instead on the new rules on clawback to ensure that there would generally be sufficient vested variable remuneration at risk of potential clawback to deliver the desired adjustment to the balance of risk and reward incentives. Clearly the scope for applying clawback would be a function of the amount of vested variable remuneration at any point in time, which might take time to build up, but as clawback potentially applies to all variable remuneration, not just the deferred portion, and is potentially available up to seven years from award for all MRTs, it should go some way to making the necessary adjustment over time.

**Question 8** What do you see as the advantages and disadvantages of the approaches identified above?

**Question 9** What views do you have on the potential options for addressing the disadvantages of particular approaches?

**Question 10** What are the relative merits of pursuing the different approaches and any alternative approaches that might be identified?

## 6 Risk adjustment

6.1 Risk adjustment is critical to align remuneration with risk and therefore the PRA and FCA expect appropriate risk adjustments to be made by firms when determining variable remuneration to ensure that employees are not incentivised to take undue or inappropriate risks.

6.2 Techniques for risk adjustment vary considerably but all firms should have a clear and robust framework in place that effectively captures and distinguishes the intrinsic risks in the firm's business activities from specific risk events that may have crystallised during the year.

6.3 Measures of financial performance, such as accounting-based profit or revenue, should be risk adjusted. Where discretion is applied as part of the process, firms must be able to provide details to the regulator.

### Determination of profit for remuneration purposes

6.4 Nearly all UK-regulated firms use profit as an initial reference point for determining variable remuneration with UK GAAP reporting institutions using the fair-value accounting model to calculate profit for this purpose.

6.5 The fair-value model has been criticised for overstating profits for remuneration purposes as it brings the present value of future cash flows into current earnings even though those cash flows are uncertain given they are still subject to ongoing market and operational risk.

6.6 The PCBS concluded that the means by which profits are determined for remuneration should be subject to greater standardisation to remove the current scope for adverse incentives and recommended that explicit criteria be developed which exclude unrealised profits from thinly traded or illiquid markets from being counted as profit to determine remuneration.<sup>(1)</sup>

6.7 The PRA takes the view that firms should establish clear, transparent and robust frameworks for measuring performance and adjusting for risk for the purposes of determining pay. The most effective way to achieve this objective is to use the PRA's existing prudential valuation regime, which already requires banks to report quarterly their prudent valuation adjustments of fair valued positions.<sup>(2)</sup>

6.8 The PRA therefore proposes to introduce a rule requiring all UK-regulated firms, when determining the size of their annual bonus pools, to calculate profit for this purpose by deducting a prudential valuation adjustment figure<sup>(3)</sup> from fair value accounting profit. The EBA proposals on recognising prudent valuation adjustments in common equity Tier 1 (CET1) under the CRR<sup>(4)</sup> are due to take effect in 2015 and firms should then deduct the prudential valuation adjustment figure using this EBA methodology from fair value accounting profit to determine profit for remuneration purposes.

**Question 11** Do you agree with the proposal to require firms to use the above approach to ensure that the measure of profit used for determining variable remuneration is based on prudent valuation?

### Performance metrics

6.9 The PCBS also concluded<sup>(5)</sup> that banks over-relied on a narrow set of metrics of profitability in setting remuneration. Return on equity (RoE) in particular was singled out as a

(1) Paragraph 861, Chapter 8, PCBS report.

(2) FSA Policy Statement PS12/7, 'Regulatory Prudent Valuation Return', April 2012; [www.fsa.gov.uk/library/policy/policy/2012/12-07.shtml](http://www.fsa.gov.uk/library/policy/policy/2012/12-07.shtml).

(3) From the Q4 return.

(4) EBA Final draft RTS on prudent valuation under Article 105(14) of Regulation (EU) No 575/2013 (*Capital Requirements Regulation – CRR*) published on 31 March 2014.

(5) Paragraph 862, Chapter 8, *Changing Banking For Good*.

perverse incentive for firms to become over-leveraged. The PRA share this concern that there is too much reliance on metrics based on short-term revenue or profit, such as RoE, earnings per share (EPS) and total shareholder return (TSR). This was reflected in guidance in the existing Code on long-term incentive plans, but has broader application.

**6.10 The PRA therefore proposes to introduce a rule that simple revenue-based measures, such as RoE, EPS and TSR, may not be relied on to determine variable remuneration at aggregate or individual level, except as part of a balanced and risk-adjusted scorecard.**

**Question 12** Do you agree that there should be a rule that simple revenue or profit-based measures may not be relied on to determine variable remuneration at aggregate or individual level, except as part of a balanced and risk-adjusted scorecard?

## 7. Disclosure

7.1 The PCBS recommended that firms should disclose in their annual reports expected levels of remuneration by division for the year ahead and subsequent year and comment on the reasons for any differences between the years.

7.2 There have been a number of recent developments in disclosure since the PCBS reported its findings, including the introduction of a new statutory regime for UK-quoted companies that significantly enhances remuneration reporting requirements at board level.

7.3 In view of those developments the PRA and FCA have decided against introducing further disclosure requirements at this time. In particular, they are concerned that publicly disclosed forecasts of remuneration would be unreliable, bearing in mind the potentially adverse signals that firms may feel that downward future projections might send to their own employees, those they are seeking to recruit or the wider market.

7.4 However, the PRA intends to take a more forward-looking approach to its supervisory judgements around the capital affordability of remuneration and greater consideration will be given by supervisors to the future remuneration assumptions that underpin a firm's capital projections.

## 8 Remuneration of non-executive directors

8.1 The PCBS recommended that non-executive directors should not receive any variable pay. The current Remuneration Code states that the variable remuneration component rules do not apply to non-executive directors. However it is not specific about expectations that non-executives directors should not receive variable remuneration at all.

8.2 It is common practice in the United Kingdom that non-executive directors do not receive variable remuneration in respect of activity carried out in their roles as non-executives. **The PRA and FCA agree with the PCBS that this should be made explicit in the Remuneration Code and proposes to introduce a rule to amend the Code to this effect.** The rule does not, however, affect executive roles which may be carried out by non-executive directors and which may, separately, be subject to the requirements of the Remuneration Code.

**Question 13** Do you agree that there should be an explicit rule that non-executive directors should not receive variable remuneration in respect of activity carried out in their roles as non-executives?

## 9 Sales-based incentives for retail staff

9.1 The PCBS recommended that the new Remuneration Code should include a provision to limit the use and scale of sales-based incentives at individual or business unit level, and for the FCA to have the ability to limit, or even prohibit, such incentives.

9.2 It is widely accepted that incentives can reward and incentivise 'good' performance. However, this inducement can also have an undesirable effect if poorly designed, with consumers ultimately being worse off. The FCA introduced guidance in January 2013 to help firms manage the risks associated with sales-based incentive structures. This was followed by thematic work to assess if and how firms were using the guidance to manage risks to consumers.

9.3 The findings, as published in March 2014,<sup>(1)</sup> showed that the response to the guidance was positive and that FCA intervention has resulted in significant change and increased awareness and focus on financial incentives.

9.4 The current Code applies to all MRTs — those individuals who pose the greatest risk to a firm's risk profile. The specific requirements of the Code have been devised to apply on a proportionate basis to these individuals. Applying the Code to other individuals at individual or business unit level would go well beyond the international standards on remuneration. The FCA does not believe it would be appropriate to apply the full requirements of the Code firm-wide, but the FCA agrees with the Commission that remuneration, including sales-based incentives, can cause conduct failings and poor conduct outcomes. The FCA therefore intends to revisit financial incentive schemes for sales staff as it implements MiFID II and MiFIR II.

(1) [www.fca.org.uk/news/the-fca-publishes-latest-review-of-sales-incentives-at-retail-financial-services-firms](http://www.fca.org.uk/news/the-fca-publishes-latest-review-of-sales-incentives-at-retail-financial-services-firms).

## 10 Summary of non-handbook guidance

10.1 Both the PRA and FCA have previously issued information to help firms to implement the various aspects of the Remuneration Code. The appendices contain updated guidance for firms for the proportionality guidance, and new FCA only guidance for malus:<sup>(1)</sup>

### Proportionality

10.2 The remuneration requirements are already subject to the principle of proportionality taking into account the size, internal organisation and the nature, scope and complexity of the firms' activities. This is currently reflected in the FCA's General Guidance on Proportionality for SYSC 19A, SYSC 19B and SYSC 19C.

10.3 The proposed changes to SYSC 19A and the creation of SYSC 19D — explained in detail in paragraphs 1.16 and 1.17 — require a number of consequential changes to the proportionality framework. The proposed consequential amendments are mostly administrative and they do not reflect changes in policy.

10.4 Therefore, the FCA proposes to consult on:

- (i) the creation of General Guidance on Proportionality for the new chapter SYSC 19D: this new guidance is based on the existing guidance for SYSC 19A but with specific scope on dual regulated firms (Appendix 7).
- (ii) amendments to the General Guidance on Proportionality for SYSC 19A: this guidance is amended to limit its scope to IFPRU investment firms and to provide for group treatment (Appendix 7); and
- (iii) amendments to the General Guidance on Proportionality for SYSC 19C: this guidance is amended to provide for group treatment (Appendix 7).

**Question 14** Do you have any objections to any of the proposed changes to the proportionality framework for SYSC 19A, SYSC 19C and SYSC 19D?

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(1) The PRA issued information for firms in *PRA Supervisory Statement SS2/13*, 'PRA expectations regarding the application of malus to variable remuneration', October 2013; [www.bankofengland.co.uk/pradocuments/publications/ss/2013/ss2013.pdf](http://www.bankofengland.co.uk/pradocuments/publications/ss/2013/ss2013.pdf).

# Appendices

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  - 5 [FCA Statutory Instrument](#)  
[Senior Management Arrangements, Systems and Controls \(Remuneration\) Instrument 2014](#)

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  - 6 [FCA non-handbook guidance on Malus](#)

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  - 7 [FCA non-handbook guidance on proportionality](#)

## Appendix 1 Compatibility statement

Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA) have different objectives. While both look to meet their own objectives, the PRA and FCA are aware of each other's objectives.

### Compatibility with PRA's general duties and regulatory principles

1. This appendix sets out how the proposals in this CP are compatible with the general duties and regulatory principles of the PRA.

2. The PRA is required, by section 138J(2)(d) of the Financial Services and Markets Act 2000 (FSMA), to explain its reasons for believing that making the proposed rules is compatible with (i) its duty to act in a way which advances its general objective (ie to promote the safety and soundness of PRA-authorized persons), and (ii) its duty to act, so far as is reasonably possible, in a way which, as a secondary objective, facilitates effective competition in the markets for services provided by PRA-authorized persons in carrying on regulated activities.

3. The PRA believes these proposals will advance its general objective, as the proposed rules would introduce (in the format of the Rulebook) measures which are designed to incentivise staff to take decisions which are in the long-term interests of PRA-regulated firms. This will mitigate against excessive risk-taking and short-termism.

4. The PRA has given due weight to the interests of effective competition in evaluating and developing the proposals in this CP — although it recognises that the proposals have the potential to change competitive conditions in the markets in which PRA-regulated firms operate through the imposition of more stringent requirements on PRA-regulated firms than may apply to firms regulated by other jurisdictions.

5. The PRA has a statutory requirement under section 138K(2) of FSMA to state whether the impact on mutual societies will be significantly different from the impact on other firms. The proposals in this CP will apply to mutual societies which, the PRA considers, will not be affected any differently from other firms.

6. In developing the proposals in this CP, the PRA has had regard to the eight Regulatory Principles which are set out in section 3B of FSMA. Of these, the proportionality principle and the transparency principle are of particular relevance to the current proposals. With regard to these two principles:

- The principle of proportionality requires that the burden or restriction imposed by a measure should be proportionate to the benefits which are expected as a result. The PRA has followed this principle when developing the rules outlined in this CP, and has indicated in the CP and attached documents the key elements of its thinking.
- The principle of transparency requires that the PRA should exercise its functions transparently. In this CP, the PRA sets out all the key information relevant to its proposals, and gives respondents the opportunity to comment on the proposals, the specific rules reflecting those proposals, and, in cases where a specific proposal is not advanced, on the various options which the PRA is considering.

7. This paper includes proposals for longer deferral periods. There is some evidence of psychological discounting of the value of awards due to longer deferral with a tendency to heavier discounting by young employees and women. However, the perceived value of awards does not affect actual value and can be brought more into line by increasing understanding and the better targeting of performance measures.

### Compatibility with FCA's general duties

8. This appendix sets out FCA's view on how the consultation proposals and draft rules in this CP are compatible with certain requirements under FSMA, and our regulatory objectives set out in this section, and sections 1C, 1D and 1E of FSMA.

9. When consulting on new rules, the FCA is required by section 138I(2)(d) of FSMA to explain why it believes making the proposed rules is compatible with its strategic objective, advances one or more of its operational objectives, and has regard to the regulatory principles in section 3B of FSMA.

### The FCA's objectives and regulatory principles

10. In discharging our general functions, FCA's duty is, as far as is reasonably possible, to act in a way that is compatible with its strategic objective, to ensure that the relevant markets function well, and to advance one or more of our operational objectives.

11. This appendix also sets out the FCA's view of how the proposed rules are compatible with the duty on the FCA to discharge its general functions (which include rule-making) in a way which promotes effective competition in the interests of consumers (section 1B(4)). This duty applies in so far as promoting competition is compatible with advancing the FCA's consumer protection and/or integrity objectives.

12. In preparing the proposals set out in this CP, we have had regard to the regulatory principles set out in section 3B of FSMA.

13. The proposals set out in this CP will mainly advance two of FCA's operational objectives of:

- Enhancing market integrity — protecting and enhancing the integrity of the UK financial system.
- Building competitive markets — promoting effective competition in the interests of consumers.

14. The proposals contained in this CP will also indirectly impact FCA's third operational objective:

- Delivering consumer protection — securing an appropriate degree of protections for consumers.

15. It has been evident in some cases of mis-selling identified in firms that remuneration of individuals has an impact in those firms delivering poor consumer protection.

### Enhancing market integrity

16. In enhancing market integrity, the FCA will be concerned with a number of things, including:

- the soundness, stability and resilience of the financial markets;
- combating market abuse; and
- the orderly operation of the financial markets.

17. To ensure that the relevant markets work well, we focus on delivering good market conduct.

18. We aim to ensure that market infrastructure is sound and well-run. To perform this role, we look at a wide range of behaviour that damages trust in the integrity of markets and we become involved where we see poor behaviour by the parties concerned that has a wider impact on trust in the integrity of markets.

19. By maintaining effective remuneration codes this helps to ensure that firms achieve good market conduct which helps to support a sound and well-run market infrastructure.

### Building competitive markets.

20. What the competition duty means is that we must look to achieve our desired outcomes using solutions that promote competition. As a matter of policy we will normally choose the most pro-competitive measure open to us provided that is compatible with the FCA duties as a whole.

21. The FCA's competition remit also covers looking beyond its regulatory perimeter to consider competition issues that may affect the markets we regulate and seeking to address them by working in collaboration with UK and EU competition authorities when appropriate.

22. In assessing competition the FCA considers all the market features that could inhibit or distort competition, including but not necessarily limited to:

- Market power held by suppliers — where rivalry is impacted because of new requirements, strategic behaviour by established firms, or their reputation.
- Problems in the flow of information — where consumers cannot obtain the information they require on the services available.
- Problems in the way firms make decisions — resulting in situations where the unrequired behaviours of suppliers is not adequately constrained.

23. We do not think that the proposed changes are likely to have a significant impact on our competition objectives.

### FCA regulatory principles

24. In considering the proposals set out in this consultation, the FCA is required to consider the regulatory principles set out in section 3B FSMA. We have had regard to the eight regulatory principles:

Regulatory principle	Compatibility
<p><b>Efficiency and economy</b></p> <p>The need to use FCA resources in the most efficient and economical way</p>	<p>The FCA believes that the proposals in this CP will have minimal impact on FCA resources. We already supervise firm's compliance with the remuneration codes.</p>
<p><b>Proportionality</b></p> <p>A burden or restriction should be proportionate to the benefits, considered in general terms, which are expected to result from the imposition of that burden or restriction.</p>	<p>We have explained the costs imposed by these proposals alongside our policy proposals. We expect the benefits to warrant the costs to firms to achieve the right outcome, namely to positively influence the behaviour of a firm's senior management in line with the interests of its customers by means of remuneration.</p>
<p><b>Sustainable growth</b></p> <p>The desirability of sustainable growth in the UK economy in the medium or long term</p>	<p>Since the outcome of these changes should be positive changes in behaviour of senior management, we expect that will be no material effect on sustainable growth in the UK economy in the medium or long term.</p>
<p><b>Consumer responsibility</b></p> <p>Consumers should take responsibility for their decisions</p>	<p>These proposals do not affect this principle.</p>

Regulatory principle	Compatibility
<p><b>Senior management responsibility</b></p> <p>The responsibilities of senior management of persons subject to requirements imposed by or under FSMA, including those affecting consumers, in relation to compliance with those requirements</p>	<p>These proposals should support the proper behaviour of firm's senior management in line with the interests of its customers by means of remuneration.</p>
<p><b>Recognising the differences in the businesses carried on by different regulated persons</b></p> <p>The desirability of exercising our function that recognises differences in the nature of the businesses carried on by different persons we regulate</p>	<p>The proposals in: SYSC 19D will impact dual-regulated firms; SYSC 19A will impact IFPRU investment firms; and the general guidance on malus and on proportionality will affect dual-regulated firms, IFPRU investment firms and BIPRU firms.</p>
<p><b>Openness and disclosure</b></p> <p>The desirability of publishing information relating to persons</p>	<p>These proposals do not affect this principle.</p>
<p><b>Transparency</b></p> <p>The FCA should exercise its functions as transparently as possible</p>	<p>We have engaged with trade association and firms throughout this process in relation to our approach to PCBS implementation.</p>

## Expected effect on mutual societies

25. The FCA is also required by section 138K(2) of FSMA to state its opinion on whether the proposed rules will have a significantly different impact on mutual societies as opposed to other authorised persons.

26. We do not expect the proposals in this paper to have a significantly different impact on mutual societies.

## Equality and diversity

27. Neither the PRA nor the FCA may act in an unlawfully discriminatory manner. They are also required under the Equality Act 2010 to have due regard to the need to eliminate discrimination and to promote equality of opportunity in carrying out its policies, services and functions. As part of this the PRA and the FCA assess the equality and diversity implications of any new policy proposals. It is our assessment that the proposals in this CP do not give rise to equality and diversity implications, but comments on this are welcomed nonetheless.

## Appendix 2 Cost benefit analysis

### Introduction

1. The Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) are required to carry out and publish a cost benefit analysis (CBA) when proposing draft rules (sections 138I and 138J FSMA). The PRA and FCA consider that the CBA set out below meets the FSMA CBA requirements.

2. This CBA provides information on both the direct and indirect costs that the PRA and FCA think will arise from the proposals. However, given the degree of uncertainty surrounding the indirect effects it is difficult to accurately predict the impact on competition at this stage.

3. To inform this CBA, the FCA engaged Europe Economics (EE), a specialist economics consultancy, to assist in assessing the costs and benefits of the proposed new accountability and remuneration regimes and produce a report.<sup>(1)</sup> EE provided the analysis using two main sources of information:

- (a) 20 structured interviews with a sample of different-sized firms (banks, buildings societies, investment firms and credit unions<sup>(2)</sup>); and
- (b) existing literature/research, specifically price information and comparison to prior work.

4. As acknowledged in the EE report, the remuneration proposals put forward in the consultation paper differ, to varying degrees, from those that formed their cost modelling and analysis. These include differences in the definition of senior managers, deferral periods and the criteria and period in which clawback may occur. This may result in some of the costs outlined being overstated relative to the proposals set out in the consultation paper. However, the extent and nature of the analysis put forward still informs our assessment of the likely impact of the proposals.

5. The PRA and FCA also consulted representative groups including trade associations and practitioner panels as well as relevant academic and consultancy literature to inform its analysis of the potential impacts resulting from the proposals put forward. As the FCA intends to publish the full EE report, this CBA combines its key findings alongside this analysis.

6. The PCBS report identified weaknesses in the alignment between risk and reward in the banking sector and investment businesses, whereby employees' performance-related, variable remuneration, often provided a significant upside but insufficient downside penalty, contributing to the incentivisation of excessive risk-taking.

7. By strengthening the alignment between risk and reward over the longer term, the proposals are intended to reduce incentives for excessive risk-taking and a focus on short-termism, instead encouraging more effective risk management through better alignment of individuals' interests with firms' long-term performance. A primary focus of the PRA and FCA remuneration regime is to adjust incentives so that the amounts being awarded and paid out more closely reflect the risks inherent in the individuals' activities; risks that might only crystallise at a future date.

### Remuneration proposals

8. The consultation paper sets out detailed proposals for amendment to the Remuneration Code in a number of areas. These include:

Area	Main proposals
Deferral	<ul style="list-style-type: none"> <li>• Extending the deferral period for Senior Managers to:                             <ul style="list-style-type: none"> <li>– deferral for no less than seven years;</li> <li>– first vesting of deferred remuneration no earlier than the third anniversary of award; and</li> <li>– vesting no faster than <i>pro rata</i> between years three and seven.</li> </ul> </li> <li>• For all other Material Risk-Takers:                             <ul style="list-style-type: none"> <li>– deferral for no less than five years;</li> <li>– first vesting of deferred remuneration no earlier than the first anniversary of award; and</li> <li>– vesting no faster than <i>pro rata</i>.</li> </ul> </li> </ul>
Clawback	<ul style="list-style-type: none"> <li>• Deferred and undeferred variable remuneration awards will be subject to clawback for a period of at least seven years from the date of award.</li> <li>• Option for firms to extend the clawback period for senior managers up to a further three years (ie to ten years) if there are facts or events under investigation that could leave to the application of clawback.</li> </ul>
Bailed-out banks	<ul style="list-style-type: none"> <li>• Reinforce existing presumption against discretionary payments for senior staff of firms that have required taxpayer bailouts, except where these are justified.</li> </ul>
Risk adjustment: determination of profit for remuneration	<ul style="list-style-type: none"> <li>• Fair value profit should be adjusted in accordance with the prudent valuation regime. (PRA only — the FCA is not consulting on these proposals.)</li> </ul>
Risk adjustment: use of metrics for variable remuneration	<ul style="list-style-type: none"> <li>• Simple profit or revenue-based measures may not be relied on except as part of a balanced and risk-adjusted scorecard. (PRA only — the FCA is not consulting on these proposals.)</li> </ul>
Remuneration of Non-Executive Directors	<ul style="list-style-type: none"> <li>• To prohibit variable pay for Non-Executive Directors acting in their non-executive role.</li> </ul>
Guidance on malus (FCA only)	<ul style="list-style-type: none"> <li>• Application of malus and payment in shares and other instruments and to clarify the deduction of fines from bonus pools.</li> </ul>

(1) *Cost Benefit Analysis of the New Regime for Individual Accountability and Remuneration Final Report*, 3 July 2014.

(2) Credit unions are not subject to the Remuneration Code and therefore excluded from considerations for remuneration.

Area	Other proposals (to be finalised)
Buy-outs	<ul style="list-style-type: none"> <li>The PRA and FCA is presenting four potential policy approaches for discussion:               <ul style="list-style-type: none"> <li>Banning buy-outs</li> <li>Maintaining unvested awards</li> <li>Applying malus to bought-out awards</li> <li>Reliance on clawback</li> </ul> </li> </ul>
Sales-based incentives for retail staff (FCA only)	<ul style="list-style-type: none"> <li>The FCA intend to review financial incentive schemes for sales staff as they implement MiFID II and MiFIR II.</li> </ul>

## Interaction between our accountability and remuneration proposals

9. The FCA commissioned EE to assess the likely impacts of the package of accountability and remuneration measures in a single external report.

10. The baseline for the CBA is what firms do to meet the current Remuneration Code. However, EE have also taken into account any activities that have been undertaken in anticipation of the new regime being introduced.

11. In this CBA, the PRA and FCA focus on the incremental impact of the remuneration proposals. The FCA asked EE to provide their judgement of the additional impact of the remuneration proposals within their overall analysis.

## Compliance costs

12. Policy changes may result in increased compliance costs for firms. EE looked to quantify the one-off and ongoing incremental compliance cost impacts by proposal and in aggregate. Cost questions were included in interviews with firms and formed the basis of the estimated costs.

13. Changes to minimum deferral requirements for variable remuneration will result in one-off costs to the industry including changes to employment contracts and the developing of guidance and rules including legal advice. Ongoing costs will include monitoring of deferred payments to ensure that the payments schedule is met. EE estimated that average one-off costs for banks and investment firms for a large firm could be in the region of £300,000 and for a small firm approximately £25,000. Ongoing compliance costs are estimated to be in the region of £30,000 for a large firm and £10,000 for a small firm.<sup>(1)</sup>

14. Clawback will result in similar levels of one-off costs to those listed above and the majority of ongoing compliance costs are likely to result from firms taking action in specific cases. EE estimates that average one-off costs for banks and investment firms for a large firm could be around £750,000

and £35,000 for a small firm. These estimated costs were based on the overall effect of the clawback proposals as outlined in the PRA's consultation in March (not the potential costs resulting from the extension of three years to the clawback period for senior managers), which were more burdensome than the final proposals put forward in the PRA's policy statement. As such, many of the cost implications associated with introducing and implementing clawback policies have already been reported to the PRA as part of its consultation on clawback<sup>(2)</sup> and been taken into account.

15. The FCA and PRA do not consider there to be any material one-off or ongoing costs of supervising firms as a result of implementing these new proposals.

## Indirect costs

16. A quantitative analysis of the indirect costs has not been undertaken as part of this exercise as it is considered disproportionate to do so and not reasonably practicable, given the high degree of uncertainty surrounding such impacts and the extensive input that would be required from firms in terms of data collection.

17. The EE report identified the following as the most important drivers of potential indirect impacts:

- Staff motivation and effort was considered by EE. Most firms in the sample did not anticipate a significant impact of the policies on motivation even though a small number of firms did raise concerns that the ability to motivate staff would become more difficult primarily attributable to longer deferral periods.
- Wage structures: as deferred pay awards are discounted by as much as 30% per annum, to compensate for the reduction in the perceived value of variable pay brought about by longer deferral, firms may move towards increased fixed pay in order to keep pay at competitive industry levels. This would increase fixed costs for the firm which could increase operational inefficiencies and reduce the level of alignment between risk and reward that the PRA and FCA are seeking to achieve.
- An increase in fixed pay might distort the international banking labour market in favour of UK banks by making these firms more attractive to individuals given the higher levels of fixed pay and potentially overall compensation they might receive, relative to non-UK banks.

(1) Page 27 of the EE report.

(2) PRA Consultation Paper CP6/14, 'Clawback', March 2014; [www.bankofengland.co.uk/pradocuments/publications/policy/2014/clawbackcp6-14.pdf](http://www.bankofengland.co.uk/pradocuments/publications/policy/2014/clawbackcp6-14.pdf).

(d) Staff retention is seen by many firms as being an issue in particular for the more risk-averse staff because they may be less willing to accept a promotion which would result in them becoming a 'material risk-taker'. Some of those staff, especially those in support roles such as legal and accounting, may be able to move to firms not covered by the code.

18. Labour market effects were a key concern for firms. Large banks and investment firms could be at a competitive disadvantage compared with non-UK based firms and with the potential attractiveness of other, non-financial business sectors. Impact on staff hiring and retention could be most apparent among those in operational roles whose skills are more readily applicable to other sectors.

19. Firms are of the view that operational inefficiencies are likely to increase in the short term at least under the new remuneration regime. This will be particularly noticeable for larger firms with more complex organisational structures. It is the view of the PRA and FCA that such operational inefficiencies may decrease over time as the new processes are embedded.

20. Long-term employees who have accumulated deferred pay awards that have not yet vested will be incentivised to remain in their employment for longer by virtue of longer deferral periods (unless their deferred payment can be bought out by a new employer or, via Approach 2: Maintaining Unvested Awards,<sup>(1)</sup> the existing employer is required to maintain unvested awards when an employer moves to a competitor). Longer deferral periods and stricter vesting schedules could impact the flexibility of the labour market as individuals remain at firms for longer due to large accumulated deferred awards yet to vest. There is also evidence of a significant reduction in lateral recruiting among large global banks in recent years which has been linked to the additional costs hiring firms have had to pay to buy out deferred compensation. Longer deferral periods and stricter vesting schedules may exacerbate this further as the size of buyout awards might need to increase significantly. But this will depend on the approach taken to buyouts (see Section 4 of the consultation paper).

21. The impact of the proposals on individual behaviour will vary by firm as each firm has a unique reward culture and values. It is anticipated that the CRD IV bonus cap will already have reduced the overall proportion of variable remuneration for material risk-takers in some firms and therefore the significance of deferral periods for these individuals will already have been lessened to some extent. However, the introduction of longer deferral and a stricter vesting schedule for senior managers may affect the labour market as risk-averse staff might be less willing to take on additional responsibility and progress to senior management level as a

result. Alternatively, these individuals might prefer to work in non-banking sectors.

## Benefits

22. Deferred awards make it possible for banks to either apply malus adjustments to unvested variable remuneration or to claw back amounts already paid if risk management failures or financial problems brought about by the transactions or activities of the individual or firm emerge over time. In addition, to the extent that material risk-takers could be motivated to think more carefully about the impacts of their decisions, these proposals might restrict short-termism and excessive risk-taking.

23. Effective management of risk in firms depends on the judgement of a small number of senior management individuals. It is difficult to determine the exact number of incidences of financial instability in firms brought about by errors in strategic decision-making. Enhanced minimum deferral and vesting periods for senior managers should help to align the interests of these individuals with the long-term safety and financial soundness of the firm.

24. On proposals on deferral, evidence in the EE report is mixed with many firms in the sample stating that the impacts on risk-taking behaviour could be limited because existing pay structures already link risk and variable reward. Overall, EE find that the measures will have most impact on large banks and investment firms who tend to offer the higher variable remuneration packages.

25. The PRA Clawback consultation CP6/14 noted the objectives of clawback as a means to promote the general objective of the Remuneration Code to ensure firms have remuneration policies that foster sound risk management and discourage excessive risk-taking and short-termism. The proposal to increase the overall period for which variable remuneration is to apply for senior persons is intended to acknowledge and better reflect the longer-term impacts of decisions made by such individuals. The cost associated with amending employment contracts and the enforceability of clawback remains.

26. The PRA is proposing strengthening the frameworks for measuring performance and adjusting risk for the purposes of the determination of bonus pools. How the quantum of firm bonus pools is determined affects the level of individual bonuses and consequently has an important impact on employee behaviour. If variable remuneration is awarded based primarily on short-term financial performance, then short-termism particularly in relation to attitudes to risk-taking will persist. Ensuring that appropriate risk adjustments are incorporated into the methodology for

(1) Paragraphs 5.6–5.8 of the consultation paper.

determining the bonus pool will help to build a culture of prudent risk management and increase the focus on risk-taking in general.

## Conclusion

27. The EE report indicated the direct compliance costs for firms to be relatively modest but the proposals are also likely to have indirect effects, potentially on the balance of fixed and variable pay within remuneration structures and on the flexibility of the labour market for individuals within the scope of the regulatory remuneration regime. It is not clear how these indirect effects will alter the balance of costs and benefits so please help us to better understand them.

28. On balance, the PRA and FCA consider the potential benefits of the policies to be persuasive enough to merit

consultation. By strengthening the alignment between risk and reward and deterring short-termism in relation to risk-taking, the proposals should improve firms' risk management and financial soundness.

29. While noting the potential for indirect costs to result from these proposals, the benefits can reasonably be expected to outweigh the direct costs as the intended outcome of these proposals is to address the incentivisation of excessively risk-taking behaviour. This was widely acknowledged to have been a contributing factor to the 2008–09 financial crisis. However, given the potential for the indirect effects to be significant, the PRA and FCA will consider any further evidence provided to us as part of this consultation.

**PRA RULEBOOK: CRR FIRMS: REMUNERATION INSTRUMENT [YEAR]**

**Powers exercised**

- A. The Prudential Regulation Authority (“PRA”) makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 137G (The PRA’s general rules);
  - (2) section 137H (General rules about remuneration);
  - (3) section 137T (General supplementary powers); and
  - (4) section 138C (Evidential provisions).
- B. The rule-making powers referred to above are specified for the purpose of section 138G(2) (Rule-making instrument) of the Act.

**Pre-conditions to making**

- C. In accordance with section 138J of the Act (Consultation by the PRA), the PRA consulted the Financial Conduct Authority. After consulting, the PRA published a draft of proposed rules and had regard to representations made.

**PRA Rulebook: CRR Firms: Remuneration Instrument [Year]**

- D. The PRA makes the rules in Annexes A and B to this instrument.

**Commencement**

- E. This instrument comes into force on [DATE].

**Citation**

- F. This instrument may be cited as the PRA Rulebook: CRR Firms: Remuneration Instrument [YEAR].

**By order of the Board of the Prudential Regulation Authority**

[DATE]

Annex A

# REMUNERATION

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## Chapter content

1. APPLICATION AND DEFINITIONS
2. APPLICATION DATES
3. MATERIAL RISK TAKERS
4. GROUPS
5. PROPORTIONALITY
6. REMUNERATION POLICIES
7. GOVERNANCE
8. CONTROL FUNCTIONS
9. REMUNERATION AND CAPITAL
10. EXCEPTIONAL GOVERNMENT INTERVENTION
11. RISK ADJUSTMENT
12. PENSION POLICY
13. PERSONAL INVESTMENT STRATEGIES
14. NON-COMPLIANCE
15. REMUNERATION STRUCTURES
16. BREACH OF THE REMUNERATION RULES

## Links:

- [Supervisory Statement: Proportionality](#)
- [Supervisory Statement: PRA expectations regarding the application of malus to variable remuneration](#)
- **Supervisory Statement: Remuneration Guidance**
- [Regulation \(EU\) No. 604/2014 of 4 March 2014 \(the Material Risk Takers Regulation\)](#)
- [CEBS Guidelines on remuneration policies and practices](#)

## 1 APPLICATION AND DEFINITIONS

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1.1 Unless otherwise stated, this Part applies to:

- (1) a *CRR firm* in relation to its;
  - (a) *UK activities*;
  - (b) *passport activities* carried on from a branch in another *EEA State*; and
  - (c) other activities wherever they are carried on, in a *prudential context*; and
- (2) a *third country CRR firm* in relation to its activities carried on from an establishment in the *UK*.

1.2 This Part applies:

- (1) in relation to *regulated activities*, activities that constitute *principal dealing*;
- (2) in relation to the carrying on of *unregulated activities* in a *prudential context*; and
- (3) taking into account activities of other members of a *group* of which the *firm* is a member.

1.3 In this Part, the following definitions shall apply:

*ancillary activity*

means an activity which is not a *regulated activity* but which is:

- (1) carried on in connection with a *regulated activity*; or
- (2) held out as being for the purposes of a *regulated activity*.

*ancillary services*

means any of the services listed in Section B of Annex I to *MiFID*.

*material risk taker*

has the meaning given in 3.1.

*Material Risk Takers Regulation*

means Commission Delegated Regulation (EU) No 604/2014 of 4 March 2014 supplementing Directive 2013/36/EU of the European Parliament and of the Council with regard to regulatory technical standards with respect to qualitative and appropriate quantitative criteria to identify categories of staff whose professional activities have a material impact on an institution's risk profile.

*principal dealing*

means the regulated activity, specified in Article 14 of the *Regulated Activities Order* (Dealing in investments as principal), disregarding the exclusion in Article 15 of the *Regulated Activities Order* (Absence of holding out etc), *ancillary activities* and (in relation to *MiFID business*) *ancillary services*.

*remuneration*

means any form of remuneration, including salaries, discretionary pension benefits and benefits of any kind.

*remuneration requirements*

means the requirements in 6-15 .

*share*

means the investment specified in Article 76 of the *Regulated Activities Order* (Shares etc),

- 1.4 Unless otherwise defined, any italicised expression used in this Part and in the *CRD* or *CRR* has the same meaning as in the *CRD* or *CRR*.

## 2 APPLICATION DATES

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- 2.1 Subject to 2.2 and 2.3, a *firm* must apply the *remuneration requirements* in relation to:
- (1) *remuneration* awarded, whether pursuant to a contract or otherwise, on or after 1 January 2011;
  - (2) *remuneration* due on the basis of contracts concluded before 1 January 2011 which is awarded or paid on or after 1 January 2011; and
  - (3) *remuneration* awarded, but not yet paid, before 1 January 2011, for services provided in 2010.
- 2.2 A *firm* must apply 15.9(3) and 15.10 in relation to *remuneration* awarded for services provided or performance from the year 2014 onwards, whether due on the basis of contracts concluded before, on or after 31 December 2013.
- [Note: Art. 162(3) of the *CRD*]**
- 2.3 A *firm* must apply 15.3, 15.20(2), (3) and (4), 15.22 and 16.1(3) in relation to *remuneration* awarded on or after [date].

## 3 MATERIAL RISK TAKERS

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- 3.1 A *firm* must, save where otherwise stated, apply the requirements of this Part in relation to a person (a "material risk taker") who is:
- (1) an *employee* of a *CRR firm* who is deemed, in accordance with the *Material Risk Takers Regulation*, to have a material impact on the *firm's* risk profile; or
  - (2) subject to 3.2, an *employee* of a *third country CRR firm* who would meet any of the criteria set out in Article 3 or Article 4(1) of the *Material Risk Takers Regulation* if it had applied to him or her.
- 3.2 A *third country CRR firm* may deem an *employee* not to be a *material risk taker* where:
- (1) the *employee*:

- (a) would meet any of the criteria in Article 4(1) of the *Material Risk Takers Regulation*,
  - (b) would not meet any of the criteria in Article 3 of the *Material Risk Takers Regulation*; and
  - (c) was awarded total remuneration of less than €750,000 in the preceding financial year; and
- (2) the *third country CRR firm* determines that the professional activities of the *employee* do not have a material impact on its risk profile on the grounds described in Article 4(2) of the *Material Risk Takers Regulation*.
- 3.3 Where a *third country CRR firm* deems an employee not to be a *material risk taker* as set out in 3.2, it must notify the *PRA*, applying exactly the approach described in Article 4(4) of the *Material Risk Takers Regulation*.
- 3.4 A *firm* must maintain a record of its *material risk takers* in accordance with the general record-keeping requirements.
- 3.5 A *firm* must take reasonable steps to ensure that its *material risk takers* understand the implications of their status as such, including the potential for *remuneration* which does not comply with certain requirements of this Part to be rendered void and recoverable by the *firm*.

#### 4 GROUPS

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- 4.1 A *firm* must apply the requirements at *group, parent undertaking and subsidiary undertaking* levels, including those *subsidiaries* established in a country or territory which is not in an *EEA State*.
- 4.2 A *firm* must:
- (1) ensure that the risk management processes and internal control mechanisms of the other members of the *group* of which it is a member comply with the obligations set out in this Part on a *consolidated or sub-consolidated basis*; and
  - (2) ensure that compliance with (1) enables the members of the *group* of which it is a member to have arrangements, processes and mechanisms that are consistent and well integrated and that any data relevant to the purpose of supervision can be produced.

**[Note: Arts. 92(1) and 109 of the CRD]**

#### 5 PROPORTIONALITY

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- 5.1 A *firm* must comply with this Part in a way and to the extent that is appropriate to its size, internal organisation and the nature, the scope and the complexity of its activities, when establishing and applying the total *remuneration* policies for *material risk takers*.
- 5.2 5.1 does not apply to the requirement for significant *firms* to have a *remuneration* committee (7.4).

**[Note: Art. 92(2) of the CRD]**

## 6 REMUNERATION POLICIES

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- 6.1 In this Chapter, 6.2 and 6.5 apply to *firms* in relation to *firms' remuneration* policies, practices and procedures generally, not only in relation to *material risk takers*.
- 6.2 A *firm* must establish implement and maintain a *remuneration* policy, practices and procedures which are consistent with and promote sound and effective risk management and do not encourage risk-taking that exceeds the level of tolerated risk of the *firm*.
- [Note: Arts. 74(1) and 92(2)(a) of the CRD]**
- 6.3 A *firm* must ensure that its *remuneration* policy is in line with the business strategy, objectives, values and long-term interests of the *firm*.
- [Note: Art. 92(2)(b) of the CRD]**
- 6.4 A *firm* must ensure that its *remuneration* policy includes measures to avoid conflicts of interest.
- [Note: Art. 92(2)(b) of the CRD]**
- 6.5 A *firm* must ensure that its *remuneration* policies, practices and procedures, including performance appraisal processes and decisions, are clear and documented

## 7 GOVERNANCE

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- 7.1 In this Chapter, 7.4 applies generally, not only in relation to *material risk takers*.
- 7.2 A *firm* must ensure that its *management body in its supervisory function* adopts and periodically reviews the general principles of the *remuneration* policy and is responsible for overseeing its implementation.
- [Note: Art. 92(2)(c) of the CRD and Standard 1 of the FSB Compensation Standards]**
- 7.3 A *firm* must ensure that the implementation of the *remuneration* policy is, at least annually, subject to central and independent internal review for compliance with policies and procedures for *remuneration* adopted by the *management body in its supervisory function*.
- [Note: Art. 92(2)(d) of the CRD and Standard 1 of the FSB Compensation Standards]**
- 7.4 A *CRR firm* that is significant in terms of its size, internal organisation and the nature, scope and complexity of its activities must establish a *remuneration* committee, and ensure that the committee:
- (1) is constituted in a way that enables it to exercise competent and independent judgment on *remuneration* policies and practices and the incentives created for managing risk, capital and liquidity;
  - (2) comprises a chairman and members who are members of the *management body* who do not perform any executive function in the *firm*;

- (3) is responsible for the preparation of decisions regarding *remuneration*, including those which have implications for the risk and risk management of the *firm* and which are to be taken by the *management body*; and
- (4) takes into account, when preparing such decisions, the long-term interests of *shareholders*, investors and other stakeholders in the *firm* as well as the public interest.

**[Note: Art. 95 of the CRD and Standard 1 of the FSB Compensation Standards]**

7.5 A *firm* that maintains a website must explain on the website how it complies with this Part.

**[Note: Art. 96 of the CRD]**

## 8 CONTROL FUNCTIONS

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8.1 A *firm* must ensure that *employees* engaged in *control functions*:

- (1) are independent from the business units they oversee;
- (2) have appropriate authority; and
- (3) are *remunerated*:
  - (a) adequately to attract qualified and experienced staff; and
  - (b) in accordance with the achievement of the objectives linked to their functions, independent of the performance of the business areas they control.

**[Note: Art. 92(2)(e) of the CRD and Standard 2 of the FSB Compensation Standards]**

8.2 A *firm* must ensure that the remuneration of the senior officers in risk management and compliance functions is directly overseen by the *remuneration* committee referred to in 7.4, or, if such a committee has not been established, by the *governing body in its supervisory function*.

**[Note: Art. 92(2)(f) of the CRD]**

## 9 REMUNERATION AND CAPITAL

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9.1 A *firm* must ensure that total variable *remuneration* does not limit the *firm's* ability to strengthen its capital base.

**[Note: Art. 94(1)(c) of the CRD and Standard 3 of the FSB Compensation Standards]**

## 10 EXCEPTIONAL GOVERNMENT INTERVENTION

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- 10.1 A *firm* that benefits from exceptional government intervention must ensure that:
- (1) variable *remuneration* is strictly limited as a percentage of net revenues when it is inconsistent with the maintenance of a sound capital base and timely exit from government support;
  - (2) it restructures *remuneration* in a manner aligned with sound risk management and long-term growth, including when appropriate establishing limits to the *remuneration* of members of its *management body*; and
  - (3) no variable or discretionary *remuneration* of any kind is paid to members of its *management body* unless this is justified.

**[Note: Art. 93 of the CRD and Standard 10 of the FSB Compensation Standards]**

## 11 RISK ADJUSTMENT

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- 11.1 (1) A *firm* must ensure that any measurement of performance used to calculate variable *remuneration* components or pools of variable *remuneration* components:
- (a) includes adjustments for all types of current and future risks and takes into account the cost and quantity of the capital and the liquidity required; and
  - (b) takes into account the need for consistency with the timing and likelihood of the *firm* receiving potential future revenues incorporated into current earnings.
- (2) A *firm* must ensure that the allocation of variable *remuneration* components within the *firm* also takes into account all types of current and future risks.

**[Note: Art.s 94(1)(j) and (k) of the CRD and Standard 4 of the FSB Compensation Standards]**

- 11.2 A *firm* must have a clear and verifiable mechanism for measuring performance, with risk adjustment applied thereafter in a clear and transparent manner.
- 11.3 A *firm* must base assessments of financial performance used to calculate *variable remuneration* components or pools of *variable remuneration* components principally on profits. To determine profits for this purpose, a *firm* must reconcile fair valuations used in its financial statements with prudent valuations.
- 11.4 A *firm's* risk-adjustment approach must reflect both ex-ante adjustment (which adjusts remuneration for intrinsic risks that are inherent in its business activities) and ex-post adjustment (which adjusts remuneration for crystallisation of specific risk events).
- 11.5 A *firm* must not base the ex-ante risk adjustments referred to in 11.4 on revenue-based measures, except as part of a balanced, risk-adjusted scorecard.
- 11.6 A *firm* must ensure that its total variable remuneration is generally considerably contracted where subdued or negative financial performance of the *firm* occurs, taking into account both current *remuneration* and reductions in payouts of amounts previously earned, including through malus or clawback arrangements.

[Note: Art. 94(1)(n) of the *CRD* and Standard 5 of the FSB Compensation Standards]

## 12 PENSION POLICY

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- 12.1 A *firm* must ensure that:
- (1) its pension policy is in line with its business strategy, objectives, values and long-term interests;
  - (2) when an *employee* leaves the *firm* before retirement, any discretionary pension benefits are held by the *firm* for a period of five years in the form of instruments referred to in 15.15; and
  - (3) when an *employee* reaches retirement, discretionary pension benefits are paid to the *employee* in the form of instruments referred to in 15.15 and subject to a five-year retention period.

[Note: Art. 94(1)(o) of the *CRD*]

## 13 PERSONAL INVESTMENT STRATEGIES

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- 13.1 (1) A *firm* must ensure that its *employees* undertake not to use personal hedging strategies to undermine the risk alignment effects embedded in their *remuneration* arrangements.
- (2) A *firm* must ensure that its *employees* undertake not to use *remuneration*- or liability-related *contracts of insurance* to undermine the risk alignment effects embedded in their *remuneration* arrangements.
- (3) A *firm* must maintain effective arrangements designed to ensure that *employees* comply with their undertaking.

[Note: Art. 94(1)(p) of the *CRD* and Standard 14 of the FSB Compensation Standards]

## 14 NON-COMPLIANCE

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- 14.1 A *firm* must ensure that variable *remuneration* is not paid through vehicles or methods that facilitate non-compliance with obligations arising from *CRR*, *CRD* or this Part.

[Note: Art. 94(1)(q) of the *CRD*]

## 15 REMUNERATION STRUCTURES

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### General Requirement

- 15.1 A *firm* must ensure that the structure of an *employee's remuneration* is consistent with and promotes effective risk management.
- 15.2 A *firm* must ensure that its *remuneration* policy makes a clear distinction between criteria for setting:
- (1) basic fixed *remuneration* that primarily reflects an *employee's* professional experience and organisational responsibility as set out in the *employee's* job description and terms of employment; and
  - (2) variable *remuneration* that reflects performance in excess of that required to fulfil the *employee's* job description and terms of employment and that is subject to performance adjustment in accordance with this Part.

**[Note: Art. 92(2)(g) of the CRD]**

- 15.3 A *firm* may not, save in exceptional circumstances, award variable *remuneration* to a non-executive *director* in relation to his or her role as such.

**Assessment of performance**

- 15.4 A *firm* must ensure that where *remuneration* is performance-related:
- (1) the total amount of *remuneration* is based on a combination of the assessment of the performance of:
    - (a) the individual;
    - (b) the business unit concerned; and
    - (c) the overall results of the *firm*; and
  - (2) when assessing individual performance, financial as well as non-financial criteria are taken into account.

**[Note: Art. 94(1)(a) of the CRD and Standard 6 of the FSB Compensation Standards]**

- 15.5 A *firm* must clearly explain the performance assessment process referred to in 15.4 to relevant *employees*.
- 15.6 A *firm* must ensure that the assessment of performance is set in a multi-year framework in order to ensure that the assessment process is based on longer-term performance and that the actual payment of performance-based components of *remuneration* is spread over a period which takes account of the underlying business cycle of the *firm* and its business risks.

**[Note: Art. 94(1)(b) of the CRD]**

**Specific award structures: guaranteed variable remuneration and buy-outs**

- 15.7 A *firm* must ensure that guaranteed variable *remuneration* is not part of prospective *remuneration* plans. A *firm* must not award, pay or provide guaranteed variable *remuneration* unless:
- (1) it is exceptional;

- (2) it occurs in the context of hiring a new *employee*;
- (3) the *firm* has a sound and strong capital base; and
- (4) it is limited to the first year of service.

**[Note: Arts. 94(1)(d) and (e) of the CRD and Standard 11 of the FSB Compensation Standards]**

- 15.8 A *firm* must ensure that *remuneration* packages relating to compensation for, or buy out from, an *employee's* contracts in previous *employment* align with the long term interests of the *firm* including appropriate retention, deferral and performance and clawback arrangements.

**[Note: Art. 94(1)(i) of the CRD]**

**Ratio between fixed and variable components of total remuneration**

- 15.9 A *firm* must set appropriate ratios between the fixed and variable components of total *remuneration* and ensure that:
- (1) fixed and variable components of total *remuneration* are appropriately balanced;
  - (2) the fixed component represents a sufficiently high proportion of the total *remuneration* to allow the operation of a fully flexible policy on variable *remuneration* components, including the possibility to pay no variable *remuneration* component; and
  - (3) subject to 15.10, the ratio of the variable component of total *remuneration* to the fixed component does not exceed 1:1.

**[Note: Arts 94(1)(f) and 94(1)(g)(i) of the CRD]**

- 15.10 A *firm* may set a ratio between the fixed and the variable components of total *remuneration* that exceeds 1:1 provided the ratio:
- (1) does not exceed 1:2; and
  - (2) is approved by the shareholders or owners or members of the *firm* in accordance with 15.11.
- 15.11 A *firm* must ensure that any approval by the shareholders or owners or members of the *firm* of a ratio that exceeds 1:1 is carried out in accordance with the following procedure:
- (1) the *firm* must give reasonable notice to all shareholders or owners or members of the *firm* that the *firm* intends to seek approval of a ratio that exceeds 1:1;
  - (2) the *firm* must make a detailed recommendation to all shareholders or owners or members of the *firm* giving the reasons for, and the scope of, the approval sought, including the number of staff affected, their functions and the expected impact on the requirement to maintain a sound capital base;
  - (3) the *firm* must, without delay, inform the *PRA* of the recommendation to its shareholders or owners or members, including the proposed ratio and the reasons therefor and must demonstrate to the *PRA* that the proposed higher ratio does not conflict with the *firm's* obligations under the *CRD* and the *CRR*, having regard in particular to the *firm's own funds* obligations;

- (4) the *firm* must ensure that *employees* who have an interest in the proposed higher ratio are not allowed to exercise, directly or indirectly, any voting rights they may have as shareholders or owners or members of the *firm* in respect of the approval sought; and
- (5) the higher ratio is approved by:
  - (a) at least 66% of the shares or equivalent ownership rights represented, if at least 50% of the shares or equivalent ownership rights in the *firm* are represented; or
  - (b) at least 75% of the shares or equivalent ownership rights represented if less than 50% of the shares or equivalent ownership rights in the *firm* are represented.

**[Note: Art. 94(1)(g)(ii) of the CRD]**

- 15.12 A *firm* must notify without delay the *PRA* of the decisions taken by its shareholders or members or owners including any approved higher maximum ratio.

**[Note: Art. 94(1)(g)(ii) of the CRD]**

- 15.13 A *firm* may apply a discount rate to a maximum of 25% of an *employee's* total variable *remuneration* provided it is paid in instruments that are deferred for a period of not less than five years. In applying this discount rate, firms must apply the [EBA Guidelines on the applicable notional discount rate for variable remuneration](#) of 27 March 2014.

**[Note: Art. 94(1)(g)(iii) of the CRD]**

**Payments related to early termination**

- 15.14 A *firm* must ensure that payments relating to the early termination of a contract reflect performance achieved over time and are designed in a way that does not reward failure or misconduct.

**[Note: Art. 94(1)(h) of the CRD and Standard 12 of the FSB Compensation Standards]**

**Retained shares or other instruments**

- 15.15 A *firm* must ensure that:
- (1) a substantial portion, which is at least 50%, of any variable *remuneration* consists of an appropriate balance of:
    - (a) *shares* or equivalent ownership interests, subject to the legal structure of the *firm* concerned, or *share*-linked instruments or equivalent non-cash instruments in the case of a non-listed *firm*; and
    - (b) where possible other instruments which are eligible as *Additional Tier 1 instruments* or are eligible as *Tier 2 instruments* or other instruments that can be fully converted to *Common Equity Tier 1 instruments* or written down, that in each case adequately reflect the credit quality of the *firm* as a going concern and are appropriate for use as variable *remuneration*; and
  - (2) the instruments referred to in paragraph (1) are subject to an appropriate retention policy designed to align incentives with the longer-term interests of the *firm*.

15.16 A *firm* must apply 15.15 to both the portion of the variable *remuneration* component deferred in accordance with 15.17 and 15.18 and the portion not deferred.

**[Note: Art. 94(1)(l) of the CRD and Standard 8 of the FSB Compensation Standards]**

### Deferral

15.17 A *firm* must not award, pay or provide a variable *remuneration* component unless a substantial portion of it, which is at least 40%, is deferred over a period which is not less than:

- (1) in the case of a *material risk taker* who does not perform a *PRA senior management function*, five years, vesting no faster than on a pro-rata basis; or
- (2) in the case of a *material risk taker* who does perform a *PRA senior management function*, seven years, with no vesting to take place until three years after award, and vesting no faster than on a pro-rata basis thereafter.

15.18 In the case of a variable *remuneration* component:

- (1) of £500,000 or more; or
- (2) payable to a *director* of a *firm* that is significant in terms of its size, internal organisation and the nature, scope and complexity of its activities;

at least 60% of the amount must be deferred on the basis set out in 15.17.

15.19 Subject to 15.17, the length of the deferral period must be established in accordance with the business cycle, the nature of the business, its risks and the activities of the *employee* in question.

**[Note: Art. 94(1)(m) of the CRD and Standards 6 and 7 of the FSB Compensation Standards]**

### Performance adjustment

15.20 A *firm* must ensure that:

- (1) any variable *remuneration*, including a deferred portion, is paid or vests only if it is sustainable according to the financial situation of the *firm* as a whole, and justified on the basis of the performance of the *firm*, the business unit and the individual concerned;
- (2) any variable *remuneration* is subject to clawback, such that it is not awarded save where an amount corresponding to it can be recovered from the individual by the *firm* if the recovery is justified on the basis of the circumstances described in 15.21(2) or 15.22; and
- (3) any variable *remuneration* is subject to clawback for a period of at least 7 years from the date on which the variable *remuneration* is awarded; and
- (4) in the case of a *material risk taker* who performs a *PRA senior management function*, the *firm* can, by notice to the *employee* to be given no later than 7 years after the variable *remuneration* was awarded, extend the period during which variable *remuneration* is subject to clawback to at least 10 years from the date on which the variable *remuneration* is awarded, where:

- (a) the *firm* has commenced an investigation into facts or events which it considers could potentially lead to the application of clawback were it not for the expiry of the clawback period; or
- (b) the *firm* has been notified by a regulatory authority (including an overseas regulatory authority) that an investigation has been commenced into facts or events which the *firm* considers could potentially lead to the application of clawback by the *firm* were it not for the expiry of the clawback period.

**[Note: Art. 94(1)(n) of the CRD and Standards 6 and 9 of the FSB Compensation Standards]**

15.21 A *firm* must:

- (1) set specific criteria for the application of malus and clawback; and
- (2) ensure that the criteria for the application of malus and clawback in particular cover situations where the *employee*:
  - (a) participated in or was responsible for conduct which resulted in significant losses to the *firm*; or
  - (b) failed to meet appropriate standards of fitness and propriety.

**[Note: Art. 94(1)(n) of the CRD]**

15.22 A *firm* must make all reasonable efforts to recover an appropriate amount corresponding to some or all vested variable *remuneration* where either of the following circumstances arise during the period in which clawback applies:

- (1) there is reasonable evidence of *employee* misbehaviour or material error; or
- (2) the *firm* or the relevant business unit suffers a material failure of risk management.

A *firm* must take into account all relevant factors (including, where the circumstances described in (b) arise, the proximity of the *employee* to the failure of risk-management in question and the *employee*'s level of responsibility) in deciding whether and to what extent it is reasonable to seek recovery of any or all of their vested variable *remuneration*.

15.23 (1) A *firm* should reduce unvested deferred variable *remuneration* when, as a minimum:

- (a) there is reasonable evidence of *employee* misbehaviour or material error;
- (b) the *firm* or the relevant business unit suffers a material downturn in its financial performance; or
- (c) the *firm* or the relevant business unit suffers a material failure of risk management.

(2) For performance adjustment purposes, awards of deferred variable *remuneration* made in *shares* or other non-cash instruments should provide the ability for the firm to reduce the number of *shares* or other non-cash instruments.

(3) Contravention of any of (1) or (2) may be relied on as tending to establish contravention of 15.20(1). Contravention of (1) or (2) does not give rise to any of the consequences provided for by provisions of *FSMA* other than section 138C.

## 16 BREACH OF THE REMUNERATION RULES

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- 16.1 Subject to 16.2 to 16.7, the voiding provisions in 16.9 to 16.13 apply in relation to the prohibitions on *material risk takers* being *remunerated* in the ways specified in:
- (1) 15.7 (guaranteed variable remuneration);
  - (2) 15.17-19 (deferred variable remuneration);
  - (3) 15.20(2) (performance adjustment – clawback); and
  - (4) 16.16 (replacing payments recovered or property transferred).
- 16.2 16.1 applies only to those prohibitions as they apply in relation to a *firm* that satisfies either Condition 1 or Condition 2, as set out in 16.3 and 16.4.
- 16.3 Condition 1 is that the *firm* is a *CRR firm*, that has relevant total assets exceeding £50 billion.
- 16.4 Condition 2 is that the *firm*:
- (1) is a *credit institution* or a *UK designated investment firm*; and
  - (2) is part of a group containing a *firm* that has relevant total assets exceeding £50 billion and that is a *CRR firm*.
- 16.5 For the purposes of 16.3 and 16.4 “relevant total assets” means the arithmetic mean of the *firm*’s total assets as set out in its balance sheet on its last three accounting reference dates.
- 16.6 The voiding provisions in 16.9 to 16.13 do not apply in relation to the prohibition on *material risk takers* being *remunerated* in the way specified in 15.7 (guaranteed variable remuneration) if both the conditions in paragraphs (2) and (3) of that rule are met.
- 16.7 The voiding provisions in 16.9 to 16.13 do not apply in relation to a *material risk taker* (X) in respect of whom both the following conditions are satisfied:
- (1) Condition 1 is that Xs variable *remuneration* is no more than 33% of total remuneration; and
  - (2) Condition 2 is that Xs total *remuneration* is no more than £500,000.
- 16.8 In relation to 16.7:
- (1) references to *remuneration* are to *remuneration* awarded or paid in respect of the relevant performance year;
  - (2) the amount of any *remuneration* is:
    - (a) if it is money, its amount when awarded;
    - (b) otherwise, whichever of the following is greatest: its value to the recipient when awarded; its market value when awarded; or the cost of providing it at the time of the award;

- (3) where *remuneration* is, when awarded, subject to any condition, restriction or other similar provision which causes the amount of the *remuneration* to be less than it otherwise would be, that condition, restriction or provision is to be ignored in arriving at its value; and
- (4) it is to be assumed that the *material risk taker* will remain so for the duration of the relevant performance year.

### Voiding provisions

- 16.9 Any provision of an agreement that contravenes a prohibition on persons being *remunerated* in a way specified in a rule to which this rule applies (a “contravening provision”) is void.
- 16.10 A contravening provision does not cease to be void because:
  - (1) the *firm* concerned ceases to satisfy any of the conditions set out in 16.3 to 16.4; or
  - (2) the *material risk taker* concerned starts to satisfy both of the conditions set out in 16.7 (1) and (2).
- 16.11 A contravening provision that, at the time a rule to which this rule applies was first made (including in any previous rules in the *PRA Handbook*), is contained in an agreement made before that time is not rendered void by 16.9 unless it is subsequently amended so as to contravene such a rule.
- 16.12 (1) A pre-existing provision is not rendered void by 16.9.
  - (2) In this Chapter, a pre-existing provision is any provision of an agreement that would (but for this rule) be rendered void by 16.9 that was agreed at a time when either:
    - (a) the *firm* concerned did not satisfy any of the conditions set out in 16.3 to 16.4; or
    - (b) the *material risk taker* concerned satisfied both of the conditions set out in 16.7(1) and (2).
  - (3) But an amendment to, or in relation to, a pre-existing provision is not to be treated as a pre-existing provision where the amendment is agreed at a time when both:
    - (a) the *firm* concerned satisfies at least one of the conditions set out in 16.3 to 16.4; and
    - (b) the *material risk taker* concerned does not satisfy both of the conditions set out in 16.7(1) and (2).
- 16.13 For the purposes of this Chapter it is immaterial whether the law which (apart from 16.9 to 16.16) governs a contravening provision is the law of the *UK*, or of a part of the *UK*.

### Recovery of payments made or property transferred pursuant to a void contravening provision

- 16.14 In relation to any payment made or other property transferred in pursuance of a contravening provision other than a pre-existing provision, a *firm* must take reasonable steps to:
  - (1) recover any such payment made or other property transferred by the *firm*; and

- (2) ensure that any other *person* recovers any such payment made or other property transferred by that *person*.

16.15 16.14 continues to apply in one or both of the following cases:

- (1) the *firm* concerned ceases to satisfy any of the conditions set out in 16.3 to 16.4;
- (2) the *material risk taker* concerned starts to satisfy both of the conditions set out in 16.7 (1) and (2).

**Replacing payments recovered or property transferred**

- 16.16 (1) A *firm* must not award, pay or provide variable *remuneration* to a *person* who has received *remuneration* in pursuance of a contravening provision other than a pre-existing provision (the "contravening *remuneration*") unless the *firm* has obtained a legal opinion stating that the award, payment or provision of the *remuneration* complies with this Part.
- (2) This rule applies only to variable *remuneration* relating to a performance year to which the contravening *remuneration* related.
  - (3) The legal opinion in (1) must be properly reasoned and be provided by an appropriately qualified independent *individual*.
  - (4) Paragraph (1) continues to apply in one or both of the following cases:
    - (a) the *firm* concerned ceases to satisfy any of the conditions set out in 16.3 to 16.4;
    - (b) the *material risk taker* concerned starts to satisfy both of the conditions set out in 16.7(1) and (2).

Annex B

Amendments to the Glossary

In the Glossary Part of the PRA Rulebook, insert the following new definitions:

*MiFID*

means Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments, amending Directive 2002/92/EC and Directive 2011/61/EU.

*passport activity*

means an activity carried on by an *EEA firm*, or by a *UK firm*, under an *EEA right*.

*prudential context*

means, in relation to activities carried on by a *firm*, the context in which the activities have, or might reasonably be regarded as likely to have, a negative effect on:

- (1) the safety and soundness of *firms*; or
- (2) the ability of the *firm* to meet either:
  - (a) the “fit and proper” test in *threshold condition* 4E and 5E (Suitability); or
  - (b) the applicable requirements and standards under the *prudential regulatory system* relating to the *firm's* financial resources.

*regulatory system*

means the arrangements for regulating a *firm* or other *person* in or under *FSMA*, including the *threshold conditions*, the *Fundamental Rules* and other rules made by the *PRA*, the *FCA Handbook*, any codes and guidance given by the *PRA* or the *FCA* and including any relevant directly applicable provisions of an *EU Directive* or *Regulation* including those specified under section 204A(2) of *FSMA*.

*third country CRR firm*

means an *overseas firm* that:

- (1) is not an *EEA firm*;
- (2) has its *head office* outside the *European Economic Area*; and
- (3) would be a *CRR firm* if it had been a *UK undertaking*, had carried on all of its business in the UK and had obtained whatever authorisations for doing so as are required under *FSMA*.

**HANDBOOK (REMUNERATION CONSEQUENTIALS) INSTRUMENT [YEAR]**

**Powers exercised**

A. The Prudential Regulation Authority (“PRA”) makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):

- (1) section 137G (The PRA’s general rules); and
- (2) section 137T (General supplementary powers).

B. The rule-making powers referred to above are specified for the purpose of section 138G(2) (Rule-making instrument) of the Act.

**Pre-conditions to making**

C. In accordance with section 138J of the Act (Consultation by the PRA), the PRA consulted the Financial Conduct Authority. After consulting, the PRA published a draft of proposed rules and had regard to representations made.

**Handbook (Remuneration Consequentials) Instrument [Year]**

D. The PRA makes the rules in Annexes A and B to this instrument.

**Commencement**

E. This instrument comes into force on [DATE].

**Amendments to the PRA Handbook**

F. The Glossary of definitions is amended in accordance with Annex A to this instrument.

G. The Senior Management Arrangements, Systems and Controls sourcebook (SYSC) is amended in accordance with Annex B to this instrument.

**Citation**

H. This instrument may be cited as the Handbook (Remuneration Consequentials) Instrument [Year].

**By order of the Board of the Prudential Regulation Authority**  
[DATE]

## Annex A

## Amendments to the Glossary of Definitions

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

Amend the following definitions as shown:

- discretionary pension benefit* (A) ~~In the PRA Handbook:~~
- ~~(in SYSC 19A) enhanced pension benefits granted on a discretionary basis by a firm to an employee as part of that employee's variable remuneration package, but excluding accrued benefits granted to an employee under the terms of his company pension scheme. [deleted]~~
- ~~[Note: article 4(49) of the *Banking Consolidation Directive*]~~
- (B) In the FCA Handbook:
- ...
- investment firm* (A) In the PRA Handbook:
- ...
- ~~(5) (in SYSC 19A) a firm in (3) except for a BIPRU firm [deleted]~~
- (B) In the FCA Handbook:
- ...
- parent undertaking* (A) In the PRA Handbook:
- (1) ...
- (c) (for the purposes of *BIPRU* (except *BIPRU* 12), *GENPRU* (except *GENPRU* 3) and *INSPRU* as they apply on a consolidated basis and for the purposes of *SYSC* 12 (Group risk systems and controls requirement) and *SYSC* 19C (Remuneration Code for BIPRU firms) and in relation to whether an *undertaking* is a *parent undertaking*) an *undertaking* which has the following relationship to another *undertaking* ("S"):
- (i) a relationship described in (a) other than (a)(vii); or

- (ii) it effectively exercises a dominant influence over S;

and so that (a)(v) does not apply for the purpose of *BIPRU* as it applies on a consolidated basis (including *BIPRU* 8 (Group risk - consolidation)) or *BIPRU* 10.

(2) ...

- (3) (for the purposes of *GENPRU* 3, *BIPRU* 12, and *IFPRU* and *SYSC* 19A (Remuneration Code)) has the meaning in article 4(1)(15) of the *EU CRR* but so that (in accordance with article 2(9) of the *Financial Groups Directive*) article 4(1)(15)(b) applies for the purpose of *GENPRU* 3.

(B) In the FCA Handbook:

...

...

*Remuneration Code* ~~*SYSC* 19A (Remuneration Code)~~ [deleted]

*Remuneration Code general requirement* ~~*SYSC* 19A.2.1R~~ [deleted]

*Remuneration Code staff* (A) ~~In the PRA Handbook:~~

~~(for a *CRR* firm and an *overseas* firm in *SYSC* 19A1.1.1R(1)(f)) has the meaning given in *SYSC* 19A.3.4R~~ [deleted]

(B) In the FCA Handbook:

...

*remuneration principles proportionality rule* ~~(in *SYSC* 19A) has the meaning given in *SYSC* 19A.3.3R.~~ [deleted]

## Annex B

## Amendments to the Senior Management Arrangements, Systems and Controls sourcebook (SYSC)

In this Annex, underlining indicates new text and striking through indicates deleted text.

**1 Application and purpose**

**1.1A Application**

...

- 1.1A.1 G The application of this sourcebook is summarised at a high level in the following table. The detailed application is set out in SYSC 1 Annex 1 and in the text of each chapter.

Type of firm	Applicable chapters
<i>Insurer</i>	Chapters 2, 3, 11 to 18, 21
<i>Managing agent</i>	Chapters 2, 3, 11, 12, 18, 21
<i>Society</i>	Chapters 2, 3, 12, 18, 21
Every other <i>firm</i>	Chapters 4 to 12, 18, <del>19A</del> , <u>19D</u> , and 21

*Dual-regulated firms* should also refer to the Remuneration part of the PRA Rulebook

...

**1.4 Application of SYSC 11 to SYSC 21**

...

- 1.4.1A R SYSC 12, SYSC 19A, SYSC 19D, SYSC 20 and SYSC 21 do not apply to a *firm* in relation to its carrying on of *auction regulation bidding*.

- 1.4.1B G Apart from SYSC 12, SYSC 19A, SYSC 19D, SYSC 20 and SYSC 21 which are disapplied by SYSC 1.4.1A R, the other chapters of SYSC 11 to SYSC 17 do not apply in relation to a *firm's* carrying on of *auction regulation bidding* because they only apply to an *insurer*. SYSC 18 provides guidance on the Public Interest Disclosure Act.

...

**4 General organisational requirements**

**4.1 General Requirements**

...

4.1.2 R For a *common platform firm*, the arrangements, processes and mechanisms referred to in SYSC 4.1.1R must be comprehensive and proportionate to the nature, scale and complexity of the risks inherent in the business model and of the *common platform firm's* activities and must take into account the specific technical criteria described in SYSC 4.1.7R, SYSC 5.1.7R, SYSC 7 and whichever of the following as applicable:

- (1) (for a *firm* to which SYSC 19A applies) SYSC 19A (IFPRU Remuneration Code); ~~;~~ ~~or~~
- (2) (for a *full-scope UK AIFM*) SYSC 19B (AIFM Remuneration Code);
- (3) (for a *firm* to which SYSC 19C applies) SYSC 19C (BIPRU Remuneration Code);
- (4) (for a *firm* to which SYSC 19D applies) SYSC 19D (Dual-regulated firms Remuneration Code);
- (5) (for a *firm* to which the Remuneration part of the *PRA* Rulebook applies) the Remuneration part of the *PRA* Rulebook.

...

**6 Compliance, internal audit and financial crime**

**6.1 Compliance**

...

6.1.4-A G In setting the method of determining the *remuneration of relevant persons* involved in the compliance function:

- (1) *firms* that SYSC 19A applies to will also need to comply with the *Remuneration Code*; ~~and~~
- (2) *BIPRU firms* will also need to comply with the *BIPRU Remuneration Code*;
- (3) *firms* that SYSC 19D applies to will also need to comply with the *Dual-regulated firms Remuneration Code*; and
- (4) *firms* that the Remuneration part of the *PRA* Rulebook applies to will also need to comply with it.

...

**7 Risk control**

**7.1 Risk control**

7.1.7B G In setting the method of determining the *remuneration* of *employees* involved in the risk management function;

...

(1) *firms* that SYSC ~~19A~~ 19D applies to will also need to comply with the Dual-regulated firms Remuneration Code; and

(2) *firms* that the Remuneration part of the PRA Rulebook applies to will also need to comply with it.

...

**12 Group risk systems and control requirements**

**12.1 Application**

...

CRR firms and non-CRR firms that are parent financial holding companies in a Member State

12.1.13 R If this *rule* applies under SYSC 12.1.14 R to a *firm*, the *firm* must:

...

(2) ensure that the risk management processes and internal control mechanisms at the level of any *consolidation group* or non-EEA *sub-group* of which it is a member comply with the obligations set out in the following provisions on a consolidated (or sub-consolidated) basis:

...

(dA) the Remuneration Code or the Dual-regulated Firms Remuneration Code, whichever is applicable;

...

...

**21.1 Risk control: guidance on governance arrangements**

...

Chief Risk Officer

21.1.2 G

(1) A Chief Risk Officer should:

...

- (j) provide risk-focused advice and information into the setting and individual application of the *firm's remuneration* policy (Where the *Remuneration Code* applies, see in particular SYSC 19A.3.15 E. Where the BIPRU Remuneration Code applies, see in particular SYSC 19C.3.15E. Where the *Dual-regulated Remuneration Code* applies, see in particular SYSC 19D.2.15E. Where the Remuneration part of the *PRA* Rulebook applies, see the *PRA's* Supervisory Statement SS [ ] on Remuneration).

...

Delete SYSC 19A. This text is not shown.

## Appendix 4 Draft supervisory statement on Remuneration

### 1 Introduction

1.1 This supervisory statement applies to all firms and designated investment firms regulated by the Prudential Regulation Authority (PRA), within the scope of the Remuneration Part of the Rulebook (the 'Remuneration Part'). This statement clarifies the PRA's expectations on how firms should comply with the requirements of the Remuneration Part of the Rulebook, which will enable firms to make judgements which advance the objectives of the PRA.

1.2 This statement is intended to be read together with the rules contained in the Remuneration Part. The Remuneration Part aims to ensure that firms have risk-focused remuneration policies, which are consistent with and promote effective risk management. This includes eliminating incentives towards excessive risk-taking, encouraging sound risk management, and aligning employee incentives with the longer-term interests of the business, taking account of the potential for financial risks to crystallise over long timeframes.

1.3 This statement, together with the existing statements on Remuneration standards: the application of proportionality (LSS8/13) and PRA expectations regarding the application of malus to variable remuneration (SS2/13) comprises the PRA's expectations in relation to remuneration.

1.4 This statement sets out the expectations of firms in relation to the:

- types of remuneration;
- material risk takers;
- proportionality;
- firm-wide application;
- governing body/remuneration committees;
- risk management and control functions;
- remuneration and capital;
- risk adjustment;
- personal investment strategies;
- remuneration structures; and
- breaches of the remuneration rules.

1.5 The Remuneration Part implements the provisions of Capital Requirements Directive (CRD) which relate to remuneration. The Committee of European Banking Supervisors ('CEBS') published Guidelines on Remuneration Policies and Practices on 10 December 2010.

### 2 Types of remuneration

2.1 The Remuneration Part covers all aspects of remuneration that could have a bearing on effective risk management

including salaries, bonuses, long-term incentive plans, options, hiring bonuses, severance packages and pension arrangements. References to remuneration include remuneration paid, provided or awarded by any person to the extent that it is paid, provided or awarded in connection with employment by a firm.

### 3 Material risk-takers

3.1 Chapter 3 of the Remuneration Part identifies the criteria for determining who is a material risk-taker.

3.2 Where a *third country CRR firm* wishes to deem an employee who earns more than €750,000 not to be a material risk taker, the firm should apply for a waiver of the Remuneration rules in respect of that person, using s138A of FSMA.

### 4 Proportionality

4.1 Chapter 5 of the Remuneration Part is aligned with the PRA's existing approach to proportionality.<sup>(1)</sup> The PRA does not expect firms to apply rules 15.7–15.8 (guaranteed variable remuneration and buy-outs), 15.15–15.16 (retained shares or other instruments), 15.17–15.19 (deferral) and 15.20–15.23 (performance adjustment), where, in relation to an individual, both the following conditions are satisfied:

- (a) Condition 1 is that the individual's variable remuneration is no more than 33% of their total remuneration; and
- (b) Condition 2 is that the individual's total remuneration is no more than £500,000.

### 5 Firm-wide application

5.1 The PRA expects firms to apply at least the following rules on a firm-wide basis:

- remuneration policies;
- governance;
- risk adjustment;
- pension policy;
- personal investment strategies;
- payments related to early termination; and
- deferral.

### 6 Governing body/remuneration committees

6.1 Firms are expected to demonstrate that its decisions are consistent with an assessment of its financial condition and

(1) See [www.bankofengland.co.uk/publications/Documents/other/pr/policy/2013/remunerationstandardslss8-13.pdf](http://www.bankofengland.co.uk/publications/Documents/other/pr/policy/2013/remunerationstandardslss8-13.pdf).

future prospects. In particular, practices by which remuneration is paid for potential future revenues whose timing and likelihood remain uncertain should be evaluated carefully. The governing body or remuneration committee (or both) should work closely with the firm's risk function in evaluating the incentives created by its remuneration system.

6.2 The governing body and any remuneration committee are responsible for ensuring that the firm's remuneration policy complies with the rules on remuneration and where relevant should take into account relevant guidance, such as that issued by the Basel Committee on Banking Supervision, the International Association of Insurance Supervisors (IAIS) and the International Organization of Securities Commissions (IOSCO).

## 7 Risk management and control functions

7.1 The PRA expects the ratio of the potential variable component of remuneration to the fixed component of remuneration to be significantly lower for employees in risk management and compliance functions than for employees in other business areas whose potential bonus is a significant proportion of their remuneration. The PRA expects firms to ensure that the total remuneration package offered to those employees is sufficient to attract and retain staff with the skills, knowledge and expertise to discharge those functions. The method of determining the remuneration of relevant persons involved in the compliance function must not compromise their objectivity or be likely to do so.

7.2 The PRA expects firms to ensure that its risk management and compliance functions have appropriate input into setting the remuneration policy for other business areas. This includes allowing the firm's risk and compliance functions to have significant input into the setting of individual remuneration awards where those functions have concerns about the behaviour of the individuals concerned or the level of risk of the business undertaken. This expectation can be relied on as tending to establish contravention of the rule on employees engaged in control functions having appropriate authority (rule 8.1).

## 8 Remuneration and capital

8.1 A firm's variable remuneration arrangements should be sufficiently flexible to allow it to direct the necessary resources towards capital building.

## 9 Risk adjustment

9.1 The governing body (or, where appropriate, the remuneration committee) should approve performance adjustment policies, including the triggers under which

adjustment would take place. The PRA may ask firms to provide a copy of their policies and expects firms to make adequate records of material decisions to operate the adjustments.

### Risk adjustment frameworks

9.2 The PRA expects firms to have a risk-adjustment framework that provides a clear and verifiable mechanism for measuring performance, and which leads to quantifiable risk adjustments being made in a clear and transparent manner. Firms will be expected to justify to the PRA how they have adjusted for risk.

9.3 A number of risk-adjustment techniques and measures are available, and the PRA expects firms to choose those most appropriate to its circumstances. Firms are expected to provide a quantitative reference or starting point that explicitly includes risk-adjusted metrics, before the application of more discretionary factors. Common measures include those based on economic profit or economic capital. Whatever technique is chosen, the full range of future risks should be covered and firms should be able to provide the PRA with details of all adjustments that the firm has made, whether through application of formulae or the exercise of discretion. This will enable the PRA to ensure that the firms risk adjustment frameworks are sufficiently robust. Where discretion has been applied, the firm should be able to provide a clear explanation for, and quantification of such adjustments. Firms should also ask the risk management function to validate and assess risk-adjustment techniques, and to attend a meeting of the governing body or remuneration committee for this purpose.

### Accounting for profit for remuneration purposes

9.4 The starting point for verifying financial performance for variable remuneration pools is profits. The fair value accounting model used to calculate profitability gives a market valuation of a firm's assets and liabilities at a particular point in time based on the assumption that the assets will be traded in the short term.

9.5 Market illiquidity can render fair values difficult to measure and unreliable as risks that might not be realised for months or years after transactions have completed are often not recognised. Unrealised gains for mature, illiquid assets may also reverse over time. Using the fair value accounting model for determining financial performance may as a result incentivise employees to take imprudent risks in pursuit of short-term gains.

9.6 To ensure that incentives are better aligned with the long-term sustainable financial performance of the firm, the PRA expects variable awards to reflect the long-term *ex-ante* risks associated with employee activities and to reduce the sensitivity of financial performance measures to short-term profit.

9.7 Profits for remuneration purposes should be determined using a prudent valuation approach with any profit figure taken from a fair valuation accounting model adjusted by deducting from this figure the total of all prudent valuation adjustments of fair valued positions (the 'Additional Valuation Adjustments' figure). The PRA expects prudent valuation adjustments to be determined using the Simplified Approach or Core Approach proposed by the EBA in its Final draft regulatory technical standards (RTS) on prudent valuation under Article 105(14) of Regulation (EU) No 575/2013 (Capital Requirements Regulation — CRR). This RTS will become a legally binding Regulation once it is adopted as such by the European Commission.

### Use of metrics

9.8 Aligning variable awards to sustainable financial performance requires firms to make appropriate *ex-ante* adjustments to take account of the potential for future unexpected losses. Performance measures commonly used such as earnings per share (EPS), total shareholder return (TSR) and return on equity (RoE) are not suitably adjusted for long-term risk factors, and have a tendency to incentivise highly-leveraged activities notwithstanding regulatory constraints on leverage such as capital requirements. The PRA expects these earnings based metrics to form part of the risk adjustment process only if it can be demonstrated that their use is part of a balanced scorecard which gives credible weight to non-profit based measures.

## 10 Personal investment strategies

10.1 The circumstances in which the PRA expects a personal hedging strategy to be used include (and are not limited to) entering into an arrangement with a third party under which the third party will make payments, directly or indirectly, to that person that are linked to or commensurate with the amounts by which the person's remuneration is subject to reductions.

## 11 Remuneration structures

### Assessment of performance

11.1 The PRA expects that when firms refer to the non-financial criteria in rule 15.4(2) this should include the extent of the employee's adherence to effective risk management, and compliance with the regulatory system and relevant overseas regulatory requirements.

### Specific award structures: guaranteed variable remuneration, buyouts and retention awards

11.2 The PRA considers guaranteed variable remuneration to be subject to the general rules for variable remuneration awarded by the firm including deferral, malus and clawback. Guaranteed variable awards should not be something that is expected as the norm by new material risk takers and should

be limited to rare, infrequent occurrences. The PRA expects a firm to provide prior notification in respect of each proposed award.

11.3 Retention awards shall form part of variable remuneration for the purpose of rule 15.10 (Ratio between fixed and variable components of total remuneration).

11.4 The PRA expects firms to structure buyouts so that they vest no faster than the awards that they replace.

### Procedure to increase the permitted ratio of fixed to variable remuneration

11.5 The percentage thresholds referred to in rule 15.11(5) — the 50% threshold, the 66% threshold and the 75% threshold — should all be calculated by reference to the shares or other ownership rights in the firm. This, in turn, should be taken to mean the voting rights capable of being cast on the relevant resolution, which attach to the shares or ownership rights (see point in paragraph 11.8 regarding directly concerned staff).

11.6 The 75% threshold, which applies when fewer than 50% of shares are represented in the vote and the 66% threshold, which applies when at least 50% of shares are represented, are percentages of the share or ownership voting rights represented, not of the firm's whole issued share capital or ownership rights.

11.7 The concept of shares or ownership rights being 'represented' is not clearly defined for these purposes in EU or UK law and may depend on the legal nature of the firm in question.

- (i) To be clear what proportion of the share/ownership rights is 'represented' as required by CRD, the PRA expects a poll vote to take place at the relevant shareholder meeting (even if the outcome of such a vote may appear obvious from a show of hands and/or any proxies received).
- (ii) The PRA has not ascribed a specific meaning to the word 'represented'. The PRA expects firms to set their own rules as to which forms of conduct will constitute being represented for the purpose of this vote (within the range of meanings that the word 'represented' could sensibly carry).
- (iii) The PRA expects firms to make it clear to shareholders how each form of conduct (voting for or against, sending a proxy, abstaining, attending but not voting etc) will be treated for the purpose of being represented.
- (iv) It is prudent to proceed on the basis that the meaning of being 'represented' is the same for the threshold test (ie the 50% test) as for the majority test (ie the 66% or 75% test) — even if other interpretations are possible.

11.8 Staff who are directly concerned by the higher maximum levels of variable remuneration are not permitted to exercise any voting rights they may have. Accordingly, their voting rights should be disregarded when calculating the percentages.

#### **Retained shares or other instruments**

11.9 The PRA regards six months as the minimum retention period compatible with rule 15.15(2).

#### **Deferral**

11.10 The PRA expects firms to have a firm-wide policy (and group-wide policy, where appropriate) on deferral. The proportion deferred should generally rise with the ratio of variable remuneration to fixed remuneration and with the amount of variable remuneration. Where an employee's variable remuneration component is £500,000 or more, at least 60% should be deferred. However, firms should also consider whether this deferral ratio should also be applied in cases of variable remuneration below £500,000.

## **12 Breach of the remuneration rules**

### **Recovery of payments made or property transferred pursuant to a void contravening provision**

12.1 Rule 16.14(2) applies in the context of a secondment. Where a group member seconded an individual to a firm and continues to be responsible for the individual's remuneration in respect of services provided to the firm, the PRA expects the firm to take reasonable steps to ensure that the group member recovers from the secondee any remuneration paid in pursuance of a contravening.

### **Notification to the PRA**

12.2 The PRA expects any breach of a rule referred to in 16.1 to be notified to the PRA. Such a notification should include information on the steps which a firm or other person has taken or intends to take to recover payments or property in accordance with rule 16.14.

## SENIOR MANAGEMENT ARRANGEMENTS, SYSTEMS AND CONTROLS (REMUNERATION) INSTRUMENT 2014

### Powers exercised

- A. The Financial Conduct Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1)
    - (a) section 137A (The FCA’s general rules);
    - (b) section 137H (General rules about remuneration);
    - (c) section 137T (General supplementary powers);
    - (d) section 138C (Evidential provisions);
    - (e) section 138D (Action for damages); and
    - (f) section 139A (Power of the FCA to give guidance); and
  - (2) the other rule and guidance making powers listed in Schedule 4 (Powers exercised) to the General Provisions of the FSA’s Handbook.
- B. The rule-making powers referred to above are specified for the purpose of section 138G(2) (Rule-making instruments) of the Act.

### Commencement

- C. This instrument comes into force on [*date*].

### Amendments to the Handbook

- D. The modules of the FCA’s Handbook of rules and guidance listed in column (1) below are amended in accordance with the Annexes in this instrument listed in column (2) below.

(1)	(2)
Glossary of definitions	Annex A
Senior Management Arrangements, Systems and Controls sourcebook (SYSC)	Annex B
Supervision manual (SUP)	Annex C

### Notes

- E. In the Annexes to this instrument, the “notes” (indicated by “**Note:**”) are included for the convenience of readers but do not form part of the legislative text.

### Citation

- F. This instrument may be cited as the Senior Management Arrangements, Systems and Controls (Remuneration) Instrument 2014.

By order of the Board of the Financial Conduct Authority  
[*date*]

## Annex A

### Amendments to the Glossary of definitions

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

Insert the following new definitions and amendments in the appropriate alphabetical position. The text is not underlined

<i>dual-regulated firm</i>	(in SYSC 19D) a <i>firm</i> that is <i>bank</i> , a <i>building society</i> or a <i>UK designated investment firm</i> .
<i>dual-regulated firms Remuneration Code</i>	SYSC 19D (Dual-regulated firms Remuneration Code).
<i>dual-regulated firms remuneration principles proportionality rule</i>	SYSC 19D.3.3R which, in summary, requires a <i>dual-regulated firm</i> to apply the remuneration principles for <i>dual-regulated firms</i> in SYSC 19D proportionate to its size, internal organisation and the nature, the scope and the complexity of its activities.
<i>dual-regulated firms Remuneration Code staff</i>	(in relation to a <i>dual-regulated firm</i> and an <i>overseas firm</i> in SYSC 19D.1.1R(1)(d) that would have been a <i>bank</i> , <i>building society</i> or <i>UK designated investment firm</i> if it had been a <i>UK domestic firm</i> ) has the meaning in SYSC 19D.3.4R which is, in summary, an <i>employee</i> who is deemed to have a material impact on the <i>firm's</i> risk profile in accordance with Regulation (EU) 604/2014 (Regulatory technical standards to identify staff who are material risk takers).
<i>EBA</i>	European Banking Authority.
<i>PRA senior management function</i>	as defined in the [Rulebook Glossary] of the <i>PRA</i> Rulebook. [Note: see definition in CP 'Strengthening accountability in banking: a new regulatory framework for individuals']

Amend the following definitions as shown:

<i>discretionary pension benefit</i>	...
	(B) In the FCA Handbook:
	...
	(2) (in <i>IFPRU</i> , <del>and</del> SYSC 19A ( <u>IFPRU Remuneration Code</u> ) and SYSC 19D ( <u>Dual-regulated firms Remuneration Code</u> ) has the meaning in article 4(1)(73) of the <i>EU</i>

CRR.

...

*investment firm*

...

(B) In the FCA Handbook:

...

(5) (in SYSC 19A (IFPRU Remuneration Code)) a *firm* in (3).

(6) (in SYSC 19D (Dual-regulated firms Remuneration Code) a firm in (3) that is a UK designated investment firm.)

*parent undertaking*

...

(B) In the FCA Handbook:

...

(3) (for the purposes of *GENPRU 3*, *BIPRU 12*, *IFPRU*, ~~and~~ SYSC 19A (IFPRU Remuneration Code) and SYSC 19D (Dual-Regulated firms Remuneration Code)) has the meaning in article 4(1)(15) of the *EU CRR* but so that (in accordance with article 2(9) of the *Financial Groups Directive*) article 4(1)(15)(b) applies for the purpose of *GENPRU 3*.

*Remuneration Code*

SYSC 19A (IFPRU Remuneration Code) for IFPRU investment firms and overseas firms in SYSC 19A.1.1R(1)(d) that would have been an IFPRU investment firm if it had been a UK domestic firm.

*Remuneration Code staff*

...

(B) In the FCA Handbook:

(for a ~~CRR firm~~ an IFPRU investment and an overseas firm in SYSC 19A.1.1R(1)(fd) that would have been an IFPRU investment firm if it had been a UK domestic firm) has the meaning given in SYSC 19A.3.4R which is, in summary, an employee who is deemed to have a material impact on the firm's risk profile in accordance with Regulation (EU) 604/2014 (Regulatory technical standards to identify staff who are material risk takers).

*UK designated investment firm*

...

(B) in the FCA Handbook:

(in *BIPRU 12* and *SYSC 19D*) a *designated investment firm* which is a *body corporate* or *partnership* formed under the law of any part of the *UK*.

## Annex B

### Amendments to the Senior Management Arrangements, Systems and Controls sourcebook (SYSC)

In this Annex, underlining indicates new text and striking through indicates deleted text.

#### 1 Application and purpose

##### 1.1A Application

- 1.1A.1 G The application of this sourcebook is summarised at a high level in the following table. The detailed application is cut back in SYSC 1 Annex 1 and in the text of each chapter.

Type of firm	Applicable chapters
<i>Insurer</i>	Chapters 2, 3, 11 to 18, 21
<i>Managing agent</i>	Chapters 2, 3, 11, 12, 18, 21
<i>Society</i>	Chapters 2, 3, 12, 18, 21
Every other <i>firm</i>	Chapters 4 to 12, 18, <del>19A</del> , <del>19D</del> , 21, <u>Remuneration part of the PRA Rulebook</u>

- 1.1A.1A G The application of this sourcebook to *firms* that are not *PRA-authorised persons* is summarised at a high level in the following table. The detailed application is cut back in SYSC 1 Annex 1 and in the text of each chapter.

<u>Type of firm</u>	<u>Applicable chapters</u>
<u><i>Full-scope UK AIFM</i></u>	<u>Chapter 19B, 21</u>
<u><i>BIPRU firm (including a third-country BIPRU firm)</i></u>	<u>Chapters 4 to 10, 12, 18, 19C, 21</u>
<u><i>IFPRU investment firm (including an overseas firm that would have been an</i></u>	<u>Chapters 4 to 10, 12, 18, 19A, 21</u>

<u>IFPRU investment firm if it had been a UK domestic firm)</u>	
---	--

...

## 1.4 Application of SYSC 11 to SYSC 21

...

1.4.1A R *SYSC 12, SYSC 19A, SYSC 19D, SYSC 20 and SYSC 21 and the remuneration part of the PRA Rulebook do not apply to a *firm* in relation to its carrying on of *auction regulation bidding*.*

1.4.1B R Apart from *SYSC 12, SYSC 19A, SYSC 19D, SYSC 20, and SYSC 21 and the remuneration part of the PRA Rulebook which are disapplied by SYSC 1.4.1AR, the other chapters of SYSC 11 to SYSC 17 do not apply in relation to a *firm's* carrying on of *auction regulation bidding* because they only apply to an *insurer*. SYSC 18 provides guidance on the Public Interest Disclosure Act.*

...

## 4 General organisational requirements

### 4.1 General Requirements

...

4.1.2 R For a *common platform firm*, the arrangements, processes and mechanisms referred to in SYSC 4.1.1R must be comprehensive and proportionate to the nature, scale and complexity of the risks inherent in the business model and of the *common platform firm's* activities and must take into account the specific technical criteria described in SYSC 4.1.7 R, SYSC 5.1.7 R, SYSC 7 and ~~(for a *firm* to which SYSC 19A applies) SYSC 19A or for a *full-scope UK AIFM*) SYSC 19B~~ whichever of the following as applicable:

(1) (for a *firm* to which SYSC 19A applies) SYSC 19A (IFPRU Remuneration Code);

(2) (for a *full-scope UK AIFM*) SYSC 19B (AIFM Remuneration Code);

(3) (for a *firm* to which SYSC 19C applies) SYSC 19C (BIPRU Remuneration Code);

(4) (for a *firm* to which SYSC 19D applies) SYSC 19D (Dual-regulated

firms Remuneration Code); or

- (5) (for a firm to which the remuneration part of the PRA Rulebook applies) the remuneration part of the PRA Rulebook.

...

## **6 Compliance, internal audit and financial crime**

### **6.1 Compliance**

...

6.1.4-A G In setting the method of determining the *remuneration of relevant persons* involved in the compliance function:

- (1) *firms that SYSC 19A applies to will also need to comply with the Remuneration Code; and*
- (2) *BIPRU firms will also need to comply with the BIPRU Remuneration Code;*
- (3) *firms that SYSC 19D applies to will also need to comply with the dual-regulated firms Remuneration Code; and*
- (4) *firms that the remuneration part of the PRA Rulebook applies to will also need to comply with it.*

...

## **7 Risk control**

### **7.1 Risk control**

7.1.7B G In setting the method of determining the *remuneration of employees* involved in the risk management function;

- (1) *firms that SYSC 19A 19D applies to will also need to comply with the dual-regulated firms Remuneration Code; and*
- (2) *firms that the remuneration part of the PRA Rulebook applies to will also need to comply with it.*

7.1.7BC G In setting the method of determining the remuneration of employees involved in the risk management function, firms that SYSC 19A applies to will also need to comply with the Remuneration Code.

...

## 12 Group risk systems and control requirements

### 12.1 Application

...

CRR firms and non-CRR firms that are parent financial holding companies in a Member State

12.1.13 R If this *rule* applies under SYSC 12.1.14 R to a *firm*, the *firm* must:

...

- (2) ensure that the risk management processes and internal control mechanisms at the level of any *consolidation group* or non-*EEA sub-group* of which it is a member comply with the obligations set out in the following provisions on a consolidated (or sub-consolidated) basis:

...

- (dA) the Remuneration Code or the dual-regulated firms Remuneration Code, whichever is applicable;

...

...

### **IFPRU Remuneration Code**

#### 19A.1 General application and purpose

Who? What? Where?

19A.1.1 R (1) The *Remuneration Code* applies to :

- (a) ~~a *building society*~~; [deleted]  
(b) ~~a *bank*~~; [deleted]  
(c) an *IFPRU investment firm*;  
(d) an *overseas firm* that;

...

#### 19A.3 Remuneration principles for ~~banks, building societies and~~ IFPRU investment firms

...

19A.3.4 R ~~*Remuneration Code staff* comprises categories of staff including senior management, risk takers, staff engaged in control functions and any employee receiving total remuneration that takes them into the same remuneration bracket as senior management and risk takers, whose professional activities have a material impact on the firm's risk profile.~~

(1) *Remuneration Code staff* comprises:

(a) an employee of an IFPRU investment firm who is deemed to have a material impact on the firm's risk profile in accordance with Regulation (EU) 604/2014 (Regulatory technical standards to identify staff who are material risk takers); or

(b) subject to paragraphs (2) and (3), an employee of an overseas firm in SYSC 19A1.1.1R(1)(d) (ie, an overseas firm that would have been an IFPRU investment firm if it had been a UK domestic firm) who would meet any of the criteria set out in articles 3 or 4(1) of Regulation (EU) 604/2014 (Regulatory technical standards to identify staff who are material risk takers) if it had applied to him.

(2) An overseas firm in SYSC 19A1.1.1R(1)(d) (ie, an overseas firm that would have been an IFPRU investment firm if it had been a UK domestic firm) may deem an employee not to be *Remuneration Code staff* where:

(a) the employee

(i) would meet the criteria in article 4(1) of Regulation (EU) No 604/2014;

(ii) would not meet any of the criteria in article 3 of Regulation (EU) No 604/2014; and

(iii) was awarded total remuneration of less than €750,000 in the previous year;

and

(b) the overseas firm determines that the professional activities of the employee do not have a material impact on its risk profile on the grounds described in article 4(2) of Regulation (EU) 604/2014.

(3) Where the overseas firm deems an employee not to be *Remuneration Code staff* as set out in (2), it must notify the FCA, applying the approach described in article 4(4) of Regulation

(EU) 604/2014.

[**Note:** article 92(2) of *CRD* and articles 3 and 4 of Regulation (EU) No 604/2014]

19A.3.4A    G    Where an *overseas firm* in SYSC 19A1.1.1R(1)(d) (ie, an *overseas firm* that would have been a *IFPRU investment firm* if it had been a *UK domestic firm*) wishes to deem an *employee* who earns more than €750,000 not to be *Remuneration Code staff*, the *overseas firm* may apply for a *waiver* of the requirement in SYSC 19A.3.4R in respect of that *employee*.

...

19A.3.44E    R    In applying the discount rate in SYSC 19D.2.44DR, a *firm* must apply the *EBA Guidelines on the applicable notional discount rate for variable remuneration* published on 27 March 2014.

[**Note:** the *EBA Guidelines on the applicable notional discount rate for variable remuneration* can be found at:  
<http://www.eba.europa.eu/documents/10180/643987/EBA-GL-2014-01+%28Final+Guidelines+on+the+discount+rate+for+remuneration%29.pdf/e8b3b3f6-6258-439d-a2d9-633e6e5de5e9> ]

...

19A.3.54    R    ...

(1B)    Condition 1 is that the *firm* is a ~~*UK bank*, a *building society*, a *designated investment firm*, or a relevant *IFPRU 730k firm*~~ that has relevant total assets exceeding £50 billion.

...

(1D)    Condition 2 is that the *firm*:

- (a)    is a ~~*full credit institution*, a *designated investment firm*, a relevant *IFPRU 730k firm*~~ or a relevant *third country IFPRU 730k firm*; and
- (b)    is part of a *group* containing a *firm* that has relevant total assets exceeding £50 billion and that is a ~~*UK bank*, a *building society*, a *designated investment firm*~~ or a relevant *IFPRU 730k firm*.

...

## 21.1    Risk control: guidance on governance arrangements

...

Chief Risk Officer

21.1.2 G (1) A Chief Risk Officer should:

...

- (j) provide risk-focused advice and information into the setting and individual application of the *firm's remuneration* policy (Where the *Remuneration Code* applies, see in particular SYSC 19A.3.15E. Where the BIPRU Remuneration Code applies, see in particular SYSC 19C.3.15E. Where the *dual-regulated Remuneration Code* applies, see in particular SYSC 19D.2.15E. Where the remuneration part of the PRA Rulebook applies, see the PRA's Supervisory Statement SS [ ] on Remuneration).

...

**Sch 5 Right of action for damages**

...

Sch 5.4 G

Chapter/ Appendix	Section/ Annex	Paragraph	Right of action under section 138D		
			For private person?	Removed?	For other person?
<u>SYSC 11 to SYSC 19A, and SYSC 19D</u>			No	Yes SYSC 1.4.2R	No

The following new text is inserted after SYSC 19C BIPRU Remuneration Code. The new text is not underlined.

**19D Dual-regulated firms Remuneration Code**

**19D.1 Application and purpose**

Who? What? Where?

19D.1.1 R (1) The *dual-regulated firms Remuneration Code* applies to:

- (a) a *building society*;
- (b) a *bank*;

- (c) an *UK designated investment firm*;
- (d) an *overseas firm* that;
  - (i) is not an *EEA firm*;
  - (ii) has its head office outside the *EEA*; and
  - (iii) would be a *firm* in (a), (b) or (c) if it had been a *UK domestic firm*, had carried on all of its business in the *UK* and had obtained whatever authorisations for doing so as are required under the *Act*.

- (2) For a *firm* which falls under (1)(a), (1)(b) or (1)(c), the *dual-regulated firms Remuneration Code* applies, in a *prudential context*, in relation to:
  - (a) its *UK* activities;
  - (b) its *passported activities* carried on from a *branch* in another *EEA State*; and
  - (c) a *UK domestic firm's* activities wherever they are carried on.
- (3) For a *firm* that falls under (1)(d), the *dual-regulated firms Remuneration Code* applies only in relation to activities carried on from an establishment in the *United Kingdom*.

19D.1.2 R Subject to the provisions on group risk systems and controls requirements in SYSC 12 (Group risk systems and controls requirements), the *dual-regulated firms Remuneration Code*:

- (1) applies in relation to *regulated activities*, activities that constitute *dealing in investments as principal* (disregarding the exclusion in article 15 of the *Regulated Activities Order* (Absence of holding out etc.)), *ancillary activities* and (in relation to *MiFID business*) *ancillary services*;
- (2) applies in relation to the carrying on of *unregulated activities* in a *prudential context*; and
- (3) takes into account activities of other *group* members.

When?

19D.1.3 R (1) Except as set out in (2) and (3), a *firm* must apply the *remuneration* requirements in SYSC 19D.3 (Remuneration principles) in relation to:

- (a) *remuneration* awarded, whether pursuant to a contract or otherwise, on or after 1 January 2011;
- (b) *remuneration* due on the basis of contracts concluded before 1 January 2011 which is awarded or paid on or after 1 January 2011; and
- (c) *remuneration* awarded, but not yet paid, before 1 January 2011, for services provided in 2010.

[**Note:** article 3(2) of Directive 2010/76/EU]

- (2) A *firm* must apply the *remuneration* requirements in SYSC 19D.3.48R(3) (1:1 ratio of variable to fixed components) and SYSC 19.3.49R (1:2 ratio of fixed to variable components) in relation to *remuneration* awarded for services provided or performance from the year 2014 onwards, whether due on the basis of contracts concluded before, on or after 31 December 2013.

[**Note:** article 162(3) of CRD]

- (3) A *firm* must apply the *remuneration* requirements in SYSC 19D.3.38R, SYSC 19D.3.61R(2), SYSC 19D.3.61R(3), SYSC 19D.3.61R(4), SYSC 19D.3.64R and SYSC 19D.3.67R(1)(c) in relation to variable *remuneration* awarded on or after [1 January 2015].

19D.1.4 G Subject to SYSC 19D.1.5R, SYSC 19D.1.3R does not require a *firm* to breach requirements of applicable contract or employment law.

[**Note:** recital 14 of Directive 2010/76/EU]

#### Conflict with other obligations

- 19D.1.5 R
- (1) Where a *firm* is unable to comply with the *dual-regulated firms Remuneration Code* because to do so would breach a provision of a prior contract (including a provision in a contract with a *dual-regulated firms Remuneration Code staff member*), it must take reasonable steps to amend or to terminate the provision in question in a way which enables it to comply with the *dual-regulated firms Remuneration Code* at the earliest opportunity.
  - (2) Until the provision in (1) ceases to prevent the *firm* from complying with the *dual-regulated firms Remuneration Code*, it must adopt specific and effective arrangements, processes and mechanisms to manage the risks raised by the provision.

#### Purpose

- 19D.1.6 G
- (1) The aim of the *dual-regulated firms Remuneration Code* is to ensure that *firms* have risk-focused *remuneration* policies, which are consistent with and promote effective risk management and do

not expose them to excessive risk. It expands upon the general organisational requirements in SYSC 4.

- (2) The *dual-regulated firms Remuneration Code* implements the main provisions of the *CRD* which relate to *remuneration*. The Committee of European Banking Supervisors published Guidelines on Remuneration Policies and Practices on 10 December 2010. Provisions of the Capital Requirements Amendment) Regulations 2012 (SI 2012/917) together with the *EBA's* Guidelines to article 22(3) and (5) of the *Banking Consolidation Directive* relating to the collection of *remuneration* benchmarking information and high earners information have been implemented through *SUP 16 Annex 33AR* and *SUP 16 Annex 34AR*. The Guidelines can be found at [http://www.abbl.lu/sites/abbl.lu/files/Guidelines\\_Remuneration\\_C\\_EBS\\_0.pdf](http://www.abbl.lu/sites/abbl.lu/files/Guidelines_Remuneration_C_EBS_0.pdf) and <https://www.eba.europa.eu/documents/10180/107643/EBA-GL-2012-05---GL-5-on-remuneration-data-collection-exercise-1.pdf>.

#### Notifications to the FCA

- 19D.1.7 G (1) The *dual-regulated firms Remuneration Code* does not contain specific notification requirements. However, general circumstances in which the *FCA* expects to be notified by *firms* of matters relating to their compliance with requirements under the *regulatory system* are set out in *SUP 15.3* (General notification requirements).
- (2) For *remuneration* matters in particular, such circumstances should take into account *unregulated activities* as well as *regulated activities* and the activities of other members of a *group* and would include each of the following:
- (a) significant breaches of the *dual-regulated firms Remuneration Code*, including any breach of a *rule* to which the provisions on voiding and recovery in *SYSC 19D Annex 1* apply;
  - (b) any proposed *remuneration* policies, procedures or practices which could:
    - (i) have a significant adverse impact on the *firm's* reputation; or
    - (ii) affect the *firm's* ability to continue to provide adequate services to its *customers* and which could result in serious detriment to a *customer* of the *firm*; or
    - (iii) result in serious financial consequences to the *financial system* or to other *firms*;

- (c) any proposed changes to *remuneration* policies, practices or procedures which could have a significant impact on the *firm's* risk profile or resources;
  - (d) fraud, errors and other irregularities described in SUP 15.3.17R (notification of fraud, errors and other irregularities) which may suggest weaknesses in, or be motivated by, the *firm's remuneration* policies, procedures or practices.
- (3) Such notifications should be made immediately as the *firm* becomes aware or has information which reasonably suggests such circumstances have occurred, may have occurred or may occur in the foreseeable future.

#### Individual guidance

- 19D.1.8 G The *FCA's* policy on individual *guidance* is set out in SUP 9. *Firms* should particularly note the policy on what the *FCA* considers to be a reasonable request for *guidance* (see SUP 9.2.5G). For example, where a *firm* is seeking *guidance* on a proposed *remuneration* structure, the *FCA* will expect the *firm* to provide a detailed analysis of how the structure complies with the *dual-regulated firms Remuneration Code*, including the general requirement for *remuneration* policies, procedures and practices to be consistent with, and promote, sound and effective risk management.

#### Interpretation

- 19D.1.9 G Save as provided in the *Glossary*, any expression used in, or for the purpose of, this chapter which is defined or used in *EU CRR* has the meaning given by, or used in, those Regulations.

## 19D.2 General requirement

### Remuneration policies must promote effective risk management

- 19D.2.1 R A *firm* must establish, implement and maintain *remuneration* policies, procedures and practices that are consistent with, and promote, sound and effective risk management.

[**Note:** article 74(1) of *CRD*]

- 19D.2.2 G (1) The *dual-regulated firms Remuneration Code* covers all aspects of *remuneration* that could have a bearing on effective risk management, including salaries, bonuses, long-term incentive plans, options, hiring bonuses, severance packages and pension arrangements.

- (2) As with other aspects of a *firm's* systems and controls, in accordance with SYSC 4.1.2R (general organisational requirements) *remuneration* policies, procedures and practices must be comprehensive and proportionate to the nature, scale and complexity of the *common platform firm's* activities. What a *firm* must do in order to comply with the *dual-regulated firms Remuneration Code* will therefore vary. For example, while the *dual-regulated firms Remuneration Code* refers to a *firm's remuneration committee* and risk management function, it may be appropriate for the *governing body* of a smaller *firm* to act as the *remuneration committee* and for the *firm* not to have a separate risk management function.
- (3) The *FCA* may also ask *remuneration committees* to provide it with evidence of how well the *firm's* remuneration policies meet the *dual-regulated firms Remuneration Code's* principles, together with plans for improvement where there is a shortfall. The *FCA* also expects relevant *firms* to use the principles in assessing their exposure to risks arising from their *remuneration* policies as part of the *internal capital adequacy assessment process (ICAAP)*.
- (4) The *FCA* would also expect *firms* to apply, on a *firm-wide* basis, at least the following principles relating to:
  - (a) risk management and risk tolerance (Remuneration Principle 1);
  - (b) supporting business strategy, objectives, values and long-term interests of the firm (Remuneration Principle 2);
  - (c) avoiding conflicts of interest (Remuneration Principle 3);
  - (d) governance (Remuneration Principle 4);
  - (e) risk adjustment (Remuneration Principle 8);
  - (f) pension policy (Remuneration Principle 9);
  - (g) personal investment strategies (Remuneration Principle 10);
  - (h) payments related to early termination (Remuneration Principle 12(e)); and
  - (i) deferral (Remuneration Principle 12(g)).

#### Record keeping

- 19D.2.3 R In line with the record-keeping requirements in SYSC 9, a *firm* must ensure that its *remuneration* policies, practices and procedures, including performance appraisals processes and decisions, are clear and

documented.

#### Interpretation of references to remuneration

- 19D.2.4 R (1) In this chapter references to *remuneration* include *remuneration* paid, provided or awarded by any *person* to the extent that it is paid, provided or awarded in connection with *employment* by a *firm*.
- (2) (1) is without prejudice to the meaning of *remuneration* elsewhere in the *Handbook*.
- 19D.2.5 G For example, *remuneration* includes payments made by a seconding organisation which is not subject to the *dual-regulated firms Remuneration Code* to a secondee in respect of their *employment* by a *firm* which is subject to the *dual-regulated firms Remuneration Code*.

### 19D.3 Remuneration principles

#### Application: groups

- 19D.3.1 R (1) A *firm* must apply the requirements of this section at *group*, *parent undertaking* and *subsidiary undertaking* levels, including those *subsidiaries* established in a country or territory which is not an *EEA State*.
- (2) (1) does not limit SYSC 12.1.13R(2)(dA) (which relates to the application of the *dual-regulated firms Remuneration Code* within *UK consolidation groups* and *non-EEA sub-groups*).

[**Note:** article 92(1) of *CRD*]

- 19D.3.2 G SYSC 12.1.13R (2)(dA) requires the *firm* to ensure that the risk management processes and internal control mechanisms at the level of any *UK consolidation group* or *non-EEA sub-group* of which a *firm* is a member, comply with the obligations in this section on a consolidated basis (or sub-consolidated basis).

#### Application: categories of staff and proportionality

- 19D.3.3 R (1) This section applies in relation to *dual-regulated firms Remuneration Code staff*, except as set out in (3).
- (2) When establishing and applying the total *remuneration* policies for *dual-regulated firms Remuneration Code staff*, a *firm* must comply with this section in a way, and to the extent, that is appropriate to its size, internal organisation and the nature, the scope and the complexity of its activities (the *dual-regulated firms remuneration principles proportionality rule*).

- (3) (1) and (2) do not apply to the requirement for significant *firms* to have a *remuneration committee* (SYSC 19D.3.12R).

[**Note:** article 92(2) of *CRD*]

[**Note:** In addition to the *guidance* in this section about the *dual-regulated firms remuneration principles proportionality rule*, the *FSA* gave guidance on the division of *firms* into categories for the purpose of providing a framework for the operation of the *dual-regulated firms remuneration principles proportionality rule*. This *guidance* is available on the *FCA* website at [link to follow]]

- 19D.3.4 R (1) *Dual-regulated firms Remuneration Code staff* comprises:
- (a) an *employee* of a *dual-regulated firm* who is deemed to have a material impact on the *firm's* risk profile in accordance with Regulation (EU) 604/2014 (Regulatory technical standards to identify staff who are material risk takers); or
  - (b) subject to (2) and (3), an *employee* of an *overseas firm* in SYSC 19D1.1.1R(1)(d) (ie, an *overseas firm* that would have been a *bank, building society* or *UK designated investment firm* if it had been a *UK domestic firm*) who would meet any of the criteria set out in articles 3 or 4(1) of Regulation (EU) 604/2014 if it had applied to him.
- (2) An *overseas firm* in SYSC 19D1.1.1R(1)(d) (ie, an *overseas firm* that would have been a *dual-regulated firm* if it had been a *UK domestic firm*) may deem an *employee* not to be a *dual-regulated firms Remuneration Code staff* where:
- (a) the *employee*
    - (i) would meet the criteria in article 4(1) of Regulation (EU) No 604/2014;
    - (ii) would not meet any of the criteria in article 3 of Regulation (EU) No 604/2014; and
    - (iii) was awarded total remuneration of less than €750,000 in the previous year;and
  - (b) the *overseas firm* determines that the professional activities of the *employee* do not have a material impact on its risk profile on the grounds described in article 4(2) of Regulation (EU) 604/2014.
- (3) Where the *overseas firm* deems an *employee* not to be *dual-*

*regulated firms Remuneration Code staff* as set out in (2), it must notify the *FCA*, applying the approach described in article 4(4) of Regulation (EU) 604/2014.

[**Note:** article 92(2) of *CRD* and articles 3 and 4 of Regulation (EU) No 604/2014]

19D.3.5 G Where an *overseas firm* in SYSC 19D1.1.1R(1)(d) (ie, an *overseas firm* that would have been a *dual-regulated firm* if it had been a *UK domestic firm*) wishes to deem an *employee* who earns more than €750,000 not to be *dual-regulated firms Remuneration Code staff*, the *overseas firm* may apply for a *waiver* of the requirement in SYSC 19D.3.4R in respect of that *employee*.

19D.3.6 R A *firm* must:

- (1) maintain a record of its *dual-regulated firms Remuneration Code staff* under the general record-keeping requirements (SYSC 9); and
- (2) take reasonable steps to ensure that its *dual-regulated firms Remuneration Code staff* understand the implications of their status as such, including the potential for *remuneration* which does not comply with certain requirements of the *dual-regulated firms Remuneration Code* to be rendered void and recoverable by the *firm*.

Remuneration Principle 1: Risk management and risk tolerance

19D.3.7 R A *firm* must ensure that its *remuneration* policy is consistent with, and promotes, sound and effective risk management and does not encourage risk-taking that exceeds the level of tolerated risk of the *firm*.

[**Note:** article 92(2)(a) of *CRD*]

Remuneration Principle 2: Supporting business strategy, objectives, values and long-term interests of the firm

19D.3.8 R A *firm* must ensure that its *remuneration* policy is in line with the business strategy, objectives, values and long-term interests of the *firm*.

[**Note:** article 92(2)(b) of *CRD*]

Remuneration Principle 3: Avoiding conflicts of interest

19D.3.9 R A *firm* must ensure that its *remuneration* policy includes measures to avoid conflicts of interest.

[**Note:** article 92(2)(b) of *CRD*]

Remuneration Principle 4: Governance

19D.3.10 R A *firm* must ensure that its *management body* in its *supervisory function*

adopts and periodically reviews the general principles of the *remuneration* policy and is responsible for overseeing its implementation.

[**Note:** article 92(2)(c) of *CRD* and Standard 1 of the *FSB Compensation Standards*]

19D.3.11 R A *firm* must ensure that the implementation of the *remuneration* policy is, at least annually, subject to central and independent internal review for compliance with policies and procedures for *remuneration* adopted by the *management body* in its *supervisory function*.

[**Note:** article 92(2)(d) of *CRD* and Standard 1 of the *FSB Compensation Standards*]

- 19D.3.12 R
- (1) A *firm* that is significant in terms of its size, internal organisation and the nature, the scope and the complexity of its activities must establish a *remuneration committee*.
  - (2) A *firm* in (1) must ensure that:
    - (a) the *remuneration committee* is constituted in a way that enables it to exercise competent and independent judgment on *remuneration* policies and practices and the incentives created for managing risk, capital and liquidity;
    - (b) the chairman and the members of the *remuneration committee* must be members of the *management body* who do not perform any executive function in the *firm*;
    - (c) the *remuneration committee* is responsible for the preparation of decisions regarding *remuneration*, including those which have implications for the risk and risk management of the *firm* and which are to be taken by the *management body*; and
    - (d) when preparing such decisions, the *remuneration committee* must take into account the long-term interests of shareholders, investors and other stakeholders in the *firm* and the public interest.

[**Note:** article 95 of *CRD* and Standard 1 of the *FSB Compensation Standards*]

19D.3.13 R A *firm* that maintains a website must explain on the website how it complies with the *dual-regulated firms Remuneration Code*.

[**Note:** article 96 of the *CRD*]

19D.3.14 G (1) A *firm* should be able to demonstrate that its decisions are consistent with an assessment of its financial condition and future prospects. In particular, practices by which *remuneration* is paid

for potential future revenues whose timing and likelihood remain uncertain should be evaluated carefully and the *governing body* or *remuneration committee* (or both) should work closely with the *firm's* risk function in evaluating the incentives created by its *remuneration system*.

- (2) The *governing body* and any *remuneration committee* are responsible for ensuring that the *firm's remuneration* policy complies with the *dual-regulated firms Remuneration Code* and, where relevant, should take into account relevant guidance, such as that issued by the Basel Committee on Banking Supervision, the International Association of Insurance Supervisors (IAIS) and the International Organization of Securities Commissions (IOSCO).
- (3) Guidance on what the *supervisory function* might involve is set out in SYSC 4.3.3G (responsibility of senior personnel, in particular, the *supervisory function*).

#### Remuneration Principle 5: Control functions

- 19D.3.15 R A *firm* must ensure that *employees* engaged in control functions:
- (1) are independent from the business units they oversee;
  - (2) have appropriate authority; and
  - (3) are *remunerated*:
    - (a) adequately to attract qualified and experienced staff; and
    - (b) in accordance with the achievement of the objectives linked to their functions, independent of the performance of the business areas they control.

[**Note:** article 92(2)(e) of *CRD* and Standard 2 of the *FSB Compensation Standards*]

- 19D.3.16 E (1) A *firm's* risk management and compliance functions should have appropriate input into setting the *remuneration* policy for other business areas. The procedures for setting *remuneration* should allow risk and compliance functions to have significant input into the setting of individual *remuneration* awards where those functions have concerns about the behaviour of the individuals concerned or the riskiness of the business undertaken.
- (2) Contravention of (1) may be relied on as tending to establish contravention of the *rule* on *employees* engaged in control functions having appropriate authority (SYSC 19D.3.15R(2)).
- 19D.3.17 R A *firm* must ensure that the *remuneration* of the senior officers in risk management and compliance functions is directly overseen by the *remuneration committee* referred to in SYSC 19D.3.12R or, if such a

committee has not been established, by the *governing body* in its *supervisory function*.

[**Note:** article 92(2)(f) of *CRD*]

- 19D.3.18 G (1) This Remuneration Principle is designed to manage the conflicts of interest which might arise if other business areas had undue influence over the *remuneration* of *employees* within control functions. Conflicts of interest can easily arise when *employees* are involved in the determination of *remuneration* for their own business area. Where these could arise, they need to be managed by having in place independent roles for control functions (including, notably, risk management and compliance) and human resources. It is good practice to seek input from a *firm's* human resources function when setting *remuneration* for other business areas.
- (2) The need to avoid undue influence is particularly important where *employees* from the control functions are embedded in other business areas. This Remuneration Principle does not prevent the views of other business areas being sought as an appropriate part of the assessment process.
- (3) The *FCA* would generally expect the ratio of the potential variable component of *remuneration* to the fixed component of *remuneration* to be significantly lower for *employees* in risk management and compliance functions than for *employees* in other business areas whose potential bonus is a significant proportion of their *remuneration*. *Firms* should nevertheless ensure that the total *remuneration* package offered to those *employees* is sufficient to attract and retain staff with the skills, knowledge and expertise to discharge those functions. The requirement that the method of determining the *remuneration* of *relevant persons* involved in the compliance function must not compromise their objectivity or be likely to do so also applies (see *SYSC* 6.1.4R(4)).

#### Remuneration Principle 6: Remuneration and capital

- 19D.3.19 R A *firm* must ensure that total variable *remuneration* does not limit the *firm's* ability to strengthen its capital base.

[**Note:** article 94(1)(c) of the *CRD* and Standard 3 of the *FSB Compensation Standards*]

- 19D.3.20 G A *firm* should have variable *remuneration* arrangements that are sufficiently flexible to allow it to direct the necessary resources towards capital building.

#### Remuneration Principle 7: Exceptional government intervention

- 19D.3.21 R A *firm* that benefits from exceptional government intervention must

ensure that:

- (1) variable *remuneration* is strictly limited as a percentage of net revenues when it is inconsistent with the maintenance of a sound capital base and timely exit from government support;
- (2) it restructures *remuneration* in a manner aligned with sound risk management and long-term growth, including (when appropriate) establishing limits to the *remuneration* of members of its *management body*; and
- (3) no variable or discretionary *remuneration* of any kind is paid to members of its *management body* unless this is justified.

[**Note:** article 93 of the *CRD* and Standard 10 of the *FSB Compensation Standards*]

- 19D.3.22 G The *FCA* would normally expect it to be appropriate for the ban on paying variable *remuneration* to members of the *management body* of a *firm* that benefits from exceptional government intervention to apply only to members of the *management body* who were in office at the time that the intervention was required.

#### Remuneration Principle 8: Profit-based measurement and risk adjustment

- 19D.3.23 R (1) A *firm* must ensure that any measurement of performance used to calculate variable *remuneration* components or pools of variable *remuneration* components:
- (a) includes adjustments for all types of current and future risks and takes into account the cost and quantity of the capital and the liquidity required; and
  - (b) takes into account the need for consistency with the timing and likelihood of the firm receiving potential future revenues incorporated into current earnings.
- (2) A *firm* must ensure that the allocation of variable *remuneration* components within the *firm* also takes into account all types of current and future risks.

[**Note:** article 94(1)(j), (k) of the *CRD* and Standard 4 of the *FSB Compensation Standards*]

- 19D.3.24 G (1) This Remuneration Principle stresses the importance of risk adjustment in measuring performance, and the importance within that process of applying judgment and common sense. The *FCA* expects that a *firm* will apply qualitative judgments and common sense in the final decision about the performance-related components of variable *remuneration* pools.

- (2) A number of risk-adjustment techniques and measures are available, and a *firm* should choose those most appropriate to its circumstances.
- (3) We consider good practice in this area to be represented by those *firms* who provide a quantitative reference or starting point that explicitly includes risk-adjusted metrics, before the application of more discretionary factors. Common measures include those based on economic profit or economic capital. Whichever technique is chosen, the full range of future risks should be covered.
- (4) The *FCA* expects a *firm* to be able to provide it with details of all adjustments that the *firm* has made whether through application of formulae or the exercise of discretion. This will enable the *FCA* to ensure that the *firm's* risk adjustment framework is sufficiently robust. Where discretion has been applied, the *firm* should be able to provide a clear explanation for, and quantification of such adjustments.
- (5) A *firm* should ask the risk management function to validate and assess risk-adjustment techniques, and to attend a meeting of the *governing body* or *remuneration committee* for this purpose.

- 19D.3.25 R A *firm* must have a clear and verifiable mechanism for measuring performance, with risk adjustment applied thereafter in a clear and transparent manner.
- 19D.3.26 G A *firm* may apply discretionary factors to the extent that is appropriate and consistent with the overall aims of the risk adjustment exercise. Where such further adjustments have been made, *firms* should provide clear quantification and explanation to ensure their risk adjustment frameworks are sufficiently transparent.
- 19D.3.27 R A *firm* must base assessments of financial performance used to calculate variable *remuneration* components or pools of variable *remuneration* components principally on profits.
- 19D.3.28 G
- (1) Performance measures based primarily on revenues or turnover are unlikely to pay sufficient regard to the quality of business undertaken or services provided. Profits are a better measure provided they are adjusted for risk, including future risks not adequately captured by accounting profits.
  - (2) Management accounts should provide profit data at such levels within the *firm's* structure to enable it to see as accurate a picture of contributions of relevant staff to a *firm's* performance as is reasonably practicable.
- 19D.3.29 R
- (1) A *firm's* risk-adjustment approach must reflect both ex-ante adjustment (which adjusts remuneration for intrinsic risks that are inherent in its business activities) and ex-post adjustment (which

adjusts remuneration for crystallisation of specific risks events).

- (2) A *firm* must ensure that its total variable *remuneration* is generally considerably contracted where subdued or negative financial performance of the *firm* occurs, taking into account both current *remuneration* and reductions in payouts of amounts previously earned, including through malus or clawback arrangements.

[**Note:** article 94(1)(n) of *CRD* and Standard 5 of the *FSB Compensation Standards*]

- 19D.3.30      G
- (1) Aligning variable awards to sustainable financial performance requires *firms* to make appropriate ex-ante adjustments to take account of the potential for future unexpected losses. Performance measures commonly used (such as earnings per *share* (EPS), total shareholder return (TSR) and return on equity (RoE)) are not suitably adjusted for longer-term risk factors and have a tendency to incentive highly leveraged activities.
  - (2) Long-term incentive plans should be treated as pools of variable *remuneration*. *Firms* that have long-term incentive plans should ensure that the structure of the award is compliant with the *dual-regulated firms Remuneration Code*'s deferral and vesting requirements and that performance conditions required for vesting are appropriate. The valuation of the award should be based on its value when the award is granted, and determined using an appropriate technique.
  - (3) *Firms* should demonstrate that both the ex-ante intrinsic risks and the ex-post crystallisation of risk event have been considered as part of their risk-adjustment approach.

[**Note:** In addition to the *guidance* in this section on the Remuneration Principle 8 (Profit-based measurement and risk adjustment), the *FSA* gave guidance on the application of the requirements on risk adjustments. This *guidance* is available on the *FCA* website at [link to follow]]

#### Remuneration Principle 9: Pension policy

- 19D.3.31      R
- A *firm* must ensure that:
- (1) its pension policy is in line with its business strategy, objectives, values and long-term interests;
  - (2) when an *employee* leaves the *firm* before retirement, any *discretionary pension benefits* are held by the *firm* for a period of five years in the form of instruments referred to in *SYSC* 19D.3.56R(1); and

- (3) when an *employee* reaches retirement, *discretionary pension benefits* are paid to the *employee* in the form of instruments referred to in SYSC 19D.3.56R (1) and subject to a five-year retention period.

[**Note:** article 94(1)(o) of the *CRD*]

#### Remuneration Principle 10: Personal investment strategies

- 19D.3.32 R
- (1) A *firm* must ensure that its *employees* undertake not to use personal hedging strategies to undermine the risk alignment effects embedded in their *remuneration* arrangements.
  - (2) A *firm* must ensure that its *employees* do not use *remuneration* or liability-related *contracts of insurance* to undermine the risk alignment effects embedded in their *remuneration* arrangements.
  - (3) A *firm* must maintain effective arrangements designed to ensure that *employees* comply with their undertaking.

[**Note:** article 94(1)(p) of the *CRD* and Standard 14 of the *FSB Compensation Standards*]

- 19D.3.33 G
- In the *FCA*'s view, circumstances in which a *person* will be using a personal hedging strategy include (and are not limited to) entering into an arrangement with a third party under which the third party will make payments, directly or indirectly, to that *person* that are linked to or commensurate with the amounts by which the *person's remuneration* is subject to reductions.

#### Remuneration Principle 11: Non-compliance with the dual-regulated firms Remuneration Code

- 19D.3.34 R
- A *firm* must ensure that variable *remuneration* is not paid through vehicles or methods that facilitate non-compliance with obligations arising from the *Remuneration Code*, the *EU CRR* or the *CRD*.

[**Note:** article 94(1)(q) of the *CRD*]

#### Remuneration Principle 12: Remuneration structures - introduction

- 19D.3.35 G
- (1) Taking account of the *dual-regulated firms remuneration principles proportionality rule*, the *FCA* does not generally consider it necessary for a *firm* to apply the *rules* in (2) where, in relation to an individual (X), both the following conditions are satisfied:
    - (a) Condition 1 is that Xs variable *remuneration* is no more than 33% of total *remuneration*; and
    - (b) Condition 2 is that Xs total *remuneration* is no more than

£500,000.

- (2) The *rules* referred to in (1) are those relating to:
- (a) guaranteed variable *remuneration* (SYSC 19D.3.44R);
  - (b) retained *shares* or other instruments (SYSC 19D.3.56R);
  - (c) deferral (SYSC 19D.3.59R); and
  - (d) performance adjustment (SYSC 19D.3.61R).

[**Note:** The *FSA* also gave *guidance* on the application of certain *rules* on *remuneration* structures about individuals who are *dual-regulated firms Remuneration Code staff* for only part of a given performance year. This guidance is available on the *FCA* website at [link to follow]]

Remuneration Principle 12(a): Remuneration structures - general requirement

- 19D.3.36 R A *firm* must ensure that the structure of an *employee's remuneration* is consistent with and promotes effective risk management.
- 19D.3.37 R A *firm* must ensure that the *remuneration* policy makes a clear distinction between criteria for setting:
- (1) basic fixed *remuneration* that primarily reflects an *employee's* professional experience and organisational responsibility, as set out in the *employee's* job description and terms of *employment*; and
  - (2) variable *remuneration* that reflects performance in excess of that required to fulfil the *employee's* job description and terms of *employment* and that is subject to performance adjustment in accordance with the *dual-regulated firms Remuneration Code*.

[**Note:** article 92(2)(g) of the *CRD*]

- 19D.3.38 R Except in exceptional circumstances, a *firm* may not award variable *remuneration* to a *non-executive director* acting as such.

Remuneration Principle 12(b): Remuneration structures - assessment of performance

- 19D.3.39 R (1) A *firm* must ensure that where *remuneration* is performance-related:
- (a) the total amount of *remuneration* is based on a combination of the assessment of the performance of:
    - (i) the individual;
    - (ii) the business unit concerned; and

(iii) the overall results of the *firm*; and

(b) when assessing individual performance, financial as well as non-financial criteria are taken into account.

[**Note:** article 94(1)(a) of the *CRD* and Standard 6 of the *FSB Compensation Standards*]

- 19D.3.40 G The non-financial criteria in *SYSC* 19D.3.39R(1)(b) should include the extent of the *employee's* adherence to effective risk management, and compliance with the *regulatory system* and with relevant overseas regulatory requirements.
- 19D.3.41 G Poor performance assessed by non-financial metrics, such as poor risk management or other behaviours contrary to *firm* values, can pose significant risks for a *firm* and should, as appropriate, override metrics of financial performance.
- 19D.3.42 R A *firm* must clearly explain the performance assessment process in *SYSC* 19D.3.39R to relevant *employees*.
- 19D.3.43 R A *firm* must ensure that the assessment of performance is set in a multi-year framework in order to ensure that:
- (1) the assessment process is based on longer-term performance; and
  - (2) the actual payment of performance-based components of *remuneration* is spread over a period which takes account of the underlying business cycle of the *firm* and its business risks.

[**Note:** article 94(1)(b) of *CRD*]

Remuneration Principle 12(c): Remuneration structures – guaranteed variable remuneration, buy-outs

- 19D.3.44 R
- (1) A *firm* must ensure that guaranteed variable *remuneration* is not part of prospective *remuneration* plans.
  - (2) A *firm* must not award, pay or provide guaranteed variable *remuneration* unless:
    - (a) it is exceptional;
    - (b) it occurs in the context of hiring new *dual-regulated firms Remuneration Code staff*;
    - (c) the *firm* has a sound and strong capital base; and
    - (d) it is limited to the first year of service.

[**Note:** article 94(1)(d) and (e) of the *CRD* and Standard 11 of the *FSB*]

*Compensation Standards]*

19D.3.45 R A *firm* must ensure that *remuneration* packages relating to compensation for, or buy out from, an *employee's* contracts in previous *employment* align with its long term interests including appropriate retention, deferral and performance and clawback arrangements.

[**Note:** article 94(1)(i) of *CRD*]

19D.3.46 G (1) Guaranteed variable *remuneration* should be subject to the same requirements applicable to variable *remuneration* awarded by the *firm* including deferral, malus and clawback.

(2) The *FCA* expects that guaranteed variable awards and retention awards should not be common practice for *dual-regulated firms Remuneration Code staff* and should be limited to rare, infrequent occurrences. The *FCA* expects a *firm* to provide prior notification to the *FCA* of any such proposed awards.

19D.3.47 G Retention awards should form part of variable *remuneration* for the purpose of *SYSC* 19D.3.48R.

Remuneration Principle 12(d): Remuneration structures - ratios between fixed and variable components of total remuneration

19D.3.48 R A *firm* must set appropriate ratios between the fixed and variable components of total *remuneration* and ensure that:

- (1) fixed and variable components of total *remuneration* are appropriately balanced;
- (2) the fixed component represents a sufficiently high proportion of the total *remuneration* to allow the operation of a fully flexible policy on variable *remuneration* components, including the possibility to pay no variable *remuneration* component; and
- (3) subject to *SYSC* 19D.3.49R, the ratio of the variable component of total *remuneration* to the fixed component does not exceed 1:1.

[**Note:** article 94(1)(f) and 94(1)(g)(i) of the *CRD*]

19D.3.49 R A *firm* may set a ratio between the fixed and the variable components of total *remuneration* that exceeds 1:1 provided the ratio:

- (1) does not exceed 1:2; and
- (2) is approved by the shareholders or owners or members of the *firm* in accordance with *SYSC* 19D.3.50R.

[**Note:** article 94(1)(g)(ii) of *CRD*]

19D.3.50 R A *firm* must ensure that any approval by its shareholders or owners or

members of a ratio that exceeds 1:1 is carried out in accordance with the following procedure:

- (1) the *firm* must give reasonable notice to all its shareholders or owners or members of its intention to seek approval of a ratio that exceeds 1:1;
- (2) the *firm* must make a detailed recommendation to all its shareholders or owners or members that includes:
  - (a) the reasons for, and the scope of, the approval sought;
  - (b) the number of staff affected and their functions; and
  - (c) the expected impact on the requirement to maintain a sound capital base;
- (3) the *firm* must:
  - (a) without delay, inform the *FCA* of the recommendation to its shareholders or owners or members, including the proposed ratio and the reasons therefor; and
  - (b) demonstrate to the *FCA* that the proposed higher ratio does not conflict with its obligations under the *CRD* and the *EU CRR*, having regard in particular to the *firm's own funds* obligations;
- (4) the *firm* must ensure that *employees* who have an interest in the proposed higher ratio are not allowed to exercise, directly or indirectly, any voting rights they may have as shareholders or owners or members of the *firm* in respect of the approval sought; and
- (5) the higher ratio is approved by a majority of:
  - (a) at least 66% of the shares or equivalent ownership rights represented, if at least 50% of the *share* or equivalent ownership rights in the *firm* are represented; or
  - (b) at least 75% of of the shares or equivalent ownership rights represented, if less than 50% of the shares or equivalent ownership rights in the *firm* are represented.

[**Note:** article 94(1)(g)(ii) of the *CRD*]

19D.3.51 R A *firm* must notify without delay the *FCA* of the decisions taken by its shareholders or members or owners including any approved higher maximum ratio.

[**Note:** article 94(1)(g)(ii) of the *CRD*]

19D.3.52 R A *firm* may apply a discount rate to a maximum of 25% of an *employee's* total variable *remuneration* provided it is paid in instruments that are deferred for a period of not less than five years.

[**Note:** article 94(1)(g)(iii) of the *CRD*]

19D.3.53 R In applying the discount rate in *SYSC* 19D.3.52R, a *firm* must apply the *EBA* Guidelines on the applicable notional discount rate for variable remuneration published on 27 March 2014.

[**Note:** the *EBA* Guidelines on the applicable notional discount rate for variable remuneration can be found at:

<http://www.eba.europa.eu/documents/10180/643987/EBA-GL-2014-01+%28Final+Guidelines+on+the+discount+rate+for+remuneration%29.pdf/e8b3b3f6-6258-439d-a2d9-633e6e5de5e9>]

Remuneration Principle 12(e): Remuneration structures - payments related to early termination

19D.3.54 R A *firm* must ensure that payments relating to the early termination of a contract reflect performance achieved over time and are designed in a way that does not reward failure or misconduct.

[**Note:** article 94(1)(h) of the *CRD* and Standard 12 of the *FSB Compensation Standards*]

19D.3.55 G A *firm* should review existing contractual payments related to termination of *employment* with a view to ensuring that these are payable only where there is a clear basis for concluding that they are consistent with *SYSC* 19D.2.1R, which states that remuneration policies must be consistent with, and promote, sound and effective risk management.

[**Note:** Standard 12 of the *FSB Compensation Standards*]

Remuneration Principle 12(f): Remuneration structures - retained shares or other instruments

19D.3.56 R (1) A *firm* must ensure that a substantial portion, which is at least 50%, of any variable *remuneration* consists of an appropriate balance of:

- (a) *shares* or equivalent ownership interests, subject to the legal structure of the *firm* concerned, or *share*-linked instruments or equivalent non-cash instruments in the case of a non-listed *firm*; and
- (b) where possible, other instruments that in each case adequately reflect the credit quality of the *firm* as a going concern and are appropriate for use as variable remuneration, such as:

- (i) those which are eligible as *additional tier 1 instruments* or *tier 2 instruments*; or
- (ii) those that can be fully converted to *common equity tier 1 instruments* or written down,

(where the expressions in italics are defined, with the conditions for eligibility, in the Definition of Capital part of the *PRA Rulebook*).

- (2) The instruments in (1) must be subject to an appropriate retention policy designed to align incentives with the longer-term interests of the *firm*.
- (3) This *rule* applies to both the portion of the variable *remuneration* component deferred in accordance with SYSC 19D.3.59R and the portion not deferred.

[**Note:** article 94(1)(l) of the *CRD* and Standard 8 of the *FSB Compensation Standards*]

19D.3.57 G The *FCA* would normally consider a period of retention of six months to be sufficient, provided that other risk management techniques within the *firm* are operating to secure sound and effective risk management.

19D.3.58 G (1) The Committee of European Banking Supervisors has given guidance on the interpretation of the *CRD* provision transposed by SYSC 19D.3.56R(3). Its Guidelines provide that this requirement means that the 50% minimum threshold for instruments must be applied equally to the non-deferred and the deferred components; ie, *firms* must apply the same chosen ratio between instruments and cash for their total variable *remuneration* to both the upfront and deferred components. (Guidelines on Remuneration Policies and Practices, 10 December 2010, paragraph 133 [link provided].)

(2) This simplified example illustrates the operation of (1). The variable remuneration of a material risk taker (X) is 100 and, under SYSC 19D.3.59R(3), X is required to defer 60%. X's upfront component is 40 and X's deferred component is 60. At least 20 of X's upfront component, and at least 30 of X's deferred component, must be in instruments referred to in SYSC 19D.3.56R(1).

Remuneration Principle 12(g): Remuneration structures - deferral

19D.3.59 R (1) A *firm* must not award, pay or provide a variable *remuneration* component unless a substantial portion of it, which is at least 40%, is deferred over a period which is not less than:

- (a) for *dual-regulated firms Remuneration Code staff* who does not perform a *PRA senior management function*, five years,

with no vesting taking place until one year after the award, and vesting no faster than on a pro-rata basis.

- (b) for *dual-regulated firms Remuneration Code staff* who performs a *PRA senior management function*, seven years, with no vesting taking place until three years after the award, and vesting no faster than on a pro-rata basis.

(2) In the case of a variable *remuneration* component:

- (a) of £500,000 or more, or
- (b) payable to a *director* of a *firm* that is significant in terms of its size, internal organisation and the nature, scope and complexity of its activities;

at least 60% of the amount must be deferred on the basis set out in SYSC 19D.3.59R(1).

(3) Subject to (1), the length of the deferral period must be established in accordance with the business cycle, the nature of the business, its risks and the activities of the *employee* in question.

[**Note:** article 94(1)(m) of the *CRD* and Standards 6 and 7 of the *FSB Compensation Standards*]

- 19D.3.60      G      (1) Deferred *remuneration* paid in:
- (a) *shares* or *share-linked* instruments should be made under a scheme which meets appropriate criteria, including risk adjustment of the performance measure used to determine the initial allocation of *shares*;
  - (b) cash should also be subject to performance criteria.
- (2) The *FCA* would generally expect a *firm* to have a *firm-wide* policy (and *group-wide* policy, where appropriate) on deferral. The proportion deferred should generally rise with the ratio of variable *remuneration* to fixed *remuneration* and with the amount of variable *remuneration*. While any variable *remuneration* component of £500,000 or more paid to *dual-regulated firms Remuneration Code staff* must be subject to 60% deferral, *firms* should also consider whether lesser amounts should be considered to be 'particularly high' taking account, for example, of whether there are significant differences within *dual-regulated firms Remuneration Code staff* in the levels of variable *remuneration* paid.

Remuneration Principle 12(h): Remuneration structures - performance adjustment (affordability, malus, clawback)

- 19D.3.61 R A *firm* must ensure that:
- (1) any variable *remuneration*, including a deferred portion, is paid or vests only if it is sustainable according to the financial situation of the *firm* as a whole, and justified on the basis of the performance of the *firm*, the business unit and the individual concerned;
  - (2) any variable *remuneration* is subject to clawback, such that it is not awarded save where an amount corresponding to it can be recovered from the individual by the *firm* if the recovery is justified on the basis of the circumstances described in SYSC 19D.3.62R(2) and SYSC 19D.3.64R; and
  - (3) any variable *remuneration* is subject to clawback for a period of at least seven years from the date on which the variable *remuneration* is awarded; and
  - (4) for *dual-regulated firms Remuneration Code staff* who performs a *PRA senior management function*, a *firm* can, by notice to the *employee* to be given no later than seven years after the variable *remuneration* was awarded, extend the period during which variable *remuneration* is subject to clawback to at least ten years from the date on which the variable *remuneration* is awarded, where:
    - (a) the *firm* has commenced an investigation into facts or events which it considers could potentially lead to the application of clawback were it not for the expiry of the clawback period; or
    - (b) the *firm* has been notified by a regulatory authority (including an overseas regulatory authority) that an investigation has been commenced into facts or events which the *firm* considers could potentially lead to the application of clawback by the *firm* were it not for the expiry of the clawback period.

[**Note:** article 94(1)(n) of the *CRD* and Standards 6 and 9 of the *FSB Compensation Standards*]

- 19D.3.62 R A *firm* must:
- (1) set specific criteria for the application of malus and clawback; and
  - (2) ensure that the criteria for the application of malus and clawback in particular cover situations where the *employee*:
    - (a) participated in or was responsible for conduct which resulted in significant losses to the *firm*; or
    - (b) failed to meet appropriate standards of fitness and

propriety.

[**Note:** article 94(1)(n) of the *CRD* and Standards 6 and 9 of the *FSB Compensation Standards*]

[**Note:** The *FSA* also gave *guidance* on the application of the requirements on risk adjustments. This *guidance* is available on the *FCA* website at [link to follow]]

- 19D.3.63 E (1) A *firm* should reduce unvested deferred variable remuneration when, as a minimum:
- (a) there is reasonable evidence of *employee* misbehaviour or material error;
  - (b) the *firm* or the relevant business unit suffers a material downturn in its financial performance; or
  - (c) the *firm* or the relevant business unit suffers a material failure of risk management.
- (2) For performance adjustment purposes, awards of deferred variable remuneration made in shares or other non-cash instruments should provide the ability for the *firm* to reduce the number of shares or other non-cash instruments.
- (3) Contravention of any of (1) or (2) may be relied on as tending to establish contravention of SYSC 19D.3.61R(1) on performance adjustment.
- 19D.3.64 R (1) A *firm* must make all reasonable efforts to recover an appropriate amount corresponding to some or all vested variable remuneration where either of the following circumstances arise during the period in which clawback applies:
- (a) there is reasonable evidence of *employee* misbehaviour or material error; or
  - (b) the *firm* or the relevant business unit suffers a material failure of risk management.
- (2) A *firm* must take into account all relevant factors (including, where the circumstances described in (1)(b) arise, the proximity of the *employee* to the failure of risk-management in question and the *employee's* level of responsibility) in deciding whether, and to what extent it is reasonable, to seek recovery of any or all of their vested variable remuneration.
- 19D.3.65 G The governing body (or, where appropriate, the remuneration committee) should approve performance adjustment policies, including the triggers under which adjustment would take place. The *FCA* may ask *firms* to provide a copy of their policies and expects *firms* to make adequate

records of material decisions to operate the adjustments.

#### Effect of breaches of the Remuneration Principles

- 19D.3.66 R SYSC 19D Annex 1 makes provision about voiding and recovery.
- 19D.3.67 R (1) Subject to (2) to (7), the *rules* in SYSC 19D Annex 1.1R to 1.6R apply in relation to the prohibitions on *dual-regulated firms Remuneration Code staff* being remunerated in the ways specified in:
- (a) SYSC 19D.3.44R (guaranteed variable *remuneration*);
  - (b) SYSC 19D.3.59R (non-deferred variable *remuneration*);
  - (c) SYSC 19D.3.61R(2) (performance adjustment – clawback); and
  - (d) SYSC 19D Annex 1.10R (replacing payments recovered or property transferred).
- (2) (1) applies only to those prohibitions as they apply in relation to a *firm* that satisfies either Condition 1 or Condition 2 as set out in (3) and (4).
- (3) Condition 1 is that the *firm* is a *UK bank*, a *building society*, or a *UK designated investment firm*, that has relevant total assets exceeding £50 billion.
- (4) Condition 2 is that the *firm*:
- (a) is either a *full credit institution* or a *UK designated investment firm*; and
  - (b) is part of a *group* containing a *firm* that has relevant total assets exceeding £50 billion and that is a *bank*, a *building society* or a *UK designated investment firm*.
- (5) For the purposes of this *rule*, ‘relevant total assets’ means the arithmetic mean of the *firm*’s total assets as set out in its balance sheet on its last three *accounting reference dates*.
- (6) This *rule* does not apply in relation to the prohibition on *dual-regulated firms Remuneration Code staff* being remunerated in the way specified in SYSC 19D.3.44R (guaranteed variable *remuneration*) if both the conditions in paragraphs (2) and (3) of that *rule* are met.
- (7) This *rule* does not apply in relation to *dual-regulated firms Remuneration Code staff* (X) in respect of whom both the following conditions are satisfied:

- (a) Condition 1 is that X's variable *remuneration* is no more than 33% of total *remuneration*; and
  - (b) Condition 2 is that X's total *remuneration* is no more than £500,000.
- (8) In relation to (7):
- (a) references to *remuneration* are to *remuneration* awarded or paid in respect of the relevant performance year;
  - (b) the amount of any *remuneration* is:
    - (i) if it is money, its amount when awarded;
    - (ii) otherwise, whichever of the following is greatest:
      - (aa) its value to the recipient when awarded;
      - (bb) its market value when awarded; and
      - (cc) the cost of providing it;
  - (c) where *remuneration* is, when awarded, subject to any condition, restriction or other similar provision which causes the amount of the *remuneration* to be less than it otherwise would be, that condition, restriction or provision is to be ignored in arriving at its value; and
  - (d) it is to be assumed that the member of *dual-regulated firms Remuneration Code staff* will remain so for the duration of the relevant performance year.

- 19D.3.68 G (1) Sections 137H and 137I of the *Act* enable the *FCA* to make *rules* that render void any provision of an agreement that contravenes specified prohibitions in the *dual-regulated firms Remuneration Code*, and that provide for the recovery of any payment made, or other property transferred, in pursuance of such a provision.
- (2) *SYSC 19D.3.66R* and *SYSC 19D.3.67R* (together with *SYSC 19D Annex 1*) are:
- (a) *rules* referred to in (1) that render void provisions of an agreement that contravene the specified prohibitions on guaranteed variable *remuneration*, non-deferred variable *remuneration* and replacing payments recovered or property transferred; and
  - (2) the exception to the general position set out in section 138E(2) of the *Act* that a contravention of a *rule* does not make any transaction void or unenforceable.

19D  
Annex 1

Detailed provisions on voiding and recovery (SYSC 19D.3.66R and SYSC 19D.3.67R)

Rendering contravening provisions of agreements void		
1	R	Any provision of an agreement that contravenes a prohibition on <i>persons being remunerated</i> in a way specified in a <i>rule</i> to which this <i>rule</i> applies (a ‘contravening provision’) is void.
2	R	A contravening provision does not cease to be void because:
		(1) the <i>firm</i> concerned ceases to satisfy any of the conditions set out in SYSC 19D.3.67R(3) to (4); or
		(2) the member of <i>dual-regulated firms Remuneration Code staff</i> concerned starts to satisfy both of the conditions set out in SYSC 19D.3.67R(7)(a) and (b).
3	R	A contravening provision that, at the time a <i>rule</i> to which this <i>rule</i> applies was first made (including any previous <i>rules</i> in the <i>FCA Handbook</i> ), is contained in an agreement made before that time is not rendered void by SYSC 19D Annex 1.1R unless it is subsequently amended so as to contravene such a <i>rule</i> .
4	G	The effect of SYSC 19D Annex 1.3R, in accordance with sections 137H and 137I of the <i>Act</i> , is to prevent contravening provisions being rendered void retrospectively. However, contravening provisions may be rendered void if they are contained in an agreement made after the <i>rule</i> containing the prohibition is made by the <i>FCA</i> but before the <i>rule</i> comes into effect.
5	R	(1) A pre-existing provision is not rendered void by SYSC 19D Annex 1.1R.
		(2) In this Annex a pre-existing provision is any provision of an agreement that would (but for this <i>rule</i> ) be rendered void by SYSC 19D Annex 1.1R that was agreed at a time when either:
		(a) the <i>firm</i> concerned did not satisfy any of the conditions set out in SYSC 19D.3.67R(3) to (4); or
		(b) the member of <i>dual-regulated firms Remuneration Code staff</i> concerned satisfied both of the conditions set out in SYSC 19D.3.67R(7)(a) and (b).
		(3) But an amendment to, or in relation to, a pre-existing provision is not to be treated as a pre-existing provision where

			the amendment is agreed at a time when both:
			(a) the <i>firm</i> concerned satisfies at least one of the conditions set out in SYSC 19D.3.67R(3) to (4); and
			(b) the member of <i>dual-regulated firms Remuneration Code staff</i> concerned does not satisfy both of the conditions set out in SYSC 19D.3.67R(7)(a) and (b).
6	R	For the purposes of this chapter, it is immaterial whether the law which (apart from this annex) governs a contravening provision is the law of the <i>United Kingdom</i> , or of a part of the <i>United Kingdom</i> .	
Recovery of payments made or property transferred pursuant to a void contravening provision			
7	R	In relation to any payment made or other property transferred in pursuance of a contravening provision other than a pre-existing provision, a <i>firm</i> must take reasonable steps to:	
		(1)	recover any such payment made or other property transferred by the <i>firm</i> ; and
		(2)	ensure that any other <i>person</i> (P) recovers any such payment made or other property transferred by that <i>person</i> .
8	R	SYSC 19D Annex 1.7R continues to apply in one or both of the following cases:	
		(1)	the <i>firm</i> concerned ceases to satisfy any of the conditions set out in SYSC 19D.2.67R(3) to (4);
		(2)	the member of <i>dual-regulated firms Remuneration Code staff</i> concerned starts to satisfy both of the conditions set out in SYSC 19D.2.67R(7)(a) and (b).
9	G	The <i>rule</i> in SYSC 19D Annex 1.7R(2) would, for example, apply in the context of a secondment. Where a <i>group</i> member seconds an individual to a <i>firm</i> and continues to be responsible for the individual's <i>remuneration</i> in respect of services provided to the <i>firm</i> , the <i>firm</i> would need to take reasonable steps to ensure that the <i>group</i> member recovers from the secondee any <i>remuneration</i> paid in pursuance of a contravening provision.	
Replacing payments recovered or property transferred			
10	R	(1)	A <i>firm</i> must not award, pay or provide variable <i>remuneration</i> to a <i>person</i> who has received <i>remuneration</i> in pursuance of a contravening provision other than a pre-existing provision (the 'contravening <i>remuneration</i> ') unless the <i>firm</i> has

			obtained a legal opinion stating that the award, payment or provision of the <i>remuneration</i> complies with the <i>dual-regulated firms Remuneration Code</i> .
		(2)	This <i>rule</i> applies only to variable <i>remuneration</i> relating to a performance year to which the contravening <i>remuneration</i> related.
		(3)	The legal opinion in (1) must be properly reasoned and be provided by an appropriately qualified independent individual.
		(4)	(1) continues to apply in one or both of the following cases:
			(a) the <i>firm</i> concerned ceases to satisfy any of the conditions set out in SYSC 19D.3.67R(3) to (4);
			(b) the member of <i>dual-regulated firms Remuneration Code staff</i> concerned starts to satisfy both of the conditions set out in SYSC 19D.3.67R(7)(a) and (b).
Notification to the FCA			
11	G		The <i>FCA</i> considers any breach of a <i>rule</i> to which this annex applies to be a significant breach which should be notified to the <i>FCA</i> in accordance with SUP 15.3.11 R (Breaches of rules and other requirements in or under the Act). Such a notification should include information on the steps which a <i>firm</i> or other <i>person</i> has taken or intends to take to recover payments or property in accordance with SYSC 19D Annex 1.7R.

## Annex C

### Amendments to the Supervision manual (SUP)

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

**13A**      **Application of the Handbook to Incoming EEA firms**  
**Annex**  
**1G**

...		
(1) Module of Handbook	(2) Potential application to an incoming EEA firm with respect to activities carried on from an establishment of the firm (or its appointed representative) in the United Kingdom	(3) Potential application to an incoming EEA firm with respect to activities carried on other than from an establishment of the firm (or its appointed representative) in the United Kingdom
...		
<i>SYSC</i>	... <i>SYSC 19A, <del>and 19B, 19C and 19D</del> do not apply.</i>	... <i>SYSC 19A, 19C and 19D <del>does do</del> not apply.</i>
...		

...

## Appendix 6 - Guidance consultation

# General guidance on the application of malus to variable remuneration and ex-ante risk adjustments

[date]

### Introduction

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- 1.1 This statement is general guidance under section 139A (1) of the Financial Services and Markets Act 2000 (FSMA). This guidance statement has effect from [].
- 1.2 This guidance is aimed at all firms to whom the Financial Conduct Authority's (FCA's) Remuneration Codes in SYSC 19A (IFPRU Remuneration Code) and SYSC 19D (Dual-regulated firms Remuneration Code) apply (together the Remuneration Codes). Its purpose is to clarify the FCA's expectations of the way in which firms should comply with the current requirements on risk adjustment (also referred to as performance adjustment) in Principle 12(h) of the Remuneration Codes in SYSC 19A and SYSC 19D of the Handbook, in particular regarding the use of malus.
- 1.3 The Prudential Regulation Authority (PRA) has also issued a Supervisory Statement (SS2/13) entitled 'PRA expectations regarding the application of malus to variable remuneration' published in October 2013<sup>1</sup>.
- 1.4 The purpose of regulation of remuneration generally is to foster the sound management of risk and to control the risk-taking behaviour of individuals, including conduct risk. This advances our objectives of securing an appropriate degree of protection for consumers and protecting and enhancing the integrity of the UK financial system.
- 1.5 The effective, meaningful and timely use of **ex-ante** and **ex-post** adjustment (both covered in this guidance), including malus, is essential for aligning remuneration policy with risk-taking. It is important to distinguish between the two types of adjustment:

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<sup>1</sup> The PRA SS2/13 is available at:  
<http://www.bankofengland.co.uk/pr/Documents/publications/policy/2013/appofmalusss2-13.pdf>

1. **Ex-ante risk-adjustment** refers to adjustments made to take account of intrinsic risks that are inherent in firms' business activities (e.g. the potential for future unexpected losses or weak systems and controls that could result in a risk of undetected conduct failings).
  2. **Ex-post risk-adjustment** refers to adjustments made to take account of the crystallization of specific risk events, e.g. compliance breaches, mis-selling, other risk management failures or a material downturn in financial performance. Ex-post adjustments may be implemented by either reducing the current year bonus pool and/or through clawback / malus of deferred incentive awards that have not yet vested.
- 1.6 Ex-post risk adjustment allows firms to adjust previously awarded remuneration to take account of subsequent performance and potential risk outcomes. This enables them to recoup variable pay in the event of a risk management failure, including a conduct failing.
- 1.7 By an ex-post adjustment, we mean an adjustment made after an event, such as a historic conduct failing. The importance of ex-post risk adjustment has been underscored both in the Capital Requirements Directive (CRD)<sup>2</sup>, which requires up to 100% of the total variable remuneration to be subject to malus or clawback arrangements, and the Parliamentary Commission on Banking Standards' final report.
- 1.8 The terms malus and clawback are often used interchangeably but do in fact constitute different forms of ex-post risk adjustment. Malus is an arrangement that permits the institution to prevent vesting of all or part of the amount of a deferred remuneration award in relation to risk outcomes or performance. Clawback is a contractual agreement whereby the staff member agrees to return ownership of an amount of remuneration to the institution under certain circumstances. This can be applied to both upfront and deferred variable remuneration.<sup>3</sup>
- 1.9 This guidance is focused on the application of risk adjustments for conduct failings, but firms should also apply risk adjustments for prudential failings.
- 1.10 Firms should comply with the Remuneration Codes' provisions on risk adjustment in their spirit as well as to the letter.

### Scope

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- 1.11 Malus should be applied for conduct failings. It can be applied to deferred variable remuneration, to current year bonuses for individuals or collectively to bonus pools.
- 1.12 All unvested deferred variable remuneration should, in principle, be capable of forfeiture or reduction through ex-post risk adjustment.

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<sup>2</sup> Directive 2013/36/EU <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0604&from=EN>

<sup>3</sup> These definitions are provided for in the CEBS Guidelines for Remuneration Policies and Practices, page 76 <https://www.eba.europa.eu/documents/10180/106961/Guidelines.pdf>

- 1.13 Deferred remuneration for the purposes of adjustment includes Long-Term Incentive Plans (LTIPs).
- 1.14 The use of ex-post risk adjustment should not be limited to employees who engage directly in misconduct. For example, in cases involving a material failure of risk management or misconduct, the FCA expects firms to consider applying ex-post risk adjustment to those employees who:
1. could have been reasonably expected to be aware of the failure or misconduct at the time but failed to take adequate steps to promptly identify, assess, report, escalate or address it; or
  2. by virtue of their role or seniority could be deemed indirectly responsible or accountable for the failure or misconduct, including senior staff in charge of setting the firm's culture and strategy.
- 1.15 The FCA expects all firms subject to malus to have a firm-wide policy on ex-post risk adjustment (and group-wide policy, where appropriate) for Code staff for whom the Code is partially dis-applied due to their level of earnings under the proportionality rule.

### **Expectations in relation to the application of malus**

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- 1.16 Firms' remuneration policies and employment contracts should clarify that variable remuneration awards are conditional, discretionary and contingent upon a sustainable and risk-adjusted performance, in excess of that required to fulfil the employee's job description as part of the terms of employment. They are therefore capable of forfeiture or reduction at the employer's discretion.
- 1.17 Malus applied to individuals or collectively for conduct failings should be calculated clearly and separately from any other considerations (e.g. reductions for poor financial performance of the firm) and should separately account for each issue.
- 1.18 The primary focus in applying malus should be on individuals, with collective adjustments being used where there are systemic failings or to meet regulatory fines from bonus pools (see paragraph 1. 26). Collective adjustments should not be used as a substitute for individual adjustments.
- 1.19 As a minimum, firms should ensure that individuals do not profit from conduct failings. Firms should consider the extent to which past bonuses were earned as a result of identified failings and also give appropriate consideration to the cost of consequent redress.
- 1.20 Firms should apply further malus above this minimum and should do so robustly but fairly. In considering how much further malus to apply to individuals, firms should consider the degree of responsibility of an individual and the relevant criteria listed in paragraph 1.35. Paragraphs 1.14, 1.24 and 1.31 do not prevent firms from taking into account culpability or proximity to an incident when deciding the value of individual reductions.

- 1.21 For cases with a high degree of personal responsibility and a high impact in relation to any of the relevant criteria in paragraph 1.35, up to 100% malus should be the starting point. For lower degrees of responsibility and impact, proportionately less malus may be applied.
- 1.22 Firms should focus the application of malus primarily on those areas where conduct failings have occurred. Where failings have occurred in business functions, the application of malus should be weighted towards the management of the relevant areas.
- 1.23 Individuals in control functions (e.g. Compliance, Risk and Internal Audit) should be accountable only for identified failings of those functions.
- 1.24 Where a failure of risk management was collective or pervasive firms should apply ex-post risk adjustment to individuals or collectively to groups of employees as appropriate, focusing on adjustments to the bonuses of those staff most closely involved and with the greatest influence. They should avoid disproportionately sharing reductions, for example, with business units that were not implicated in a failing or with junior staff who were not in a position to exercise influence.
- 1.25 Firms may take account of the size and significance of any automatic in-year adjustments to bonus pools when determining the appropriate size of the malus adjustments. However, automatic reductions alone will not normally be sufficient. By "automatic" reductions, we mean reductions to bonuses as a result of reduced profits (for example, because of accounting provisions for customer redress).
- 1.26 Firms should consider deducting a substantial part of any fines imposed by UK regulators from relevant bonus pools although firms may take into account the amount of malus applied to individuals and the size of the fine relative to the size of the bonus pool.

### **Timing in the consideration of malus**

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- 1.27 Firms should start to consider malus once conduct failings have been identified and impose reductions as soon as reasonably possible and at the latest once investigations have been concluded.
- 1.28 When firms carry over consideration of conduct failings into the following performance year (for example, because they do not have sufficient information to come to a conclusion), they should deal with them as soon as reasonably practicable.
- 1.29 Firms should update the FCA on relevant pending investigations and ahead of any payment of outstanding awards to individuals under investigation for misconduct.
- 1.30 Where ex-post risk adjustments are made to current or prior year awards before the full impact of the risk management failures or misconduct is known, subsequent consideration and, where appropriate, subsequent adjustments should be made to ensure the final value of the adjustment fully reflects the impact of the incident.

- 1.31 Firms should give primary consideration to making adjustments to remuneration paid in respect of the years where failings occurred where possible. However, because risk management failures and misconduct can take years to come to light, this should not prevent firms from applying ex-post risk adjustment to the extent that the relevant individuals have variable remuneration capable of reduction, even where this does not relate to performance in the year in which the misconduct or risk management failure occurred or came to light. The overall level of reduction should in any case reflect the size of bonuses earned in the years when failings occurred.

### **Procedure for considering malus**

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- 1.32 The FCA expects firms to develop and maintain an adequate procedure for deciding cases that could result in the use of ex-post risk adjustment as part of or alongside regular internal disciplinary proceedings. This procedure should:
1. Promote consistency, fairness and robustness in the application of ex-post risk adjustment.
  2. Set out clear criteria on the kind of cases that may trigger the use of ex-post risk adjustment. These criteria should be indicative and non-exhaustive. Remuneration Committees should retain full discretion to introduce additional criteria where appropriate.
  3. Clearly record the value of the adjustments made at individual, business unit and firm levels so that it is possible to determine the value of each adjustment per incident and at the individual employee level.
  4. Indicate which roles, departments, functions and committees are responsible for reporting, escalating and deciding cases that may trigger the use of ex-post risk adjustment.
  5. Ensure that control functions including Internal Audit, Compliance, Finance, Human Resources, Legal, Reward and Risk provide relevant information and contribute to discussions as required.
  6. Set out a clear process for determining culpability, responsibility or accountability, including allowing individuals under investigation to make representations.
- 1.33 In accordance with SYSC 9, SYSC 19A and SYSC 19D firms should take adequate steps to identify and document all remuneration awards which are capable of reduction or forfeiture through malus and inform the relevant employees of the contingent nature of these portions of their remuneration.
- 1.34 Firms should freeze the vesting of all deferred awards made to individuals undergoing internal or external investigation that could result in ex-post risk adjustment until such an investigation has concluded and the firm has made a decision and communicated it to the relevant employee(s).
- 1.35 When deciding the amounts to be adjusted, the FCA expects firms to take into account all relevant criteria, including:

1. The impact on the firm's customers and the wider market;
  2. The impact of the failure on the firm's relationships with its stakeholders including shareholders, customers, employees, creditors, the taxpayer, counterparties, and regulators.
  3. The cost of fines and other regulatory actions (e.g. Section 166 of FSMA reviews).
  4. Direct and indirect financial losses attributable to the relevant failure.
  5. Reputational damage.
- 1.36 Firms should not make upward adjustments (for example, in order to retain staff) that would reduce or undermine the effect of malus unless they can be fully justified by reference to clear performance criteria.

### **Transparency in the consideration of malus**

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- 1.37 Firms should ensure that the initial process for determining bonus pools is sufficiently transparent to enable them to quantify and articulate clearly the impact of any ex-post risk adjustments they might make prior to them being approved.
- 1.38 The bonus pool before malus is applied and the way in which it is distributed should be calculated in a way that follows clear principles that can be explained. Firms should be able to provide the FCA with evidence of the size of the original bonus pool with a clear rationale of why it is that size.
- 1.39 Firms should seek to make consistent judgments and be able to explain these to the FCA. They should be able to explain how adjustments have been made and why any differences exist between incidents or the individuals concerned.
- 1.40 Firms should ensure that individual reductions due to malus are clearly communicated to individuals with reasons and that collective adjustments are communicated to affected staff as a group.

### **Ex-ante risk adjustments**

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- 1.41 Ex-ante adjustments are those used to correct for increased risk before an event.
- 1.42 Where there is a known increased risk of conduct failings (for example, where systems and controls failings have been identified or where there is an increased level of customer complaints or Financial Ombudsman Service referrals), firms should apply an ex-ante risk adjustment to the bonus pool of the area affected, proportionate to the increased level of risk.
- 1.43 In considering ex-ante adjustments, firms should give consideration to the findings of control functions, auditors and regulators.

### Co-operation with the FCA

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- 1.44 Firms are expected to provide the FCA with information on their application of malus as requested. This information should be sufficient for the FCA to assess the firm's malus decisions. It may include the following non-exhaustive list of items:
1. Conduct incidents considered for malus;
  2. Individuals considered for malus in relation to each incident;
  3. Amounts due to those individuals under deferred variable remuneration from previous years and projected bonuses due for payment;
  4. Adjustments for malus;
  5. Reasons for adjustments;
  6. Bonus pools and rationale for unadjusted size;
  7. Adjustments to bonus pools for conduct failings and rationale;
  8. Details of the performance adjustment process and governance.
- 1.45 For some firms, information on their application of malus may be requested annually. These firms are expected to comply with the timetable set by the regulators, providing sufficient time for the FCA to form a view before the date by which they are seeking agreement to their bonus plans. We will set out a timetable for firms in co-operation with the PRA.
- 1.46 For other firms, information may be requested at any time. Firms should be able to comply with a request for such information in a reasonable time.

## Appendix 7 (Part 1) - Guidance consultation

### General Guidance on Proportionality

#### The IFPRU Remuneration Code (SYSC 19A)

[date]

[Note: In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.]

## 1 Part A: Introduction and interpretations

### Introduction and status of guidance statement

- 1.1 This statement is general *guidance* given under section 139A(1) of the Financial Services and Markets Act (FSMA). It relates to the *Remuneration Code* of SYSC 19A of the *Handbook*.
- 1.2 Paragraphs 1.13 and 1.14 make provision about the interpretation of this *guidance* statement. Expressions in italics either bear the meaning given in the *Handbook Glossary*, or in Table 1.
- 1.3 This *guidance* statement has effect from [.]

### Remuneration principles proportionality rule

- 1.4 The *remuneration principles proportionality rule* is set out in SYSC 19A.3.3R (2).
- 1.5 The *Remuneration Code* requires (amongst other things) a *firm* to apply requirements in SYSC 19A.3 to *Remuneration Code staff*. The *remuneration principles proportionality rule* requires a *firm*, when establishing and applying the total *remuneration* policies for

*Remuneration Code staff*, to comply with SYSC 19A.3 in a way and to the extent that is appropriate to its size, internal organisation and the nature, the scope and the complexity of its activities.

### Guidance on the remuneration principles proportionality rule

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- 1.6 General *guidance* is given in relation to specific aspects of the *remuneration principles proportionality rule* in SYSC 19A.3 itself.<sup>1</sup>
- 1.7 Part D of this *guidance* statement provides additional general *guidance* in relation to the application of the *remuneration principles proportionality rule* to different types of *firm*.
- 1.8 Part E of this *guidance* statement provides additional general *guidance* in relation to the application of the *remuneration principles proportionality rule* to *Remuneration Code staff* who have, in relation to a given performance year, been *Remuneration Code staff* for only part of the year.
- 1.9 This *guidance* statement represents our *guidance* in a field where requirements relating to *remuneration* are being implemented within the EEA. We recognise this will be an evolving process, and intend to keep the *guidance* set out here under review.

### Individual guidance

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- 1.10 We may give individual *guidance* to a *firm*, either on its own initiative or on the application of the *firm*. Our policy on individual *guidance* is set out in SUP 9. In consequence, we may give individual *guidance* to a *firm* in relation to the *remuneration principles proportionality rule* (SYSC 19A.3.3R). Such guidance may relate to the application of the rule by the *firm* generally, or in specific areas.

### Arrangement of guidance statement

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- 1.11 This general *guidance* statement is divided into five Parts:
  - 1. This Part, Part A: Introduction & interpretation.
  - 2. Part B: *Proportionality levels*.
  - 3. Part C: Division of *firms* into *proportionality levels*.
  - 4. Part D: *Guidance* to *firms* in particular *proportionality levels*.
  - 5. Part E: *Guidance* about part-year *Remuneration Code staff*.
- 1.12 It is supplemented by Annex 1 – Supplemental *guidance* on dividing *firms* into *proportionality levels*.

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<sup>1</sup> The main provisions of guidance which specifically refer to the *remuneration principles proportionality rule* are SYSC 19A.3.34G (giving guidance in relation to *Remuneration Code staff* and certain rules on *remuneration* structures

**Interpretation**

- 1.13 This guidance *statement* is to be interpreted as if it was an Annex to SYSC 19A.3 R. In consequence, *GEN 2* (interpreting the Handbook) applies to the interpretation of this *guidance statement*.
- 1.14 In particular, an expression in italics which is defined in the *Glossary* has the meaning given there (*GEN 2.2.7R*). Where an expression in italics is not defined in the *Glossary*, it has the meaning given by the following table:

**Table 1: Glossary of terms defined in this guidance statement**

Defined expression	Definition
<i>group</i>	has the meaning given in the <i>Glossary</i> under paragraph (3).
<i>overseas Remuneration Code firm</i>	An <i>overseas firm</i> that: (i) is not an <i>EEA firm</i> ; (ii) has its head office outside the <i>EEA</i> ; and (iii) would be a <del>building society, a bank, an IFPRU</del> <i>investment firm</i> if it had been a <i>UK domestic firm</i> , had carried on all its business in the United Kingdom and had obtained whatever authorisation for doing so as required under the <i>Act</i> .
<i>proportionality level</i>	has the meaning given in paragraph 17, and references to <i>proportionality level one</i> , etc. are to be construed accordingly.
<i>Remuneration Code firm</i>	a <i>firm</i> specified in SYSC 19A.1.1 R(1)(a)-(c).
<i>relevant total assets</i>	has the meanings given in paragraph 3.4(3).
<i>relevant date</i>	has the meanings given in paragraph 3.4(3).
<i>solo Remuneration Code firm</i>	a <i>Remuneration Code firm</i> which is not part of a <i>group</i> containing one or more further <i>Remuneration Code firms</i> .

## 2 Part B: Proportionality Levels

- 2.1 SYSC 19A.1.1R provides that the *Remuneration Code* applies to a *Remuneration Code firm* and an *overseas Remuneration Code firm*, in relation to the activities carried on from an establishment in the UK.
- 2.2 This *guidance* statement provides for the division of *Remuneration Code firms* into three categories:
1. *proportionality level one*;
  2. *proportionality level two*; and
  3. *proportionality level three*.
- 2.3 The process by which firms are divided into *proportionality levels* is provided in Part C (as supplemented by Annex 1), and may also depend on individual *guidance*.
- 2.4 The *proportionality levels* provide a framework for the operation of *the remuneration principles proportionality rule*. *Guidance* is given to *firms* in different *proportionality levels* in Part D.

## 3 Part C: Process for Dividing Firms into Proportionality Levels

### Overview

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- 3.1 This Part provides the process by which a *Remuneration Code firm* should ascertain the *proportionality level* into which it falls. Annex 1 provides supplementary *guidance* (including examples).
- 3.2 A *Remuneration Code firm*, in order to ascertain its *proportionality level*, must first establish whether it is part of a *group* which contains one or more other *Remuneration Code firms*:
1. If the *firm* is not part of such a *group* (a *solo Remuneration Code firm*), its *proportionality level* will depend on its individual characteristics (as determined in accordance with paragraph 3.4).
  2. If the *firm* is part of such a *group*, its *proportionality level* will depend on a two-stage process (as provided in paragraphs 3.5 and 3.6).
    - a. (This requires all *Remuneration Code firms* that are part of the *group* to fall into the highest *proportionality level* that any individual *Remuneration Code firm* in the *group* would fall into on the assumption that it was a *solo Remuneration Code firm*.)
- 3.3 Individual *guidance* may vary the *proportionality level* into which a *firm* would otherwise fall under paragraphs 3.4 to 3.6.

### Solo Remuneration Code firms

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- 3.4 The following table shows the *proportionality level* into which a *solo Remuneration Code firm* that is an *IFPRU investment firm* or an *overseas Remuneration Code firm* falls:
1. A *firm* of the description given in the second column falls into the *proportionality level* listed in the first column.
  2. Where applicable, the *firm's proportionality level* will further depend on whether it held *relevant total assets* on the *relevant date* of the amount listed in the third column of the table.
  3. In (2) —
    - b. '*relevant total assets*' means:
      - i. for *IFPRU investment firms*, the average of the *firm's* total assets on the *firm's* last three *relevant dates*; and

- ii. for *overseas Remuneration Code firms*, the average of the *firm's total assets* that covered the activities of the branch operation in the *United Kingdom* on the *firm's last three relevant dates*;
- c. 'relevant date' means:
  - i. for IFPRU investment *firms*, an accounting reference date; and
  - ii. for *overseas Remuneration Code firm* 'relevant date ' means 31 December.

3.5 The limit confining relevant total assets to those that cover the activities of the branch operation in the UK is taken from ~~SUP 16.12.3R(1)(a)(iv)~~, which relates to a reporting requirement in relation to ~~non-EEA banks~~ (among others). We consider that a *firm* which needs to ascertain its *relevant total assets* should apply the valuation requirements set out in the *EU CRR*.

**Table 2: Proportionality levels: solo Remuneration Code firms which include IFPRU Investment firms and overseas Remuneration Code firms**

Proportionality level	Type of firm	Relevant total assets on relevant date of firm
Proportionality level one	<del>UK Bank</del>	<del>Exceeding £50bn</del>
	<del>Building society</del>	<del>Exceeding £50bn</del>
	<i>IFPRU 730k Investment firm that is a that is a full scope IFPRU investment firm</i>	Exceeding £50bn
Proportionality level two	<del>UK Bank</del>	<del>Exceeding £15bn but not exceeding £50bn</del>
	<del>Building society</del>	<del>Exceeding £15bn but not exceeding £50bn</del>
	<i>IFPRU 730k Investment firm that is a that is a full scope IFPRU investment firm</i>	Exceeding £15bn, but not exceeding £50bn
Proportionality level three	<del>UK Bank</del>	<del>Not exceeding £15bn</del>
	<del>Building society</del>	<del>Not exceeding £15bn</del>
	<i>Any full scope IFPRU Investment firm that does not fall within proportionality level one or proportionality level two (in accordance with this Table).</i>	Not applicable
	<i>IFPRU limited licence firm.</i>	
	<i>IFPRU limited activity firm.</i>	

### Groups with more than one Remuneration Code firm

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- 3.6 This paragraph applies where a *Remuneration Code firm* is part of a *group* containing one or more other *Remuneration Code firms*:
1. Each *Remuneration Code firm* in the *group* must determine *the proportionality level* into which it would fall on the assumption it was a *solo Remuneration Code firm*.
  2. Where each *Remuneration Code firm* falls into the same *proportionality level* on the assumption that it was a *solo Remuneration Code firm*, each *firm* falls into that *proportionality level*.
  3. Where the *Remuneration Code firms* fall into different *proportionality levels* on the assumption that they were *solo Remuneration Code firms*, each *firm* falls into the highest *proportionality level*.
  4. For the purposes of (3), *proportionality level one* is the highest and *proportionality level three* is the lowest.
- 3.7 Annex 1 provides examples of this approach. A *firm* which has a higher *proportionality level* as a result of the *guidance* in paragraph 3.6 than would have been the case had the *firm* been a *solo Remuneration Code firm* should note the scope to apply for individual *guidance* to vary its *proportionality level* (as discussed in paragraphs 6.5 and 6.6 of Annex 1).
- 3.8 Where a *Remuneration Code firm* is part of a *group* in which a *firm* to which SYSC 19D applies is a member, this *guidance* does not apply, SYSC 19D and its applicable general *guidance* on *proportionality* apply instead.

## 4 Part D: Guidance to firms in particular proportionality levels

### Purpose of proportionality levels

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- 4.1 In relation to the *remuneration principles proportionality rule*, the *proportionality levels* provide the following:
1. A framework for our supervisory approach, and a broad indication of our likely expectations; and
  2. *Guidance* on which remuneration principle may normally be disapplied under the *remuneration principles proportionality rule*.

### Firms to continue to consider proportionality in their individual circumstances etc.

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- 4.2 It follows from the nature of the *remuneration principles proportionality rule*, and the limited purposes noted in paragraph 4.1, that the *proportionality levels* do not provide comprehensive *guidance* on how the *remuneration principles proportionality rule* will apply to a particular *firm*. A *firm* will still need to consider the application of the *remuneration principles proportionality rule* to its individual circumstances.
- 4.3 A *firm* should bear in mind that the *Remuneration Code* may require different responses from *firms* that fall into the same *proportionality level*. This is illustrated by the following example:
1. Firm A is a *full scope IFPRU investment firm* with *relevant total assets* of £800bn with complex business operations with substantial foreign exchange exposures. It falls into *proportionality level one*.
  2. Firm B is a *full scope IFPRU investment firm* with *relevant total assets* of £100bn and a comparatively simple, conservative business model. It falls into *proportionality level one*.
  3. Firm C is an *full scope IFPRU investment firm*, with *relevant total assets* of £25bn and a comparatively simple, conservative business model. It falls into *proportionality level two*.
  4. Remuneration Principle 8 requires, amongst other things, a *firm* to risk-adjust performance measures to take account of all types of current and future risks (SYSC 19A.3.22R(1)(a)).
  5. Clearly the processes necessary to identify such risks will need to be more sophisticated for Firm A than for Firm B, despite the fact that they fall into the same *proportionality level*. Indeed, the difference in the necessary

sophistication is likely to be greater as between Firm A and Firm B than as between Firm B and Firm C.

### Disapplication of certain remuneration principles for firms in particular proportionality levels

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- 4.4 The *CRD* can be interpreted such that it may not be necessary for certain *firms* to apply certain *remuneration* principles at all.<sup>2</sup>
- 4.5 In our view, it will normally be appropriate for a *firm* in *proportionality level three* to disapply under the *remuneration principles proportionality rule* one or more of the following *rules*:
1. retained *shares* or other instruments (SYSC 19A.3.47R)
  2. deferral (SYSC 19A.3.49R)
  3. performance adjustment (SYSC 19A.3.51R – SYSC 19A.3.51A)
- 4.6 It may also be appropriate for:
1. *proportionality level three full scope IFPRU investment firms* to disapply the specific ratio between fixed and variable components of total *remuneration* (SYSC 19A.3.44R (3)); and
  2. *IFPRU limited licence firms* and *IFPRU limited activity firms* to disapply, under the *remuneration principles proportionality rule*, the ratios between fixed and variable components of total *remuneration* (SYSC 19A.3.44R);
- 4.7 In both cases (4) and (5) above, if requested by the *FCA*, the *FCA* will expect the *firm's* senior management to be able to demonstrate why the *firm* believes it is reasonable to disapply it in the light of the *remuneration principles proportionality rule*.
- 4.8 We are also of the opinion that such *firms* may 'take into account the specific features of their types of activities in applying the 'requirement on multi-year framework, in particular the accrual and ex- ante risk adjustment aspects of it. <sup>3</sup>
- 4.9 However, *firms* should also note that some *remuneration* principles set specific numerical criteria (such as on the minimum period of deferral, the minimum portion to be deferred and the minimum portion to be issued in *shares*). The following *guidance* applies where such principles apply to *Remuneration Code staff* and are not capable of disapplication under the approach set out above. In such circumstances, we do not consider that the *remuneration principles proportionality rule* permits a *firm* to apply lower numerical criteria. (For the avoidance of doubt, this *guidance* does not apply where a *firm* chooses to use deferral or issuance in *shares* more widely than required

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<sup>2</sup> *CRD* Article 92(2) provides that the principles should be applied 'in a manner and to the extent that is appropriate to their size, internal organisation and the nature, the scope and complexity of their activities'.

<sup>3</sup> As per the *FSA's* Policy Statement 10/20. See link [http://www.fsa.gov.uk/pubs/policy/ps10\\_20.pdf](http://www.fsa.gov.uk/pubs/policy/ps10_20.pdf)

by SYSC 19A.3, for example in order to comply with the *Remuneration Code general requirement*).

## 5 Part E: Guidance about part year Remuneration Code staff

### Introduction

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- 5.1 SYSC 19A.3.34G provides *guidance* on when we do not generally consider it necessary for a *firm* to apply to certain *Remuneration Code staff* certain *rules* relating to *remuneration* structures. This Part provides supplementary guidance on how certain *rules* on *remuneration* structures might normally be applied to *Remuneration Code staff* who have, in relation to a given performance year, been *Remuneration Code staff* for only part of the year.
- 5.2 In giving this *guidance*, we have taken account of the *remuneration principles proportionality rule*.

### Part-year Remuneration Code staff for more than three months

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- 5.3 This paragraph applies where an individual (A) has, in relation to a given performance year, been *Remuneration Code staff* for a period more than three months, but less than 12 months:
1. Sub-paragraphs (3) and (4) explain how the *guidance* in SYSC 19A.3.34G (as mentioned in the introduction to this Part) is to be applied in relation to A. Sub-paragraphs (5) and (6) provide that in certain circumstances it may be appropriate to apply certain rules to only a proportion of A's variable *remuneration*. Sub-paragraphs (7) to (9) provide examples.
  2. In this paragraph:
    - a. 'relevant fraction' means the fraction derived by dividing the number of days in the given performance year for which A has been *Remuneration Code staff* by the number of days in the year;
    - b. 'qualifying fixed remuneration' means A's annual fixed remuneration in A's capacity as *Remuneration Code staff* multiplied by the relevant fraction;
    - c. 'qualifying variable *remuneration*' means:
      - i. In the case where A was an *employee* of the *firm* for the whole of the given performance year, A's variable *remuneration* in relation to the performance year multiplied by the relevant fraction
      - ii. in the case where A was only ever employed in the given performance year as *Remuneration Code staff*, A's actual

variable *remuneration*;

- a. 'total qualifying *remuneration*' means qualifying fixed *remuneration* added to qualifying variable *remuneration*; and
  - b. 'threshold amount' means £500,000 multiplied by the relevant fraction.
3. We do not generally consider it necessary for a *firm* to apply the rules referred to in (4) where, in relation to A, the following conditions are satisfied:
- a. Condition 1 is that A's qualifying variable *remuneration* is no more than 33% of total qualifying remuneration, and
  - b. Condition 2 is that A's total qualifying *remuneration* is no more than the threshold amount.
4. The rules referred to in (3) are those relating to
- a. guaranteed variable *remuneration* (SYSC 19A.3.40R);
  - b. retained *shares* or other instruments (SYSC 19A.3.47R);
  - c. deferral (SYSC 19A.3.49R); and
  - d. performance adjustment (SYSC 19A.3.51R).
5. Sub-paragraph (6) applies where the conditions in (3) are not satisfied and the *firm* should apply the rules referred to in (6).
6. Where this sub-paragraph applies, we generally consider that it would be appropriate to apply the following rules to qualifying variable *remuneration* only
- a. retained *shares* or other instruments (SYSC 19A.3.47R), (b);
  - b. deferral (SYSC 19A.3.49R); and
  - c. performance adjustment (SYSC 19A.3.51R).
7. The examples in (8) and (9) illustrate this guidance. The performance year in each case is 1 January to 31 December.
8. Example 1:
- a. A1 is an *employee* of the *firm* through the performance year and is promoted to a *Remuneration Code staff* role with effect from 1 September. A1's previous fixed *remuneration* was £150,000. In his *Remuneration Code staff* role A1's fixed remuneration increases to £250,000. For the performance year, A1 is awarded variable *remuneration* of £130,000.
  - b. The relevant fraction is 122/365. A1's qualifying fixed *remuneration* is £83,560 (£250,000 multiplied by 122/365). A1's qualifying variable *remuneration* is £43,452 (£130,000 multiplied by 122/365). A1's total qualifying *remuneration* is £127,012. The threshold amount is £167,120 (£500,000 multiplied by 122/365).
  - c. A1's total qualifying *remuneration* is below the threshold amount, so condition 2 of total qualifying *remuneration*, and condition 1 of (3) is not satisfied.
  - d. The rule on guaranteed variable *remuneration* applied to A1. In

addition, the *rules* on retained *shares* and other instruments, deferral and performance adjustment must be applied to A1's qualifying variable *remuneration* of £43,452.

### 9. Example 2:

- a. A2 joins the *firm* as a *Remuneration Code staff* member with effect from 1 July. A2's annual fixed *remuneration* is £450,000. For the period of 1 June to 31 December, A2 is awarded variable *remuneration* of £50,000.
- b. The relevant fraction is 184/365. A2's qualifying fixed *remuneration* is £226,850 (£450,000 multiplied by 184/365). A2's qualifying variable *remuneration* is £50,000 (the actual amount). A2's total qualifying *remuneration* is £276,850. The threshold amount is £252,050 (£500,000 multiplied by 184/365).
- c. A2's qualifying variable *remuneration* is not more than 33% of A2's total qualifying *remuneration*, and condition 1 of (3) is satisfied. But A2's total qualifying *remuneration* is more than the threshold amount, so condition 2 of (3) is not satisfied.
- d. The rule on guaranteed variable *remuneration* applies to A2. In addition, the rules on retained *shares* and other instruments, deferral and performance adjustments must be applied to A2's qualifying variable *remuneration* of £50,000.

### **Certain part-year Remuneration Code staff for three months or less**

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5.4 Paragraphs 5.5 and 5.6 apply where:

1. an individual (B) has, in relation to a given performance year, been *Remuneration Code staff* for a period of three months or less, and
2. an exceptional or irregular payment (such as a sign-on award) has not been or is not to be made in relation to B's appointment as *Remuneration Code staff*.

5.5 Where this paragraph applies, we do not generally consider it necessary to apply the following rules in relation to B for the performance year in question:

1. retained *shares* or other instruments (SYSC 19A.3.47R);
2. deferral (SYSC 19A.3.49R); and
3. performance adjustment (SYSC 19A.3.51R).

5.6 Where this paragraph applies, the *guidance* in paragraph 5.3 (2), 5.3 (3) and 5.3 (4)(a) should be applied for the purposes of determining whether or not it will generally be necessary to apply the rule on guaranteed variable *remuneration* to B (substituting in that paragraph, for references to 'A', references to 'C').

### **Part-year Remuneration Code staff for three months or less, but where exceptional etc. payments made**

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- 5.7 Paragraph 5.8 applies where an individual (C) has, in relation to a given performance year, been *Remuneration Code staff* for a period of three months or less, but where an exceptional or irregular payment (such as a sign-on award) has or is to be made in relation to C's appointment.
- 5.8 The guidance in paragraph 5.3 applies in relation to C (substituting in that paragraph, for references to 'A', references to 'C'). The amount of exceptional or irregular payment is to be added to C's qualifying variable *remuneration* without pro rating.

## 6 Annex 1: Supplemental guidance on dividing firms into proportionality levels

### Groups with more than one Remuneration Code firm: examples

6.1 The following non-exhaustive examples illustrate the operation of the *guidance* provided in paragraph 3.6 of Part C. (It should be borne in mind that in each case individual *guidance* could vary the outcome provided by the operation of the guidance provided in that paragraph.)

6.2 Example 1:

1. Firm A is the *parent undertaking* of Firm B
2. Firm A is a *full scope IFPRU investment firm* (that is an *IFPRU 730k investment firm*) that had *relevant total assets* of £800bn on its last accounting reference date. Firm B is a *limited activity firm*.
3. On the assumption that they were *solo Remuneration Code firms*, Firm A falls into *proportionality level one* and Firm B falls into *proportionality level three*.
4. As a result of the *guidance* at paragraph 3.6 of Part C, both Firms A and B fall into *proportionality level one*.

6.3 Example 2:

1. Firm C is the *parent undertaking* of Firm D.
2. Firm C is a *limited activity firm* and Firm D is a *full scope IFPRU investment firm* (that is an *IFPRU 730k investment firm*) that had *relevant total assets* of £100bn on its last accounting reference date.
3. On the assumption that they were *solo Remuneration Code firms*, Firm C falls into *proportionality level three* and Firm D falls into *proportionality level one*.
4. As a result of the *guidance* at paragraph 3.6 of Part C, both Firms C and D fall into *proportionality level one*.

6.4 Example 3

1. Company E is the *parent undertaking* of Firms F and G and Company H. Company H is the *parent undertaking* of Firm I. Firm J is a member of the group because of an *Article 12(1) consolidation relationship*.
2. The firms and companies have the following characteristics:
  - e. Neither Companies E nor H are *Remuneration Code firms*;
  - f. Firm F is a *full scope IFPRU investment firm* (that is an *IFPRU 730k investment firm*) and that had *relevant total assets* of £40bn on its last

- accounting reference date;
  - g. Firms G and J are *limited activity firms*; and
  - h. Firm I is a *limited license firm* that had *relevant total assets* of £10bn on its last accounting reference date.
3. On the assumption that they were *solo Remuneration Code firms*
- i. Firm F falls into *proportionality level two*;
  - j. Firms G and J fall into *proportionality level three*; and
  - k. Firm I falls into *proportionality level three*.
4. As a result of the *guidance* at paragraph 3.6 in Part c, Firms F, G, I and J all fall into *proportionality level two*.

### Role of individual guidance

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- 6.5 Individual *guidance* may vary the *proportionality level* into which a *firm* would fall under the general *guidance* set out in Part C and supplemented by this Annex. In consequence, the definitions and thresholds provided in Part C do not provide an immutable classification.
- 6.6 The following provide non-exhaustive high level examples of where we might consider providing individual *guidance* to vary a *proportionality level*:
- 1. Where a *firm* was just below the threshold for a particular *proportionality level* (as determined in accordance with Part C), but where features of its business model or growth strategy suggest that it should fall within the higher *proportionality level*.
  - 2. Where a *group of firms* contained several *firms* falling into a common *proportionality level*, but where the aggregate prudential risk posed by the *group* suggested that a higher *proportionality level* was more appropriate.
  - 3. Where a *firm* falls into a higher *proportionality level* as a result of the *guidance* at paragraph .6 of Part C than would be the case on the assumption that it was a *solo Remuneration Code firm*, depending on the particular circumstances of the case

## Appendix 7 (Part 2) - Guidance consultation

### General Guidance on Proportionality

#### The Remuneration Code (SYSC 19C) and Pillar 3 disclosures on Remuneration (BIPRU 11)

[date]

[Note: In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.]

## 1 Part A: Introduction and interpretations

### Introduction

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#### Status of guidance statement

- 1.1 This statement is general *guidance* given under section 139A (1) of the Financial Services and Markets Act (FSMA). It relates both to:
  1. the *BIPRU Remuneration Code* of SYSC 19C of the *FCA Handbook*, and
  2. the requirement to make Pillar 3 disclosures in relation to *remuneration* (in accordance with *BIPRU 11* of the *Handbook*).
- 1.2 Paragraphs 1.13 and 1.14 make provision about the interpretation of this *guidance* statement. Expressions in italics either bear the meaning given in the *Handbook Glossary*, or in table 1.
- 1.3 This *guidance* statement has effect from [ ].

#### Remuneration principles proportionality rule

- 1.4 The *BIPRU remuneration principles proportionality rule* is set out in SYSC 19C.3.3R (2).

- 1.5 The *BIPRU Remuneration Code* requires (amongst other things) a *firm* to apply requirements in SYSC 19C.3 to *BIPRU Remuneration Code staff*. The *BIPRU remuneration principles proportionality rule* requires a *firm*, when establishing and applying the total remuneration policies for *BIPRU Remuneration Code staff*, to comply with SYSC 19C.3 in a way and to the extent that is appropriate to its size, internal organisation and the nature, the scope and the complexity of its activities.

### Guidance on the remuneration principles proportionality rule

- 1.6 General *guidance* is given in relation to specific aspects of the *remuneration principles proportionality rule* in SYSC 19C.3 itself.<sup>1</sup>
- 1.7 Part C of this *guidance* statement provides additional general *guidance* in relation to the application of the *BIPRU remuneration principles proportionality rule* to *BIPRU Remuneration Code staff* who have, in relation to a given performance year, been *BIPRU Remuneration Code staff* for only part of the year.
- 1.8 This *guidance* statement represents our *guidance* in a field that may be subject to change, we intend to keep the *guidance* set out here under review.

### Guidance on proportionality in relation to remuneration committees and Pillar 3 remuneration disclosures

- 1.9 The *BIPRU remuneration principles proportionality rule* does not apply to the requirement to establish a *remuneration* committee or to make disclosures in relation to *remuneration* under *BIPRU* 11 (as part of Pillar 3). But these requirements are governed by similar proportionality tests, on which *guidance* is given in Parts D and E of this *guidance* statement.

### Individual guidance

- 1.10 We may give individual *guidance* to a *firm*, either on its own initiative or on the application of the *firm*. Our policy on individual *guidance* is set out in SUP 9. In consequence, we may give individual *guidance* to a *firm* in relation to the *remuneration principles proportionality rule* (SYSC 19C.3.3R). Such *guidance* may relate to the application of the *rule* by the *firm* generally, or in specific areas.

### Arrangement of guidance statement

- 1.11 This general *guidance* statement is divided into five Parts:
1. This Part, Part A: Introduction & interpretation
  2. Part B: Guidance to *BIPRU firms* on the application of proportionality

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<sup>1</sup> The main provisions of *guidance* which specifically refer to the *remuneration principles proportionality rule* are SYSC 19C.3.34G (giving *guidance* in relation to *BIPRU Remuneration Code staff* and certain rules on *remuneration* structures).

3. Part C: Guidance about part-year *Remuneration Code staff*.
4. Part D: Remuneration committees.
5. Part E: Pillar 3 *remuneration* disclosures (*BIPRU 11*).

1.12 It is supplemented by one Annex:

1. Annex 1: Pillar 3 disclosure requirements by proportionality level

## Interpretation

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- 1.13 This *guidance* statement is to be interpreted as if it was an Annex to SYSC 19C.3 (other than Part E and Annex 1, which are to be interpreted as if they were an Annex to *BIPRU 11*). In consequence, *GEN 2* (interpreting the *Handbook*) applies to the interpretation of this *guidance* statement.
- 1.14 In particular, an expression in italics which is defined in the *Glossary* has the meaning given there (*GEN 2.2.7R*). Where an expression in italics is not defined in the *Glossary*, it has the meaning given by the following table:

**Table 1: Glossary of terms defined in this guidance statement**

Defined expression	Definition
<i>group</i>	has the meaning given in the <i>Glossary</i> under paragraph (3).
<i>BIPRU Remuneration Code firm</i>	a <i>BIPRU firm</i> or <i>third country BIPRU firm</i> to which the <i>BIPRU Remuneration Code</i> applies (in accordance with SYSC 19C.1.1R).

## 2 Part B : Guidance to BIPRU firms on the application of proportionality

### BIPRU firms that are part of a group

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- 2.1 Where a *BIPRU Remuneration Code firm* is part of a *group* comprised only of *BIPRU Remuneration Code firms*, each *firm* should apply this guidance.
- 2.2 Where a *BIPRU Remuneration Code firm* is part of a *group* in which:
1. a *firm* to which SYSC 19A applies is a member, this *guidance* does not apply, SYSC 19A and applicable *guidance* applies instead;
  2. a *firm* to which SYSC 19D applies is a member, this *guidance* does not apply, SYSC 19D and applicable *guidance* applies instead.

### Disapplication of certain remuneration principles for BIPRU firms

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- 2.3 It may not be necessary for *BIPRU firms* to apply *BIPRU remuneration* principles at all.
- 2.4 In our view, it will normally be appropriate for a *BIPRU firm* to disapply under the *BIPRU remuneration principles proportionality rule* the following *rules*
1. retained *shares* or other instruments (SYSC 19C.3.47R);
  2. deferral (SYSC 19C.3.49R);
  3. performance adjustment (SYSC 19C.3.51R); and
  4. the ratios between fixed and variable components of total *remuneration* (SYSC 19C.3.44R).
- 2.5 *BIPRU firms* may 'take into account the specific features of their types of activities' in applying the 'requirement on the multi-year framework, in particular the accrual and ex-ante risk adjustment aspects of it'.<sup>2</sup>
- 2.6 However, *BIPRU firms* should also note that some *remuneration* principles set specific numerical criteria (such as on the minimum period of deferral, the minimum portion to be deferred and the minimum portion to be issued in *shares*). The following *guidance* applies where such principles apply to *BIPRU Remuneration Code staff* and are not capable of disapplication under the approach set out above. In such circumstances, we do not consider that the *remuneration principles proportionality rule* permits a *firm* to

<sup>2</sup> As per FSA's Policy Statement 10/20. See link at [http://www.fsa.gov.uk/pubs/policy/ps10\\_20.pdf](http://www.fsa.gov.uk/pubs/policy/ps10_20.pdf).

apply lower numerical criteria. (For the avoidance of doubt, this *guidance* does not apply where a *firm* chooses to use deferral or issuance in shares more widely than required by SYSC 19C.3, for example in order to comply with the *BIPRU Remuneration Code general requirement*.)

## 3 Part C : Guidance about part-year BIPRU Remuneration Code staff

### Introduction

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- 3.1 SYSC 19C.3.34G provides *guidance* on when we do not generally consider it necessary for a *firm* to apply to certain *BIPRU Remuneration Code staff* certain *rules* relating to *remuneration* structures. This Part provides supplementary guidance on how certain *rules* on *remuneration* structures might normally be applied to *BIPRU Remuneration Code staff* who have, in relation to a given performance year, been *BIPRU Remuneration Code staff* for only part of the year.
- 3.2 In giving this *guidance*, we have taken account of the *remuneration principles proportionality rules*.<sup>3</sup>

### Part-year Remuneration Code staff for more than three months

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- 3.3 This paragraph applies where an individual (A) has, in relation to a given performance year, been *BIPRU Remuneration Code staff* for a period more than three months, but less than 12 months:
1. Sub-paragraphs (3) and (4) explain how the *guidance* in SYSC 19C.3.34G (as mentioned in the introduction to this Part) is to be applied in relation to A. Sub-paragraphs (5) and (6) provide that in certain circumstances it may be appropriate to apply certain *rules* to only a proportion of A's variable *remuneration*. Sub-paragraphs (7) to (9) provide examples;
  2. In this paragraph:
    - a. 'relevant fraction' means the fraction derived by dividing the number of days in the given performance year for which A has been *BIPRU Remuneration Code staff* by the number of days in the year;
    - b. 'qualifying fixed *remuneration*' means A's annual fixed *remuneration* in A's capacity as *BIPRU Remuneration Code staff* multiplied by the relevant fraction;
    - c. 'qualifying variable *remuneration*' means:
      - i. in the case where A was an *employee* of the *firm* for the whole of the given performance year, A's variable *remuneration* in

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<sup>3</sup> As per FSA's Policy Statement 10/20. See link at [http://www.fsa.gov.uk/pubs/policy/ps10\\_20.pdf](http://www.fsa.gov.uk/pubs/policy/ps10_20.pdf).

- relation to the performance year multiplied by the relevant fraction; and
- ii. in the case where A was only ever employed in the given performance year as *BIPRU Remuneration Code staff*, A's actual variable *remuneration*.
  - d. 'total qualifying *remuneration*' means qualifying fixed *remuneration* added to qualifying variable *remuneration*; and
  - e. 'threshold amount' means £500,000 multiplied by the relevant fraction.
3. We do not generally consider it necessary for a *firm* to apply the rules referred to in (4) where, in relation to A, the following conditions are satisfied:
    - a. Condition 1 is that A's qualifying variable *remuneration* is no more than 33% of total qualifying *remuneration*; and
    - b. Condition 2 is that A's total qualifying *remuneration* is no more than the threshold amount.
  4. The rules referred to in (3) are those relating to:
    - a. guaranteed variable *remuneration* (SYSC 19C.3.40R);
    - b. retained *shares* or other instruments (SYSC 19C.3.47R);
    - c. deferral (SYSC 19C.3.49R); and
    - d. performance adjustment (SYSC 19C.3.51R).
  5. Sub-paragraph (6) applies where the conditions in (3) are not satisfied and the *firm* should apply the rules referred to in (6).
  6. Where this sub-paragraph applies, we generally consider that it would be appropriate to apply the following rules to qualifying variable *remuneration* only:
    - a. retained *shares* or other instruments (SYSC 19C.3.47R);
    - b. deferral (SYSC 19C.3.49R); and
    - c. performance adjustment (SYSC 19C.3.51R).
  7. The examples in (8) and (9) illustrate this *guidance*. The performance year in each case is 1 January to 31 December.
  8. Example 1
    - a. A1 is an *employee* of the *firm* through the performance year and is promoted to a *BIPRU Remuneration Code staff* role with effect from 1 September. A1's previous fixed *remuneration* was £150,000. In his *BIPRU Remuneration Code staff* role A1's fixed *remuneration* increases to £250,000. For the performance year, A1 is awarded variable *remuneration* of £130,000.
    - b. The relevant fraction is 122/365. A1's qualifying fixed *remuneration* is £83,560 (£250,000 multiplied by 122/365). A1's qualifying variable

*remuneration* is £43,452 (£130,000 multiplied by 122/365). A1's total qualifying *remuneration* is 127,012. The threshold amount is £167,120 (£500,000 multiplied by 122/365).

- c. A1's total qualifying *remuneration* is below the threshold amount, so condition 2 of (3) is satisfied. But A1's qualifying variable *remuneration* is more than 33% of A1's total qualifying *remuneration*, and condition 1 of (3) is not satisfied.
- d. The rule on guaranteed variable *remuneration* applies to A1. In addition, the *rules* on retained shares and other instruments, deferral and performance adjustment must be applied to A1's qualifying variable *remuneration* of £43,452.

### 9. Example 2

- a. A2 joins the *firm* as a *BIPRU Remuneration Code staff* member with effect from 1 July. A2's annual fixed *remuneration* is £450,000. For period of 1 June to 31 December, A2 is awarded variable *remuneration* of £50,000.
- b. The relevant fraction is 184/365. A2's qualifying fixed *remuneration* is £226,850 (£450,000 multiplied by 184/365). A2's qualifying variable *remuneration* is £50,000 (the actual amount). A2's total qualifying *remuneration* is £276,850. The threshold amount is £252,050 (£500,000 multiplied by 184/365).
- c. A2's qualifying variable *remuneration* is not more than 33% of A2's total qualifying *remuneration*, and condition 1 of (3) is satisfied. But A2's total qualifying *remuneration* is more than the threshold amount, so condition 2 of (3) is not satisfied.
- d. The rule on guaranteed variable *remuneration* applies to A2. In addition, the *rules* on retained shares and other instruments, deferral and performance adjustment must be applied to A2's qualifying variable *remuneration* of £50,000.

### **Certain part-year Remuneration Code staff for three months or less**

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3.4 Paragraphs 3.5 and 3.6 apply where:

1. an individual (B) has, in relation to a given performance year, been *BIPRU Remuneration Code staff* for a period of three months or less, and;
2. an exceptional or irregular payment (such as a sign-on award) has not been or is not to be made in relation to B's appointment as *BIPRU Remuneration Code staff*.

3.5 Where this paragraph applies, we do not generally consider it necessary to apply the following rules in relation to B for the performance year in question:

1. retained *shares* or other instruments (SYSC 19C.3.47R);
  2. deferral (SYSC 19C.3.49R), and
  3. performance adjustment (SYSC 19C.3.51R).
- 3.6 Where this paragraph applies, the *guidance* in paragraph 3.3 (2), (3) and (4)(a) should be applied for the purposes of determining whether or not it will generally be necessary to apply the rule on guaranteed variable *remuneration* to B (substituting in that paragraph, for references to 'A', references to 'B').

### **Part-year Remuneration Code staff for three months or less, but where exceptional etc. payments made**

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- 3.7 Paragraph 3.8 applies where an individual (C) has, in relation to a given performance year, been *BIPRU Remuneration Code staff* for a period of three months or less, but where an exceptional or irregular payment (such as a sign-on award) has or is to be made in relation to C's appointment
- 3.8 The *guidance* in paragraph 3.3 applies in relation to C (substituting in that paragraph, for references to 'A', references to 'C'). The amount of exceptional or irregular payment is to be added to C's qualifying variable *remuneration* without pro rating

## 4 Part D : Remuneration Committees

### Remuneration Committee for BIPRU firms and third country BIPRU firms

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- 4.1 Remuneration Principle 4 (Governance) provides, in SYSC 19C.3.12R(1), that a *BIPRU firm* that is significant in terms of its size, internal organisation and the nature, the scope and the complexity of its activities must establish a *remuneration* committee
- 4.2 With regards to larger *BIPRU firms*, it would be desirable for a *remuneration* committee to be established under SYSC 19C.3.12R and we would normally expect such *firms* to do so. However, we accept that it may be possible for such *firms* to justify on the ground of proportionality not establishing under SYSC 19C.3.12R at solo level a *remuneration* committee of the *BIPRU Remuneration Code firm*. In such circumstances it would be necessary to show how the functions which would otherwise have been performed by such a *remuneration committee* would be discharged with sufficient authority, and with sufficient independence from those performing executive functions within the *firm*. Where, for example, members of the *governing body* of the *firm* acted together with a *group remuneration committee* to discharge these functions, we would expect as a minimum to be satisfied that the operational arrangements ensured sufficient independence from those performing executive functions at *BIPRU Remuneration Code firm* or *group* level, and allowed the *governing body* of the *firm* to exercise sufficient authority in relation to the *BIPRU Remuneration Code firm*.

## 5 Part E : Pillar 3 Remuneration Disclosures (BIPRU 11)

### Requirement to make Pillar 3 remuneration disclosures

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- 5.1 *BIPRU 11* requires certain *Remuneration Code firm* to disclose a series of qualitative and quantitative information relating to *remuneration* (*BIPRU 11.3* and *BIPRU 11.5.18R*).
- 5.2 *BIPRU 11* applies only to *BIPRU firms*.

### Pillar 3 remuneration disclosures and proportionality

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- 5.3 Two proportionality tests apply in relation to the requirement to make Pillar 3 disclosures in relation to *remuneration*:
1. A *BIPRU firm* that is significant in terms of its size, internal organisation and the nature, scope and the complexity of its activities must also disclose the quantitative information referred to in *BIPRU 11.5.18R* at the level of *senior personnel* (*BIPRU 11.5.20R(1)*); and
  2. *BIPRU firms* must comply with the requirements set out in *BIPRU 11.5.18R* in a manner that is appropriate to their size, internal organisation and the nature, scope and complexity of their activities (*BIPRU 11.5.20R (2)*).
- 5.4 In relation to the proportionality test referred to in paragraph 5.3 (1), the *FCA* considers that a *firm* should be regarded as 'significant' if on *relevant date* a *firm* has *relevant total assets* exceeding £50bn.
- 5.5 In relation to the proportionality test set referred to in paragraph 5.3 (2) the table in Appendix 1 sets out the categories of information that we consider *BIPRU firms* should typically disclose –where applicable.

## Annex 1 : Pillar 3 disclosure requirements by proportionality level

<b>BIPRU 11.5.18R disclosure requirement</b>
<i>BIPRU 11.5.18R (1) ('information concerning the decision-making process used for determining the remuneration policy, including if applicable, information about the composition and the mandate of a remuneration committee, the external consultant whose services have been used for the determination of the remuneration policy and the role of the relevant stakeholders')</i>
<i>BIPRU 11.5.18R (2) ('information on link between pay and performance')</i>
<i>BIPRU 11.5.18R (6) ('aggregate quantitative information on remuneration, broken down by business area')</i>
<i>BIPRU 11.5.18R (7) ('aggregate quantitative information on remuneration, broken down by senior management and members of staff whose actions have a material impact on the risk profile of the firm...')</i>

## Appendix 7 (Part 3) - Guidance consultation

### General Guidance on Proportionality

#### The Dual-Regulated firms Remuneration Code (SYSC 19D)

[date]

[Note: In this Annex, the following text is new and is not underlined]

## 1 Part A: Introduction and interpretations

### Introduction and status of guidance statement

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- 1.1 This statement is general *guidance* given under section 139A(1) of the Financial Services and Markets Act (FSMA). It relates to the *Dual Regulated firms Remuneration Code* of SYSC 19D of the *Handbook*.
- 1.2 Paragraphs 1.13 and 1.14 make provision about the interpretation of this *guidance* statement. Expressions in italics either bear the meaning given in the *Handbook Glossary*, or in table 1.
- 1.3 This *guidance* statement has effect from [ ].

### Dual-regulated firms remuneration principles proportionality rule

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- 1.4 The *Dual-regulated firms remuneration principles proportionality rule* is set out in SYSC 19D.3.3R (2).
- 1.5 The *Dual-Regulated firms Remuneration Code* requires (amongst other things) a *firm* to apply requirements in SYSC 19D.3 to *Dual-regulated firms Remuneration Code staff*. The *Dual-regulated firms remuneration principles proportionality rule* requires a *firm*, when

establishing and applying the total *remuneration* policies for *Dual-Regulated firms Remuneration Code staff*, to comply with SYSC 19D.3R in a way and to the extent that is appropriate to its size, internal organisation and the nature, the scope and the complexity of its activities.

### **Guidance on the Dual-regulated remuneration principles proportionality rule**

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- 1.6 General *guidance* is give in relation to specific aspects of the *Dual-regulated firms remuneration principles proportionality rule* in SYSC 19D.3.3R itself.<sup>1</sup>
- 1.7 Part D of this *guidance* statement provides additional general *guidance* in relation to the application of the *Dual-regulated firms remuneration principles proportionality rule* to different types of *firm*.
- 1.8 Part E of this *guidance* statement provides additional general *guidance* in relation to the application of the *Dual-regulated firms remuneration principles proportionality rule* to *Dual-regulated firms Remuneration Code staff* who have, in relation to a given performance year, been *Dual-regulated firms Remuneration Code staff* for only part of the year.
- 1.9 This *guidance* statement represents our *guidance* in a field where requirements relating to *remuneration* are being implemented within the EEA. We recognise this will be an evolving process, and intend to keep the *guidance* set out here under review.

### **Individual guidance**

- 1.10 We may give individual *guidance* to a *firm*, either on its own initiative or on the application of the *firm*. Our policy on individual *guidance* is set out in SUP 9. In consequence, we may give individual *guidance* to a *firm* in relation to the *remuneration principles proportionality rule* (SYSC 19A.3.3R). Such *guidance* may relate to the application of the *rule* by the *firm* generally, or in specific areas.

### **Arrangement of guidance statement**

- 1.11 This general *guidance* statement is divided into five Parts:
  1. This Part, Part A: Introduction and interpretation;
  2. Part B: Proportionality levels;
  3. Part C: Division of *firms* into *proportionality levels*;
  4. Part D: Guidance to firms in particular proportionality level; and

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<sup>1</sup> The main provisions of guidance which specifically refer to the *Dual-regulated firms remuneration principles proportionality rule* are SYSC 19D.3.35G (giving guidance in relation to *Dual-regulated firms Remuneration Code staff* and certain rules on *remuneration* structures).

5. Part E: Guidance about part-year Dual-regulated firms Remuneration Code staff.

1.12 It is supplemented by Annex 1 – Supplemental *guidance* on dividing *firms* into *proportionality levels*.

**Interpretation**

1.13 This *guidance* statement is to be interpreted as if it was an Annex to SYSC 19D.3.3 R. In consequence, *GEN 2* (interpreting the Handbook) applies to the interpretation of this *guidance* statement.

1.14 In particular, an expression in italics which is defined in the *Glossary* has the meaning given there (*GEN 2.2.7R*). Where an expression in italics is not defined in the *Glossary*, it has the meaning given by the following table:

**Table 1: Glossary of terms defined in this guidance statement**

Defined expression	Definition
<i>group</i>	has the meaning given in the <i>Glossary</i> in paragraph (3)
<i>overseas Dual-Regulated Remuneration Code firm</i>	an <i>overseas firm</i> that: (i) is not an <i>EEA firm</i> ; (ii) has its head office outside the <i>EEA</i> ; and (iii) would be a <i>building society, a bank or a UK designated investment firm</i> if it had been a <i>UK domestic firm</i> , had carried on all its business in the United Kingdom and had obtained whatever authorisation for doing so as required under the <i>Act</i> .
<i>proportionality level</i>	has the meaning given in paragraph 2.3, and references to <i>proportionality level one</i> , etc. are to be construed accordingly.
<i>Dual-regulated Remuneration Code firm</i>	a <i>firm</i> specified in SYSC 19D.1.1 R(1)(a)-(c).
<i>relevant total assets</i>	has the meanings given in paragraph 3.4 (3).
<i>relevant date</i>	has the meanings given in paragraph 3.4 (4).
<i>solo Dual-regulated Remuneration Code firm</i>	a <i>Dual-Regulated Remuneration Code firm</i> which is not part of a <i>group</i> containing one or more further <i>Dual-regulated Remuneration Code firms</i> .

## 2 Part B : Proportionality Levels

- 2.1 SYSC 19D.1.1R provides that the *Dual-Regulated firms Remuneration Code* applies to a *Dual-regulated Remuneration Code firm* and an *overseas Dual-regulated Remuneration Code firm*, in relation to the activities carried on from an establishment in the UK.
- 2.2 This *guidance* statement provides for the division of *Dual-regulated Remuneration Code firms* into three categories:
- a. proportionality level one;
  - b. proportionality level two; and
  - c. proportionality level three.
- 2.3 The process by which firms are divided into *proportionality levels* is provided in Part C (as supplemented by Annex 1), and may also depend on individual *guidance*.
- 2.4 The *proportionality levels* provide a framework for the operation of the *remuneration principles proportionality rule*. *Guidance* is given to *firms* in different *proportionality levels* in Part D.

## 3 Part C : Process for dividing firms into proportionality levels

### Overview

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- 3.1 This Part provides the process by which a *Dual-regulated Remuneration Code firm* should ascertain the *proportionality level* into which it falls. Annex 1 provides supplementary *guidance* (including examples).
- 3.2 A *Dual-regulated Remuneration Code firm*, in order to ascertain its *proportionality level*, must first establish whether it is part of a *group* which contains one or more other *Dual-regulated Remuneration Code firms*:
1. If the *firm* is not part of such a *group* (a *solo Dual-regulated Remuneration Code firm*), its *proportionality level* will depend on its individual characteristics (as determined in accordance with paragraph 3.4).
  2. If the *firm* is part of such a *group*, its *proportionality level* will depend on a two-stage process (as provided in paragraphs 3.5 and 3.6).  
  
(This requires all *Dual-regulated Remuneration Code firms* that are part of the *group* to fall into the highest *proportionality level* that any individual *Dual-regulated Remuneration Code firm* in the *group* would fall into on the assumption that it was a *solo Dual-regulated Remuneration Code firm*.)
- 3.3 Individual *guidance* may vary the *proportionality level* into which a *firm* would otherwise fall under paragraphs 3.4 to 3.6.

### Solo Dual-regulated Remuneration Code firms

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- 3.4 The following table shows the *proportionality level* into which a *solo Dual-regulated Remuneration Code firm* or an *overseas Dual-regulated Remuneration Code firm* falls:
1. A *firm* of the description given in the second column falls into the *proportionality level* listed in the first column;
  2. Where applicable, the *firm's proportionality level* will further depend on whether it held *relevant total assets* on the *relevant date* of the amount listed in the third column of the table (2);
  3. In (2) 'relevant total assets' means:
    - a. 'for a *Dual-regulated Remuneration Code firm*, the average of the *firm's total assets* on the *firm's last three relevant dates*; and

- b. for an *overseas Dual-regulated Remuneration Code firm*, the average of the *firm's total assets* that covered the activities of the branch operation in the *United Kingdom* on the firm's last three *relevant dates*.
- 4. Relevant date means:
  - a. for *Dual-regulated Remuneration Code firm*, an accounting reference date; and
  - b. for *overseas Dual-regulated Remuneration Code firm* 'relevant date' means 31 December.
- 5. The limit confining *relevant total assets* to those that cover the activities of the bank operation in the *UK* is taken from *SUP 16.12.3R(1)(a)(iv)*, which relates to a reporting requirement in relation to *non-EEA banks* (among others). We consider that a *firm* which needs to ascertain its *relevant total assets* should apply the valuation requirements set out in the *EU CRR*.

**Table 2: Proportionality levels: solo Dual-regulated Remuneration Code firms and overseas Dual-regulated Remuneration Code firms**

<b>Proportionality level</b>	<b>Type of firm</b>	<b>Relevant total assets on relevant date of firm</b>
<i>Proportionality level one</i>	<i>UK Bank</i>	Exceeding £50bn
	<i>Building society</i>	Exceeding £50bn
	<i>UK designated investment firm that is a CRD full-scope firm</i>	Exceeding £50bn
<i>Proportionality level two</i>	<i>UK Bank.</i>	Exceeding £15bn but not exceeding £50bn
	<i>Building society.</i>	Exceeding £15bn, but not exceeding £50bn
	<i>UK designated investment firm that is a CRD full-scope firm</i>	Exceeding £15bn, but not exceeding £50bn
<i>Proportionality level three</i>	<i>UK Bank.</i>	Not exceeding £15bn
	<i>Building society.</i>	Not exceeding £15bn
	<i>Any UK designated investment firm that is a CRD full-scope firm that does not fall within proportionality level one or proportionality level two (in accordance with this Table).</i>	Not applicable
	<i>UK designated investment firm that is a limited licence firm.</i>	
	<i>UK designated investment firm that is a limited activity firm.</i>	

**Groups with more than one Dual-regulated Remuneration Code firm**

3.5 This paragraph applies where a *Dual-regulated Remuneration Code firm* is part of a group containing one or more other *Dual-regulated Remuneration Code firms*:

1. Each Dual-regulated Remuneration Code firm in the group must determine the proportionality level into which it would fall on the assumption it was a solo Dual-regulated Remuneration Code firm;
2. Where each Dual-regulated Remuneration Code firm falls into the same proportionality level on the assumption that it was a solo Dual-regulated Remuneration Code firm, each firm falls into that proportionality level;

3. Where the Dual-regulated Remuneration Code firms fall into different proportionality levels on the assumption that they were solo Dual-regulated Remuneration Code firms, each firm falls into the highest proportionality level; and
  4. For the purposes of (3), *proportionality level one* is the highest and *proportionality level three* is the lowest.
- 3.6 Annex 1 provides examples of this approach. A *firm* which has a higher *proportionality level* as a result of the *guidance* in paragraph 3.5 than would have been the case had the *firm* been a *solo Dual-regulated Remuneration Code firm* should note the scope to apply for individual *guidance* to vary its *proportionality level* (as discussed in paragraphs 6.5 and 6.6 of Annex 1).

## 4 Part D : guidance to firms in particular proportionality levels

### Purpose of the proportionality levels

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- 4.1 In relation to the *Dual-regulated firms remuneration principles proportionality rule*, the *proportionality levels* provide the following:
1. A framework for our supervisory approach, and a broad indication of expectations; and
  2. Guidance on which remuneration principles may normally be disapplied under the *Dual-regulated firms remuneration principles proportionality rule*.

### Firms to continue to consider proportionality in their individual circumstances

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- 4.2 It follows from the nature of the *Dual-regulated firms remuneration principles proportionality rule*, and the limited purposes noted in paragraph 4.1, that the *proportionality levels* do not provide comprehensive guidance on how the *Dual-regulated firms remuneration principles proportionality rule* will apply to a particular firm. A firm will still need to consider the application of the *Dual-regulated firms remuneration principles proportionality rule* to its individual circumstances.
- 4.3 A firm should bear in mind that the *Dual-regulated firms Remuneration Code* may require different responses from firms that fall into the same *proportionality level*. This is illustrated by the following example:
1. Firm A is a global bank with *relevant total assets* of £800bn, with substantial investment banking business, foreign exchange exposures and a complex business model seeking aggressive growth. It falls into *proportionality level one*.
  2. Firm B is a large mortgage and savings bank with *relevant total assets* of £100bn and a comparatively simple, conservative business model. It falls into *proportionality level one*.
  3. Firm C is a large building society, with *relevant total assets* of £25bn and a comparatively simple, conservative business model. It falls into *proportionality level two*.
  4. *Remuneration Principle 8* requires, amongst other things, a firm to risk-adjust performance measures to take account of all types of current and future risks (SYSC 19D.3.23R(1)(a)).

5. Clearly the processes necessary to identify such risks will need to be more sophisticated for Firm A than for Firm B, despite the fact that they fall into the same *proportionality level*. Indeed, the difference in the necessary sophistication is likely to be greater as between Firm A and Firm B than as between Firm B and Firm C.

### Disapplication of certain remuneration principles for firms in particular proportionality levels

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- 4.4 The *CRD* can be interpreted such that it may not be necessary for certain *firms* to apply certain *remuneration* principles at all.<sup>2</sup>
- 4.5 In our view, it will normally be appropriate for a *firm* in *proportionality level three* to disapply under the *Dual-regulated firms remuneration principles proportionality rule* one or more of the following *rules*:
  1. retained *shares* or other instruments (SYSC 19D.3.56R)
  2. deferral (SYSC 19D.3.59R)
  3. performance adjustment (SYSC 19D.3.61R – SYSC 19D.3.64R)
- 4.6 It may also be appropriate for:
  1. *proportionality level three UK designated investment firm that is a CRD full-scope firm* to disapply the specific ratio between fixed and variable components of total *remuneration* (SYSC 19D.3.48R (3)); and
  2. a UK designated investment firm that is a limited licence firm or a limited activity firm to disapply, under the *Dual-regulated firms remuneration principles proportionality rule*, the ratios between fixed and variable components of total remuneration (SYSC 19D.3.49R);

In both cases (1) and (2) above, if requested by the *FCA*, the *FCA* will expect the *firm's* senior management to be able to demonstrate why the *firm* believes it is reasonable to disapply it in the light of the *Dual-regulated firms remuneration principles proportionality rule*.

We are also of the opinion that such *firms* may 'take into account the specific features of their types of activities in applying the 'requirement on multi-year framework, in particular the accrual and ex- ante risk adjustment aspects of it.'<sup>3</sup>
- 4.7 However, *firms* should also note that some *remuneration* principles set specific numerical criteria (such as on the minimum period of deferral, the minimum portion to be deferred and the minimum portion to be issued in *shares*). The following *guidance* applies where such principles apply to *Dual-regulated firms Remuneration Code staff* and are not

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<sup>2</sup> *CRD* Article 92(2) provides that the principles should be applied 'in a manner and to the extent that is appropriate to their size, internal organisation and the nature, the scope and complexity of their activities'.

<sup>3</sup> As per the *FSA's* Policy Statement 10/20. See link [http://www.fsa.gov.uk/pubs/policy/ps10\\_20.pdf](http://www.fsa.gov.uk/pubs/policy/ps10_20.pdf)

capable of disapplication under the approach set out above. In such circumstances, we do not consider that the *Dual-regulated firms remuneration principles proportionality rule* permits a *firm* to apply lower numerical criteria. (For the avoidance of doubt, this *guidance* does not apply where a *firm* chooses to use deferral or issuance in shares more widely than required by SYSC 19D.3).

## 5 Part E : Guidance about part-year Dual regulated firms

### Dual-regulated firms Remuneration Code staff introduction

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- 5.1 SYSC 19D.3.35G provides *guidance* on when we do not generally consider it necessary for a *firm* to apply to certain *Dual-regulated firms Remuneration Code staff* certain *rules* relating to *remuneration* structures. This Part provides supplementary *guidance* on how certain *rules* on *remuneration* structures might normally be applied to *Dual-regulated firms Remuneration Code staff* who have, in relation to a given performance year, been *Dual-regulated firms Remuneration Code staff* for only part of the year
- 5.2 In giving this *guidance*, we have taken account of the *remuneration principles proportionality rule*.

### Part-year Dual regulated firms Remuneration Code staff for more than three months

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- 5.3 This paragraph applies where an individual (A) has, in relation to a given performance year, been *Dual-regulated firms Remuneration Code staff* for a period more than three months, but less than 12 months.
1. Sub-paragraphs (3) and (4) explain how the *guidance* in SYSC 19D.3.35G (as mentioned in the introduction to this Part) is to be applied in relation to A. Sub-paragraphs (5) and (6) provide that in certain circumstances it may be appropriate to apply certain *rules* to only a proportion of A's variable *remuneration*. Sub-paragraphs (7) to (9) provide examples;
    - a. In this paragraph:
    - b. 'relevant fraction' means the fraction derived by dividing the number of days in the given performance year for which A has been *Dual-regulated firms Remuneration Code staff* by the number of days in the year; and
    - c. 'qualifying fixed *remuneration*' means A's annual fixed *remuneration* in A's capacity as *Dual-regulated firms Remuneration Code staff* multiplied by the relevant fraction.
    - d. 'qualifying variable *remuneration*' means:
      - e. in the case where A was an *employee* of the *firm* for the whole of the given performance year, A's variable *remuneration* in relation to the performance year multiplied by the relevant fraction;

- f. in the case where A was only ever employed in the given performance year as *Dual-regulated firms Remuneration Code staff*, A's actual variable remuneration;
- g. 'total qualifying remuneration' means qualifying fixed remuneration added to qualifying variable remuneration;
- h. 'threshold amount' means £500,000 multiplied by the relevant fraction.
- i. We do not generally consider it necessary for a firm to apply the rules referred to in (4) where, in relation to A, the following conditions are satisfied:
- j. Condition 1 is that A's qualifying variable remuneration is no more than 33% of total qualifying remuneration, and
- k. Condition 2 is that A's total qualifying remuneration is no more than the threshold amount.
- l. The rules referred to in (3) are those relating to:
  - m. guaranteed variable remuneration (SYSC 19D.3.44R)
  - n. retained shares or other instruments (SYSC 19D.3.56R),
  - o. deferral (SYSC 19D.3.59R), and
  - p. performance adjustment (SYSC 19D.3.61R).
- q. Sub-paragraph (6) applies where the conditions in (3) are not satisfied and the firm should apply the rules referred to in (6).
- r. Where this sub-paragraph applies, we generally consider that it would be appropriate to apply the following rules to qualifying variable remuneration only:
  - s. retained shares or other instruments (SYSC 19D.3.55R),
  - t. deferral (SYSC 19D.3.58R), and
  - u. performance adjustment (SYSC 19D.3.60R).
- v. The examples in (8) and (9) illustrate this guidance. The performance year in each case is 1 January to 31 December.
- w. Example 1
  - x. A1 is an employee of the firm through the performance year and is promoted to a *Dual-regulated firms Remuneration Code staff* role with effect from 1 September. A1's previous fixed remuneration was £150,000. In his *Dual-regulated firms Remuneration Code staff* role A1's fixed remuneration increases to £250,000. For the performance year, A1 is awarded variable remuneration of £130,000.
  - y. The relevant fraction is 122/365. A1's qualifying fixed remuneration is £83,560 (£250,000 multiplied by 122/365). A1's qualifying variable remuneration is £43,452 (£130,000 multiplied by 122/365). A1's total

qualifying *remuneration* is £ 127,012. The threshold amount is £167,120 (£500,000 multiplied by 122/365).

z. A1's total qualifying *remuneration* is below the threshold amount, so condition 2 of (3) is satisfied. But A1's qualifying *remuneration* is more than 33% of A1's total qualifying *remuneration*, and condition 1 of (3) is not satisfied.

aa. Example 2

bb. A2 joins the *firm* as a *Dual-regulated firms Remuneration Code staff* member with effect from 1 July. A2's annual fixed *remuneration* is £450,000. For the period of 1 June to 31 December, A2 is awarded variable *remuneration* of £50,000.

cc. The relevant fraction is 184/365. A2's qualifying fixed *remuneration* is £ 226,850 (£450,000 multiplied by 184/365). A2's qualifying variable *remuneration* is £50,000 (the actual amount). A2's total qualifying *remuneration* is £ 276,850. The threshold amount is £252,050 (£500,000 multiplied by 184/365).

dd. A2's qualifying variable *remuneration* is not more than 33% of A2's total qualifying *remuneration*, and condition 1 of (3) is satisfied. But A2's total qualifying *remuneration* is more than the threshold amount, so condition 2 of (3) is not satisfied.

ee. The rule on guaranteed variable *remuneration* applies to A2. In addition, the rules on retained shares and other instruments, deferral and performance adjustment must be applied to A2's qualifying *remuneration* of £50,000.

### **Certain part-year Dual regulated firms Remuneration Code staff for three months or less**

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5.4 Paragraphs 5.5 and 5.6 apply where:

1. an individual (B) has, in relation to a given performance year, been *Dual-regulated firms Remuneration Code staff* for a period of three months or less, and
  - a. an exceptional or irregular payment (such as a sign-on award) has not been or is not to be made in relation to B's appointment as *Dual-regulated firms Remuneration Code staff*.

5.5 Where this paragraph applies, we do not generally consider it necessary to apply the following rules in relation to B for the performance year in question:

- b. retained *shares* or other instruments (SYSC 19D.2.55R);
- c. deferral (SYSC 19D.2.59R); and
- d. performance adjustment (SYSC 19D.2.60R).

- 5.6 Where this paragraph applies, the guidance in paragraph 5.3(2), 5.3 (3) and 5.3 (4)(a) should be applied for the purposes of determining whether or not it will generally be necessary to apply the rule on guaranteed variable *remuneration* to B (substituting in that paragraph, for references to 'A', references to 'B').

### **Part-year Dual regulated firms Remuneration Code staff for three months or less, but where exceptional etc. payments made**

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- 5.7 Paragraph 5.8 applies where an individual (C) has, in relation to a given performance year, been *Dual-regulated firms Remuneration Code staff* for a period of three months or less, but where an exceptional or irregular payment (such as a sign-on award) has or is to be made in relation to C's appointment.
- 5.8 The guidance in paragraph 5.3 applied in relation to C (substituting in that paragraph for references to 'A', references to 'C'). The amount of exceptional or irregular payment is to be added to C's qualifying variable *remuneration* without pro rating.

## 6 Annex 1 : Supplemental guidance on dividing firms into proportionality levels

### Groups with more than one Dual-regulated Remuneration Code staff firm: examples

- 6.1 The following non-exhaustive examples illustrate the operation of the guidance provided in paragraph 3.5 of Part C. (It should be borne in mind that in each case individual *guidance* could vary the outcome provided by the operation of the guidance provided in that paragraph.)
- 6.2 Example 1.
1. Firm A is the *parent undertaking* of Firm B.
  2. Firm A is a *UK bank* that had *relevant total assets* of £800bn on its last accounting reference date. Firm B is a *limited activity firm*
  3. On the assumption that they were solo Dual-regulated Remuneration Code firms, Firm A falls into proportionality level one and Firm B falls into proportionality level three.
  4. As a result of the guidance at paragraph 23 of Part C, both Firms A and B fall into *proportionality level one*.
- 6.3 Example 2
1. Firm C is the *parent undertaking* of Firm D.
  2. Firm C is a *limited activity firm* and Firm D is a *UK bank* that had *relevant total assets* of £100bn on its last accounting reference date.
  3. On the assumption that they were *solo Dual-regulated Remuneration Code firms*, Firm C falls into *proportionality level three* and Firm D falls into *proportionality level one*
  4. As a result of the *guidance* at paragraph 3.5 of Part C, both Firms C and D fall into *proportionality level one*.
- 6.4 Example 3
1. Company E is the *parent undertaking* of Firms F and G and Company H. Company H is the *parent undertaking* of Firm I. Firm J is a member of the *group* because of an *Article 12(1) consolidation relationship*.
  2. The *firms* and companies have the following characteristics:
    - a. Neither Companies E nor H are Dual-regulated Remuneration Code firms;

- b. Firm F is an *UK designated investment firm* that is a *CRD full-scope firm* and that had *relevant total assets* of £40bn on its last accounting reference date;
  - c. Firms G and J are *limited activity firms*; and
  - d. Firm I is a *UK bank* that had *relevant total assets* of £10bn on its last accounting reference date.
3. On the assumption that they were *solo Dual-regulated Remuneration Code firms*:
  - a. Firm F falls into *proportionality level two*;
  - b. Firms G and J fall into *proportionality level three*; and
  - c. Firm I falls into *proportionality level three*.
4. As a result of the *guidance* at paragraph 3.5 of Part C, Firms F, G, I and J all fall into *proportionality level two*.

### Role of individual guidance

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- 6.5 Individual *guidance* may vary the *proportionality level* into which a *firm* would fall under the general *guidance* set out in Part C and supplemented by this Annex. In consequence, the definitions and thresholds provided in Part C do not provide an immutable classification.
- 6.6 The following provide non-exhaustive high level examples of where we might consider providing individual *guidance* to vary a *proportionality level*:
  1. Where a *firm* was just below the threshold for a particular *proportionality level* (as determined in accordance with Part C), but where features of its business model or growth strategy suggest that it should fall within the higher *proportionality level*.
  2. Where a *group of firms* contained several *firms* falling into a common *proportionality level*, but where the aggregate prudential risk posed by the *group* suggested that a higher *proportionality level* was more appropriate.
  3. Where a *firm* falls into a higher *proportionality level* as a result of the *guidance* at paragraph 23 of Part C than would be the case on the assumption that it was a *solo Dual-regulated Remuneration Code firm*, depending on the particular circumstances of the case.