



BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

Consultation Paper | CP33/16

The PRA's expectations on remuneration

September 2016

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Responses are requested by Monday 28 November 2016.

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1 Overview

1.1 In this consultation paper (CP) the Prudential Regulation Authority (PRA) proposes to create a unified supervisory statement (SS) on remuneration. The single SS will draw together the PRA's existing supervisory statements on proportionality, the application of malus and other elements of remuneration in relation to the Remuneration Part of the PRA Rulebook ('the Remuneration Part'), and set out additional expectations of firms.

1.2 This CP is relevant to all Capital Requirements Regulation (575/2013) (CRR) firms and third-country CRR firms in relation to their activities carried on from an establishment in the United Kingdom.

Background

1.3 The Remuneration Part implements those provisions of the Capital Requirements Directive (CRD)¹ which relate to remuneration. The European Banking Authority (EBA) published Guidelines² on Sound Remuneration Policies ('the EBA Guidelines') under Articles 74(3) and 75(2) of CRD and disclosures under Article 450 CRR on 21 December 2015. All firms must comply with all applicable aspects of the EBA Guidelines and all existing domestic requirements.

1.4 To provide greater clarity for firms, the PRA also proposes to consolidate existing expectations currently in:

- Legacy Supervisory Statement LSS 8/13 'Remuneration standards : the application of proportionality';³
- SS2/13 'PRA expectations regarding the application of malus to variable remuneration';⁴ and
- SS27/15 'Remuneration'.⁵

Purpose

1.5 The purpose of this draft statement is to clarify PRA expectations on how firms should comply with the requirements of the Remuneration Part. The statement should be read together with the rules contained in the Remuneration Part and the EBA Guidelines.

1.6 In respect of the EBA Guidelines, provisions have only been carried over to the unified SS to the extent necessary. Accordingly there are areas of previous statements that have not been carried over where either further comment is not required or the position has been updated by the EBA Guidelines.

The key proposals

1.7 The policy proposals included in this CP are to:

1 Directive 2013/36/EU (<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:176:0338:0436:En:PDF>).

2 <https://www.eba.europa.eu/documents/10180/1314839/EBA-GL-2015-22+Guidelines+on+Sound+Remuneration+Policies.pdf/1b0f3f99-f913-461a-b3e9-fa0064b1946b>.

3 June 2015; www.bankofengland.co.uk/pr/Pages/publications/ss/2015/lss813update.aspx.

4 June 2013; www.bankofengland.co.uk/pr/Pages/publications/ss/2015/ss213update.aspx.

5 June 2015; www.bankofengland.co.uk/pr/Pages/publications/ss/2015/ss2715.aspx.

- (i) consolidate the three existing remuneration statements;
- (ii) confirm PRA expectations regarding the manner in which firms adhere to requirements set out in the EBA Guidelines; and
- (iii) provide additional guidance in the draft SS on:
 - a. The EBA Guidelines (Chapter 1) - Firms must comply with all aspects of the EBA Guidelines with the exception of the requirement that the fixed to variable ratio of total remuneration ('the bonus cap') should apply to all firms. The bonus cap will continue to be applied only to proportionality level one and two firms.
 - b. Material risk takers (MRTs) (Chapter 3) - All firms are required to identify MRTs regardless of their proportionality level and firms should assess the risks that individuals can pose to the risk profile of the firm beyond those in Commission Delegated Regulation (EU) No 604/2014 and identify them accordingly. The PRA expects firms to identify all traders with the ability to affect materially the firm's risk profile and to provide more detailed evidence to justify exclusion as compared to other categories of staff. Requests for exclusion of staff in asset management roles will be determined by the ability of the individual to materially impact the risk profile of the firm.
 - c. The application of malus and clawback to variable remuneration (Chapter 4) - Firms should develop and maintain adequate procedures for deciding and clearly documenting cases that could lead to in-year adjustments. The use of malus and clawback, and individual and collective adjustments, should be clearly communicated to affected staff.
 - d. Remuneration committees (Chapter 5) - The PRA expects remuneration committees to fulfil the roles and functions required under Remuneration 7.4 and the EBA Guidelines. Firms should be aware that the PRA will also be releasing an Occasional Consultation Paper noting an amendment by Administrative Instrument to rule 7.4 of the Remuneration Part so that it applies to 'firms' (rather than 'CRR firms' under the current wording). The amendment aligns this rule with the position that applies to dual-regulated firms under SYSC 19D3.12R of the FCA Handbook.
 - e. Long Term Incentive Plans (LTIPs) (Chapter 5) - Firms should use a balance of financial and non-financial metrics for LTIPs; quantitative criteria should be risk adjusted and used only as part of a balanced scorecard; and discretionary approaches should be applied with appropriate controls, and be well-documented and transparent.
 - f. Remuneration structures including:
 - i. guaranteed variable remuneration (Chapter 5) - guaranteed variable remuneration should continue to be subject to the general rules for variable remuneration, including: deferral; malus and clawback; and the calculation of the bonus cap, including where the award is made in the context of hiring new staff; and
 - ii. buy-outs (Chapter 5) – 'determination' by the previous employer regarding the application of malus or clawback refers to the final determination by the approving body or committee of the previous firm. The new employer should act as an executor in relation to the determination and, while all waiver

applications will be considered on the basis of the facts of the individual case, in most cases the statutory tests for the modification or waiver of rules set out under section 138A(4) FSMA are unlikely to be met.

1.8 The expectations on buy-outs should be read alongside PRA Policy Statement 26/16 'Buy-outs of variable remuneration' published on 28 September 2016.¹ The PS provides feedback on responses to CP2/16 'Buy-outs of variable remuneration'² and includes final rules on buy-outs amending the Remuneration Part.

Implementation

1.9 All firms are required to comply with the EBA Guidelines from 1 January 2017. Firms should note that the PRA has notified the EBA of compliance with all aspects of the EBA Guidelines except the provision requiring that the bonus cap must be applied to all firms. In this respect the PRA's existing proportionality approach, as carried over in the draft unified SS, will continue to apply.

1.10 Firms remain subject to expectations in the existing statements on 'Remuneration standards: the application of proportionality' (LSS 8/13); 'PRA expectations regarding the application of malus to variable remuneration' (SS2/13) and 'Remuneration' (SS27/15) until the final statement is published.

Responses and next steps

1.11 This consultation closes on Monday 28 November 2016. The PRA invites feedback on the proposals set out in this consultation. Please address any comments or enquiries to CP33_16@bankofengland.co.uk.

2 The PRA's statutory obligations

Cost benefit analysis

2.1 The proposals in the draft SS clarify existing rules and guidance. The PRA does not expect there to be an additional impact on firms and therefore a full cost benefit analysis has not been prepared.

2.2 The proposed SS also provides additional guidance on the implementation of the Remuneration Part. The PRA considers that this additional guidance would not entail significant cost benefit implications. The draft SS sets out existing PRA requirements regarding the evidence which is required when assessing applications for exclusion from MRT identification. Similarly, firms are already required to use a balanced and risk-adjusted scorecard to determine variable remuneration. As such, any incremental costs associated with the proposals regarding MRT identification and the use of a balance of financial and non-financial metrics for LTIPs are likely to be minimal.

Impact on competition

2.3 When discharging its general function the PRA has, as a secondary objective, a duty to facilitate effective competition in the markets for services provided by PRA-authorized persons in carrying on regulated activities.

¹ www.bankofengland.co.uk/pra/Pages/publications/ps/2016/ps2616.aspx.

² January 2016; www.bankofengland.co.uk/pra/Pages/publications/cp/2016/cp216.aspx.

2.4 This SS would not affect competition significantly. The clarification of PRA expectations of firms in relation to remuneration requirements under the SS could help to ensure that the remuneration requirements are being applied consistently across all firms.

Compatibility with the PRA's objectives

2.5 The PRA is required to act in a way that advances its general objective to promote the safety and soundness of the firms it regulates. The draft SS supports this objective by setting out expectations on how firms should comply with the rules in the Remuneration Part. The SS should promote sound risk management, help to eliminate incentives towards excessive risk taking and ensure a greater alignment between risk and reward.

2.6 When discharging its general function in a way that advances its primary objectives, the PRA has, as a secondary objective, a duty to facilitate effective competition in the markets for services provided by PRA-authorized persons. The PRA does not anticipate that there will be an impact on competition as a result of the draft statement but will consider any potential impacts identified by respondents to this consultation.

Regulatory principles

2.7 In developing this SS, the PRA has had regard to the regulatory principles as set out in the Financial Services and Markets Act 2000 (FSMA).

2.8 This draft SS is compatible with the regulatory principles as the PRA sets out transparent and proportionate expectations on firms in relation to the Remuneration Part. Setting out these expectations also uses the PRA's resources efficiently.

Impact on mutuals

2.9 In the PRA's opinion, the impact of the proposed rule changes on mutuals is expected to be no different from the impact on other firms.

Equality and diversity

2.10 The PRA has performed an assessment of the policy proposals and does not consider that the proposals give rise to equality and diversity implications.

Appendix 1 Draft supervisory statement 'Remuneration'

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1 Introduction

1.1 This supervisory statement (SS) is relevant to all firms and designated investment firms regulated by the Prudential Regulation Authority (PRA) which fall within the scope of the Remuneration Part of the PRA Rulebook ('the Remuneration Part'). The purpose of this supervisory statement is to set out the PRA's expectations on how firms should comply with the requirements of the Remuneration Part, enabling firms to make judgements which advance the objectives of the PRA. It replaces the following remuneration policy documents:

- Legacy Supervisory Statement LSS 8/13 'Remuneration standards: the application of proportionality';¹
- SS2/13 'PRA expectations regarding the application of malus to variable remuneration';² and
- SS27/15 'Remuneration'.³

1.2 This statement is intended to be read together with the rules contained in the Remuneration Part.

1.3 The Remuneration Part aims to ensure that firms adopt remuneration policies that are consistent with and promote sound risk management, eliminating incentives towards excessive risk-taking, and aligning employee incentives with the longer-term interests of the business, while taking account of the timeframe over which financial risks crystallise. It covers all aspects of remuneration that could have a bearing on effective risk management including salaries, bonuses, long-term incentive plans, options, hiring bonuses, buy-outs, 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.

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

- proportionality;
- material risk takers (MRTs);
- application of malus and clawback to variable remuneration;
- governing body/remuneration committees;
- risk management and control functions;
- remuneration and capital;
- risk adjustment (including long-term incentive plans);

¹ June 2015; www.bankofengland.co.uk/pr/Pages/publications/ss/2015/lss813update.aspx.

² June 2013; www.bankofengland.co.uk/pr/Pages/publications/ss/2015/ss213update.aspx.

³ June 2015; www.bankofengland.co.uk/pr/Pages/publications/ss/2015/ss2715.aspx.

- personal investment strategies;
- remuneration structures (including guaranteed variable remuneration, buy-outs and retention awards);
- deferral; and
- breaches of the remuneration rules.

European Banking Authority (EBA) Guidelines

1.5 The Remuneration Part¹ implements those provisions of the Capital Requirements Directive (CRD)² which relate to remuneration.

1.6 The EBA published Guidelines on Sound Remuneration Policies (the EBA Guidelines) under Articles 74(3) and 75(2) of the CRD and disclosures under Article 450 of the Capital Requirements Regulation (CRR)³ on 21 December 2015.

1.7 The PRA has notified the EBA of compliance with all aspects of the Guidelines, except for the provision that the limit on awarding variable remuneration to 100% of fixed remuneration, or 200% with shareholder approval ('the bonus cap'), must be applied to all firms subject to the CRD.

1.8 Remuneration proportionality level one and two firms must continue to apply the bonus cap. In parallel, the PRA and Financial Conduct Authority (FCA) will retain the current approach of requiring proportionality level three firms to set an appropriate ratio between fixed and variable remuneration for their business.

1.9 All firms must comply with all other aspects of the Guidelines, and all existing domestic requirements. In the following chapters, the PRA provides additional clarification of its expectations regarding a number of specific remuneration requirements.

¹ Please note that all Remuneration Part references hereafter relate to the PRA Rulebook, unless stated otherwise.
² Directive 2013/36/EU.
³ EU Regulation 575/2013.

2 Proportionality

2.1 This chapter provides guidance on how firms should apply the proportionality rule set out in Remuneration 5.1.¹

2.2 In line with CRD Article 92(2), Remuneration 5.1 requires a relevant firm, when establishing and applying remuneration policies for MRTs, to comply with the Remuneration Part in a way that is appropriate to its size, internal organisation and the nature, scope and the complexity of its activities.

Table A Glossary of terms defined in this statement

Defined expression	Definition
Group	Has the meaning given in the part-specific glossary of the Internal Capital Adequacy Assessment Part of the PRA Rulebook.
Proportionality level	The division of firms into three categories based on relevant total assets: proportionality level one; proportionality level two; and proportionality level three.
Relevant total assets	Means: (i) for CRR firms, the average of the firm's total assets on the firm's last three relevant dates; and (ii) for third-country CRR 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.
Relevant date	Means: (i) for CRR firms, an accounting reference date; and (ii) for third-country CRR firms, 31 December.
Remuneration Part solo firm	A CRR firm which is not part of a group containing one or more further firms subject to the Remuneration Part or to a remuneration code in the FCA Handbook.

Proportionality levels

2.3 Remuneration 1.1 provides that the Remuneration Part applies to a CRR firm and a third country CRR firm (in the case of a third country CRR firm, in relation to the activities carried on from an establishment in the United Kingdom).² The guidance set out below applies to those Remuneration Part solo firms.

2.4 The guidance given in this chapter provides for the division of *firms* to which the Remuneration Part applies into three categories based on relevant total assets:

(iv) proportionality level one;

(v) proportionality level two; and

(vi) proportionality level three.

¹ www.prarulebook.co.uk/rulebook/Content/Chapter/292171/30-08-2016.

² www.prarulebook.co.uk/rulebook/Content/Part/292166/.

As set out in table B below, proportionality level one is the highest level and proportionality level three is the lowest.

Table B Proportionality levels: Remuneration Part solo firms

Proportionality Level	Type of firm (a)	Relevant total assets on relevant date of firm (where applicable)
Proportionality level one	Bank, building society or full scope investment firm.	Exceeding £50 billion
Proportionality level two	Bank, building society or full scope investment firm.	Exceeding £15 billion but not exceeding £50 billion
Proportionality level three	Bank or building society.	Not exceeding £15 billion
	Full scope investment firm.	Not exceeding £15 billion
	Limited licence investment firm or limited activity investment firm.	Not applicable
The 'types of firms' used in this table are standard descriptors of the firms that fall into each proportionality level, and are not intended to set the scope of this guidance.		

2.5 The purpose of the proportionality levels in relation to Remuneration 5.1 is to provide the following:

- (i) a framework for the PRA's supervisory approach, and a broad indication of the PRA's expectations; and
- (ii) guidance on which remuneration rules may normally be disappplied under Remuneration 5.1.

Process for dividing firms into proportionality levels

2.6 In order to determine the proportionality level into which a firm falls, a firm must establish whether it is part of a group which contains one or more other firms subject to the Remuneration Part of the PRA Rulebook or a Remuneration Part solo firm.

Groups with more than one firm subject to the Remuneration Part

2.7 If the firm is part of a group containing one or more other firms also subject to the Remuneration Part then each firm within the group must determine which proportionality level that firm would fall into on the assumption that it was a Remuneration Part solo firm.

2.8 Where each firm subject to the Remuneration Part falls into the same proportionality level on the assumption that it was a Remuneration Part solo firm, each firm will remain within that proportionality level.

2.9 Where firms, within a group, fall into different proportionality levels on the assumption that they were Remuneration Part solo firms, all firms in the group are reallocated to the highest proportionality level into which a firm in the same group falls. This means those firms are subject to the same remuneration rules of the highest proportionality level firm.

2.10 A firm may choose to apply for individual guidance to vary the proportionality level of a firm within a group. The next section provides further detail around this.

2.11 Table C provides non-exhaustive examples of how groups with more than one firm subject to the Remuneration Part or Remuneration Code SYSC19A or Remuneration Code SYSC19D of the FCA Handbook, should apply the proportionality levels.

Table C Groups with more than one firm subject to the Remuneration Part or Remuneration Code SYSC19A or Remuneration Code SYSC19D of the FCA Handbook

Example 1	<p>(1) Firm A is the parent undertaking of Firm B.</p> <p>(2) Firm A is a UK bank that had relevant total assets of £800 billion on its last accounting reference date. Firm B is a limited activity firm.</p> <p>(3) On the assumption that they were Remuneration Part solo firms, Firm A falls into proportionality level one and Firm B falls into proportionality level three.</p> <p>(4) As a result of the guidance at paragraph 2.9, both Firms A and B fall into proportionality level one.</p>
Example 2	<p>(1) Firm C is the parent undertaking of Firm D.</p> <p>(2) Firm C is a limited activity FCA-regulated IFPRU investment firm and Firm D is a UK bank that had relevant total assets of £100 billion on its last accounting reference date.</p> <p>(3) On the assumption that they were Remuneration Part solo firms, Firm C falls into proportionality level three and Firm D falls into proportionality level one.</p> <p>(4) As a result of the guidance at paragraph 2.9, both Firms C and D fall into proportionality level one.</p>
Example 3	<p>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.</p> <p>(2) The firms and companies have the following characteristics:</p> <ul style="list-style-type: none"> ○ neither Companies E nor H are firms subject to the Remuneration Part; ○ firm F is a designated investment firm that had relevant total assets of £40 billion on its last accounting reference date; ○ firms G and J are limited activity FCA-regulated IFPRU investment firms; and ○ firm I is a UK bank that had relevant total assets of £10 billion on its last accounting reference date. <p>(3) On the assumption that they were Remuneration Part solo firms -</p> <ul style="list-style-type: none"> ○ firm F falls into proportionality level two; ○ firms G and J fall into proportionality level three; and ○ firm I falls into proportionality level three. <p>(4) As a result of the guidance at paragraph 2.9, firms F, G, I and J all fall into proportionality level two.</p>

2.12 The limit confining relevant total assets to those that cover the activities of the branch operation in the United Kingdom is taken from Regulatory Reporting 2.4¹ which relates to a reporting requirement in relation to non-EEA banks (among others). The PRA considers that a firm that needs to ascertain its relevant total assets should comply with the requirements of the CRR in respect of valuation of those assets.

Role of individual guidance

2.13 Individual guidance may vary the proportionality level into which a firm would fall under the general guidance set out in paragraphs 2.3-2.12. In consequence, the definitions and thresholds provided in those sections do not provide an immutable classification.

2.14 The following provides non-exhaustive high level examples of where the PRA might consider providing individual guidance to vary a proportionality level:

- (i) a firm was just below the threshold for a particular proportionality level (as determined in accordance with paragraphs 2.3-2.12), but the features of its business model or growth strategy suggest that it should fall within the higher proportionality level;

- (ii) a group contained several firms falling into a common proportionality level, but the aggregate prudential risk posed by the group suggested that a higher proportionality level was more appropriate; or
- (iii) a firm falls into a higher proportionality level as a result of the guidance at paragraphs 2.7-2.12 than would be the case on the assumption that it was a Remuneration Part solo firm. This would depend on the particular circumstances of the case.

Guidance to firms in particular proportionality levels

Disapplication of remuneration rules at firm level

2.15 The PRA does not consider that Remuneration 5.1 allows firms to apply lower numerical criteria to MRTs. Firms may use higher numerical criteria in relation to the period of deferral, minimum portion to be deferred and the minimum portion to be issued in shares if they choose. 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 the Remuneration Part.

2.16 It may be appropriate for a firm in proportionality level three to disapply under Remuneration 5.1 the following rules:

- (a) retained shares or other instruments (Remuneration 15.15);
- (b) deferral (Remuneration 15.17); and
- (c) performance adjustment (Remuneration 15.20-15.23) including those rules relating to clawback.

Ratio between fixed and variable components of total remuneration

2.17 Remuneration 15.9 sets out that firms must set an appropriate ratio between the fixed and variable components of total remuneration. It also states firms must ensure that the fixed and variable components are appropriately balanced with the level of the variable remuneration not exceeding 100% of the fixed component.

2.18 The PRA takes the view that 15.9 (3) of the Remuneration Part applies to proportionality level one and two firms only.

2.19 Proportionality level three firms are required to maintain an appropriate balance between fixed and variable remuneration.

Disapplication of remuneration rules at an individual level

2.20 The PRA does not expect firms to apply the rules Remuneration 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 (including one who is an MRT), 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.

2.21 In line with Remuneration 16.7, the voiding provisions under Remuneration 16.9-16.13 may also be disapplied by individuals satisfying the above conditions.

Remuneration committees

2.22 Remuneration 7.4 (Governance) provides that a firm (a CRR firm and third-country CRR 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.

2.23 The following table provides guidance on when the PRA considers it would be appropriate for a remuneration committee to be established under Remuneration 7.4, based on the proportionality level into which the firm falls. Chapter 5 of this supervisory statement contains additional guidance on remuneration committees.

Table D Guidance on whether a remuneration committee is required

Proportionality level	Remuneration 7.4 remuneration committee
Proportionality level one	A remuneration committee should be established.
Proportionality level two	A remuneration committee should be established.
Proportionality level three	It would be desirable for such a remuneration committee to be established, and the PRA would normally expect larger proportionality level three firms to do so. The PRA accepts that it may be appropriate for the governing body of the firm to act as the remuneration committee.

Remuneration disclosures (under Article 450 CRR)

Requirement to make remuneration disclosures

2.24 Article 450 CRR requires certain firms that are subject to the Remuneration Part to disclose a series of qualitative and quantitative information relating to remuneration. Table E sets out these requirements.

2.25 Article 450 CRR only applies to CRR firms directly.

Remuneration disclosures and proportionality

2.26 Two proportionality tests apply in relation to the requirement to make disclosures under Article 450 CRR in relation to remuneration:

- (i) Under Article 450(2) CRR, CRR firms subject to the Remuneration Part that are significant in terms of their size, internal organisation and the nature, scope and the complexity of their activities must also disclose the quantitative information referred to in Article 450(1) CRR at the level of their management body.
- (ii) Under Article 450(2) CRR, CRR firms subject to the Remuneration Part must comply with the requirements set out in Article 450(1) CRR in a manner that is appropriate to their size, internal organisation and the nature, scope and complexity of their activities.

2.27 The PRA considers that it is appropriate to give guidance on these proportionality tests by reference to the proportionality levels determined in accordance with paragraphs 2.4, and 2.7-2.11 of this chapter.

2.28 However, as the disclosure requirement applies only to CRR firms, when applying the guidance in paragraphs 2.7-2.11, only firms that are subject to the Remuneration Part and which are CRR firms should be taken into account.

2.29 In relation to the proportionality test referred to in paragraph 2.26(i) the PRA considers that a firm should be regarded as 'significant' if it falls into proportionality level one.

2.30 In relation to the proportionality test set referred to in paragraph 2.26(ii), the following table sets out the categories of information that the PRA considers firms in different proportionality levels should disclose.

Table E: Disclosure requirements by proportionality level

	Proportionality level		
	One	Two	Three
Art 450(1)(a) CRR ('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').	✓	✓	✓
Art 450(1)(b) CRR ('information on link between pay and performance').	✓	✓	✓
Art 450(1)(c) CRR ('the most important design characteristics of the remuneration system, including, information on the criteria used for performance measurement and risk adjustment, deferral policy and vesting criteria').	✓	✓	X
Art 450(1)(d) CRR ('the ratios between fixed and variable remuneration set in accordance with Article 94(1)(g) of the CRD').	✓	✓	X
Art 450(1)(e) CRR ('information on the performance criteria on which the entitlement to shares, options or variable components of remuneration is based').	✓	X	X
Art 450(1)(f) CRR ('the main parameters and rationale for any variable component scheme and any other non-cash benefits').	✓	X	X
Art 450(1)(g) CRR ('aggregate quantitative information on remuneration, broken down by business area').	✓	✓	✓
Art 450(1)(h) CRR ('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...').	✓	✓	✓
...indicating the following:			
Art 450 (1)(h)(i) CRR ('amounts of remuneration for the financial year, split into fixed and variable remuneration, and the number of beneficiaries').	✓	✓	X
Art 450 (1)(h)(ii) CRR ('amounts and forms of variable remuneration, split into cash, shares and share-linked instruments and other').	✓	X	X
Art 450 (1)(h)(iii) CRR ('amounts of outstanding deferred remuneration, split into vested and unvested portions').	✓	X	X
Art 450 (1)(h)(iv) CRR ('the amounts of deferred remuneration awarded during the financial year, paid out and reduced through performance adjustments').	✓	X	X
Art 450 (1)(h)(v) CRR ('new sign-on and severance payments made during the financial year, and the number of beneficiaries of such payments').	✓	X	X
Art 450 (1)(h)(vi) CRR ('the amounts of severance payments awarded during the financial year, number of beneficiaries, and highest such award to a single person').	✓	X	X
Art 450 (1)(i) CRR ('the number of individuals being remunerated €1 million or more per financial year, for remuneration') between €1 million and €5 million broken down into pay bands of €500 000 and for remuneration of €5 million and above broken down into pay bands of €1 million').	✓	X	X

3 Material risk takers (MRTs)

3.1 Commission Delegated Regulation No 604/2014 sets out regulatory technical standards (RTS) to identify categories of staff whose professional activities have a material impact on the risk profile of firms, also known as material risk takers (MRTs). The RTS came into effect on 26 June 2014.

3.2 All firms are required to identify MRTs in accordance with the RTS, regardless of their size or remuneration proportionality level as set out in Chapter 2 of this supervisory statement. This includes UK-headquartered firms, subsidiaries and branches of non-EEA firms.

3.3 Chapter 3 of the Remuneration Part identifies the criteria for determining who is an MRT.

3.4 Individuals in firms not subject to the Remuneration Part should be included as MRTs if they pose risk to the CRR consolidation group. All remuneration requirements include the limitation on the ratio between fixed and variable remuneration unless they can apply the criteria outlined in paragraph 2.20.

3.5 The PRA expects remuneration proportionality level one firms to provide a list of MRTs on an annual basis to the PRA. Proportionality level two and three firms are expected to keep a list of current MRTs and provide that list to the PRA if requested. All firms, where necessary, should submit applications for exclusion from identification in accordance with the RTS annually.

3.6 The full requirements of the Remuneration rules apply to MRTs at proportionality level one and two firms, except where the variable remuneration of the MRT meets both the conditions set out in paragraph 2.20.

3.7 Where a third-country CRR firm wishes to rely on Remuneration 3.2(1) to deem an employee not to be an MRT, contrary to Remuneration 3.2(1)(c), if that employee earns more than €750,000 the firm should apply for a waiver of the Remuneration rules in respect of that person under section 138A of the Financial Services Markets Act (FSMA).

Types of roles identified

3.8 The RTS sets out minimum criteria for the identification of MRTs falling within the scope of Article 92(2) CRD. The PRA takes the view that all staff members carrying out activities which enable them to expose the firm to a material level of risk should be identified as MRTs, even where these staff members do not fall within any of the mandatory criteria established under the RTS.

3.9 The PRA expects all firms to apply the RTS as a minimum standard and firms should exercise discretion to identify all relevant staff as MRTs where necessary. The PRA considers it would be appropriate for firms to assess risks that individuals may pose to the risk profile of the firm beyond those set out under the RTS. As such, PRA expectations of the types of roles that should be identified as MRTs may evolve over time.

Part-year material risk takers (MRT)

3.10 This section provides supplementary guidance on how certain rules on remuneration structures might normally be applied to an MRT who has, in relation to a given performance year, been an MRT for only part of the year.

3.11 In giving this guidance, the PRA has taken account of Remuneration 5.1.

Part-year material risk takers for more than three months

3.12 For individuals who have been an MRT for a period of more than three months, but less than twelve months in a given performance year, it may be appropriate to apply the rules below to only a proportion of the individual's variable remuneration. The rules are:

- (a) guaranteed variable remuneration (Remuneration 15.7);
- (b) retained shares or other instruments (Remuneration 15.15);
- (c) deferral (Remuneration 15.17); and
- (d) performance adjustment (Remuneration 15.20-15.23).

3.13 When an individual moves from a role without MRT status to an MRT role during the performance period, providing that MRT role is more than three months of the performance year, the amount of variable remuneration awarded to the individual in that performance period is subject to the rules in paragraph 3.12. The amounts of fixed and variable remuneration awarded should also be apportioned accordingly to reflect the period of time held in the MRT role and the rules applied to that apportioned amount.

3.14 When a new hire is recruited into an MRT role during the performance period, providing that the MRT role is more than three months of the performance year, all of the variable remuneration awarded to the individual in that performance period is subject to the rules above in paragraph 3.12.

3.15 For new hire MRTs, it is permissible for the fixed amount of remuneration to be determined by reference to an annualised rate of fixed remuneration. This should be calculated as if they had been remunerated for the period prior to joining the firm at the same rate of fixed remuneration received on joining the firm. This concession can be applied to new joiner MRTs in receipt of a guaranteed variable remuneration provided the guaranteed variable remuneration award is included within the variable remuneration component.

3.16 The PRA does not consider it necessary for the rules specified in paragraph 3.12 to be applied when both of the criteria outlined in Chapter 2, paragraph 2.20 have been met.

3.17 Table F provides some examples of how paragraphs 3.13 and 3.14 should be applied.

Table F - Part-year material risk-takers for more than three months – examples to illustrate guidance in paragraphs 3.13 and 3.14.

Example		
1	Existing employee - mid-year move to an MRT role	<p>(1) Individual A is an employee of the firm and moves to an MRT role with effect from 1 September, 122 days out of 365 are spent in an MRT role.</p> <p>(2) A receives fixed remuneration of £150,000 from 1 January to 31 August increasing to £250,000 from 1 September.</p> <p>(3) For the period of time spent in the role for the performance year, A is awarded variable remuneration of £130,000.</p> <p>(4) The proportion of fixed remuneration which should be used for calculating whether A meets the criteria in paragraph 2.20 is £83,560 (£250,000 multiplied by 122/365)</p> <p>(5) The proportion of variable remuneration which should be used for calculating whether A meets the criteria in Chapter 2, paragraph 2.20 is £43,452 (£130,000 multiplied by 122/365).</p> <p>(6) The total remuneration for the period of time spent in an MRT role is £127,012. (£43,452 plus £83,560).</p> <p>(7) Condition 1 of paragraph 2.20 (a) states that the individual's variable remuneration is no more than 33% of their total remuneration. In this example A's variable remuneration is greater than 33% of the total remuneration so this condition is not met.</p> <p>(8) The calculation for determining whether condition 2 of paragraph 2.20 (b) is met is £500,000 multiplied by 122/365 equals £167,120. This condition is met.</p> <p>(9) As condition 1 of paragraph 2.20(a) has not been met, the rules in paragraph 3.12 must be applied to the variable remuneration of £43,452 for the period of time spent in an MRT role during the performance year.</p>
2	New hire into an MRT role	<p>(1) Individual B joins the firm as an MRT with effect from 1 July, 184 days out of 365 are spent in an MRT role.</p> <p>(2) B receives annual fixed remuneration of £450,000.</p> <p>(3) For the period of time spent in role during the performance year, B is awarded variable remuneration of £50,000.</p> <p>(4) The proportion of fixed remuneration which should be used for calculating whether B meets the criteria in Chapter 2, paragraph 2.20 is £226,850 (£450,000 multiplied by 184/365).</p> <p>(5) The full amount of variable remuneration (£50,000) should be used for calculating whether B meets the criteria in paragraph 2.20.</p> <p>(6) The total remuneration for the period of time spent in an MRT role is £276,850. (£226,850 plus £50,000).</p> <p>(7) Condition 1 of paragraph 2.20(a) states that the individual's variable remuneration is no more than 33% of their total remuneration. In this example B's variable remuneration is less than 33% of the total remuneration so this condition is met.</p> <p>(8) The calculation for determining whether condition 2 of paragraph 2.20 (b) is met is £500,000 multiplied by 184/365 equals £252,050. This condition is not met.</p> <p>(9) As condition 2 of paragraph 2.20(b) has not been met, the rules in paragraph 3.12 must be applied to the variable remuneration of £50,000 for the period of time spent in an MRT role during the performance year.</p>

Certain part-year material risk-takers for three months or less

3.18 Where an individual has, in relation to a given performance year, been an MRT for a period of three months or less; and a guaranteed variable remuneration award has not been (or is not to be) made in relation to their MRT appointment we do not consider it necessary to apply the following rules:

- (i) retained shares or other instruments (Remuneration 15.15);
- (ii) deferral (Remuneration 15.17); and
- (iii) performance adjustment (Remuneration 15.20-15.23).

Part-year material risk-takers for three months or less, but where exceptional payments made

3.19 Where an individual has, in relation to a given performance year, been an MRT for a period of three months or less, but is due to receive, or has received, an exceptional or irregular payment in relation to their MRT appointment this payment amount must be added to the variable remuneration for the period of time spent as an MRT, without pro-rating.

Credit and trading risk

3.20 Any staff member with the ability to take, approve, or veto credit proposals or trading book transactions above the thresholds under Article 3(11) and 3(12) of the RTS on behalf of the institution should be identified as an MRT. This requirement is not affected by the geographical location of the staff member.

3.21 The PRA expects any staff member responsible for 'initiating' credit proposals under Article 3(11)(a) to be identified in instances where, but not limited to, they are responsible for taking the decision that a specific credit proposal should be submitted for ultimate approval by a staff member identified under Article 3(11)(b), or a committee under Article 3(11)(c). This is likely to include staff members formally submitting a credit proposal rather than those involved in preparatory work.

3.22 Under Articles 3(11)(b), 3(11)(c), and 3(12), the PRA expects firms to identify those staff members who have the authority to sanction any transaction specified under Article 3(11) or 3(12). The PRA also considers that a staff member should not be identified as both initiating and authorising transactions.

3.23 The PRA expects firms to identify all staff members in a trading capacity with the ability to affect materially the risk profile of the institution, even where these staff members do not meet the limits specified under Article 3(12), or the quantitative remuneration criteria under Article 4. For example, certain roles such as foreign exchange traders may not operate under a value-at-risk limit but should be identified given their potential to affect the risk profile of the institution.

3.24 Where the total remuneration of staff members in the trading function exceeds the quantitative thresholds under Article 4(1), the PRA expects firms to provide more detailed evidence as compared to other categories of staff in order to justify whether they meet the conditions for exclusion under Article 4(2).

PRA approach to MRT exclusion applications for asset management roles

3.25 The PRA will review applications to exclude staff members employed by asset management entities within the consolidation, or sub-consolidation, group of a PRA-authorized person following the same process for staff employed by deposit-takers and investment banks. The PRA will do this by assessing the materiality of the impact of the professional activities of the staff member's role on the risk profile of the firm on a consolidated basis. Working in an asset management role is not in itself a basis for determining that the staff member meets one of the conditions for exclusion set out in Article 4, paragraph 2 of the RTS.

3.26 In applying CRD Article 92(2), to determine whether asset management staff members are MRTs, the PRA expects the factors below should be considered alongside Article 3 of the RTS. These factors include, but are not limited to, the following:

- the seniority of the role in the context of reporting lines and managerial responsibility;

- the size of the desk assets under management (AUM) as a portion of the total firm/group AUM and the size of the AUM for which the individual has overall responsibility as a portion of desk AUM;
- the extent to which the fund relates to retail clients;
- the strength of investment risk controls in place to ensure the individual adheres to the agreed fund risk profile, strategy and client expectations; and
- wider safeguards in place for liquidity, operational and product risk and independent risk monitoring.

3.27 Applications on behalf of staff members employed by FCA solo-regulated firms that are subject to the CRD within a group should be submitted to the FCA only. For those in dual-regulated firms, and FCA regulated firms that are not subject to CRD but whose parent institution is regulated by the PRA, applications should be submitted jointly to the PRA and FCA.

Definition of material business units

3.28 Firms are required to identify material business units (MBUs) under Article 3(5) of the RTS. Business units are defined in the CRR as 'any separate organisational or legal entities, business lines, or geographical locations'. The RTS defines 'material' as any business unit with a capital allocation representing '2% of the internal capital of the institution'. Where firms do not use internal capital allocation, they may use risk weighted assets (RWAs) as a proxy when defining material business units.

3.29 The identification of MBUs for third-country CRR firms which cannot rely on either internal capital or RWAs, should be based on the definition of a business unit under CRR. The materiality of specific business lines should then be identified according to the structure of the firm.

3.30 Individuals may operate from a different jurisdiction, with the United Kingdom representing one of a portfolio of entities for which they are responsible. While geographical location of the MRT is irrelevant, the Remuneration Part rules apply to the proportion of remuneration awarded in relation to responsibilities in relation to the UK regulated entity.

The exclusion process

3.31 The RTS establishes a presumption that individuals meeting the quantitative threshold under Article 4(1) are identified as MRTs. This presumption can only be rebutted by firms providing sufficient evidence that the relevant role meets one of the grounds under Article 4(2).

3.32 The approach under the RTS for excluding staff members from identification as MRTs is set out in the table below.

Table G – MRT Identification and exclusion criteria

Criterion	Regulatory oversight requirement	Basis for exclusion application
Total remuneration €500,000-750,000	Notification to PRA	Staff category or staff member
Total remuneration > €750,000; or top 0.3% high earners	Prior approval of exclusion from PRA	Staff member
Total remuneration > €1 million	PRA to inform EBA before approval	Staff member and explanation of exceptional circumstances.

3.33 Notifications and applications for prior approval to exclude staff members from identification should be submitted annually even where notification has been provided previously to the PRA. While PRA approval is not required for notifications, firms should provide the same degree of detailed information necessary to assess the decision making of the firm as compared to requests for prior approval.

3.34 In applying CRD Article 92(2) to determine whether to exclude staff members from identification, the PRA expects the factors below should be considered alongside Article 3 of the RTS. These factors include, but are not limited to, the:

- direct reporting lines of the staff member in question, and the number of MRTs identified above them in the management chain;
- independence of the staff member to commit the balance sheet of the institution without further authorisation;
- risk management controls in place to detect unauthorised trades; and
- management of maximum desk limits and the disciplinary policy in place for breaching these limits.

3.35 The RTS states that approval for exclusions for those staff members earning over €1 million shall only be granted under 'exceptional circumstances'. The PRA expects firms to provide additional explanatory reasoning in order to specify the exceptional nature of the circumstances for the staff member in question, in particular concerning the role and impact on the risk profile of the institution.

Templates

3.36 The PRA has designed a template for firms to use to submit their notifications and exclusion requests. The template is available on the Bank of England's website for firms to download and submit.¹ The template represents the expectation of the level of detail which should be included when submitting notifications or exclusions for approval. However, use of this template is voluntary, and firms may prefer to document their request in a different manner.

3.37 Notifications and exclusions should be submitted annually to the PRA. The timetable for submission will depend on the financial year of the firm.

¹ www.bankofengland.co.uk/pr/Pages/supervision/activities/remuneration.aspx.

4 Application of malus and clawback to variable remuneration

4.1 The purpose of this chapter is to clarify the PRA's expectations of the way in which firms should comply with the rules on performance adjustment in Remuneration Parts 15.20-15.23 of the PRA Rulebook.

4.2 The effective and meaningful use of performance adjustment is necessary to align risk and remuneration policy. Performance adjustment allows firms to adjust remuneration to take account of risks that have subsequently crystallised; instances of employee misbehaviour or material error; material downturn in performance; or a material failure of risk management. All variable remuneration is included within the scope of performance adjustment including awards made under long-term incentive plans (LTIPs) and buy-outs.

4.3 Performance adjustment refers to the adjustment of variable remuneration including the use of malus and clawback. The terms malus and clawback are often used interchangeably but do in fact constitute distinct forms of performance adjustment. Malus is defined¹ as '... an arrangement that permits the institution to reduce the value of all or part of deferred remuneration based on ex post risk adjustments before it has vested'. Clawback means 'an arrangement under which the staff member has to return ownership of an amount of variable remuneration paid in the past or which has already vested to the institution under certain conditions'.

4.4 Alongside malus and clawback, the PRA considers that reductions to in-year variable remuneration awards should also be considered by firms in applying 15.20(1) of the Remuneration Part.

Contracts and policies

4.5 Firms' remuneration policies and employment contracts should clarify that:

- (a) 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;
- (b) 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; and
- (c) variable remuneration awards should be reduced or clawed back according to specific criteria set by the firm under 15.21(1) of the Remuneration Part which should, as a minimum cover each of the relevant scenarios outlined in Remuneration 15.22-15.23.

4.6 In accordance with Remuneration 6.5 firms should take adequate steps to identify and document all remuneration awards which are capable of reduction or forfeiture and inform the relevant employees of the contingent nature of these portions of their remuneration.

4.7 Following Remuneration 15.20(3), all variable remuneration should be subject to clawback for a period of at least seven years from the date on which the variable remuneration is awarded. In the case of an MRT who performs a PRA senior management function (SMF), this can be extended to at least ten years if an investigation has commenced as in 15.20(4) of the

¹ EBA Guidelines on sound remuneration policies under CRD Articles 74(3) and 75(2) and disclosures under Article 450 CRR.

Remuneration Part. Firms should ensure that adequate records exist documenting all remuneration awards made to employees both current and former, should recovery of vested remuneration be required.

Scope

4.8 The use of performance adjustment should not be limited to employees directly culpable of malfeasance. For example, in cases involving a material failure of risk management or misconduct, the PRA expects firms to consider applying performance adjustment to those employees who:

- (a) were aware, or 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;
- (b) 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; and
- (c) by virtue of their role or seniority within control functions could be considered to be responsible for weaknesses and failings in control functions relevant to the failure or misconduct.

4.9 Where a failure of risk management was collective or pervasive, firms should apply performance adjustment to individuals or groups of employees as appropriate. This may take the form of a reduction to the in-year bonus pool firm-wide, at the relevant business units, and/or may also include an adjustment at an individual level.

4.10 Although firms can disapply the prescriptive requirements of the Remuneration Part on performance adjustment in respect of individuals who are not MRTs as defined in Remuneration 3.1, and those MRTs who are below the minimum threshold as set out in Chapter 2 of this supervisory statement, the PRA generally expects all firms to have a firm-wide policy on performance adjustment (and group-wide policy, where appropriate).

Timing of the relevant failure or misbehaviour

4.11 Risk management failures and misconduct can take years to come to light. This should not prevent firms from applying performance 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.

4.12 During the period in which clawback can be applied, in the event of a risk management failure or evidence of employee misbehaviour or material error coming to light after employment has ceased, the firm should take into account all relevant factors in deciding whether and to what extent it is reasonable to seek recovery of any or all of their vested variable remuneration.

Procedure for considering performance adjustment

4.13 The PRA expects firms to develop and maintain an adequate procedure for deciding cases that could result in reductions to in-year variable remuneration or in the use of malus and clawback either as part of, or alongside regular internal disciplinary proceedings. This procedure should:

- (a) promote consistency, fairness and robustness in the application of performance adjustment;
- (b) set specific criteria on the kind of cases that may trigger the use of performance adjustment. These criteria should be indicative and non-exhaustive. Remuneration committees should retain full discretion to introduce additional criteria where appropriate;
- (c) indicate which roles, departments, functions and committees are responsible for reporting, escalating and deciding cases that may trigger the use of performance adjustment;
- (d) ensure that control functions including Internal Audit, Compliance, Finance, Human Resources, Legal, Reward and Risk provide relevant information and contribute to discussions as required; and
- (e) set out a clear process for determining culpability, responsibility or accountability, including allowing individuals under investigation to make representations.

4.14 Where reductions are made to in-year variable remuneration awards, there should be a clear process for determining the amount of variable remuneration which would have been awarded prior to the adjustment being made. This amount and the reasons for the reduction should be clearly documented.

4.15 Firms should freeze the vesting of all awards made to individuals undergoing internal or external investigation that could result in performance adjustment until such an investigation has concluded and the firm has made a decision and communicated it to the relevant employee(s). The outcome of such investigations and the communication to employees should, where possible, be made at the time of the conclusion rather than waiting for the end of the performance year.

4.16 Firms should ensure that the value of performance adjustments made to an individual's variable remuneration, and the reasons for the adjustments, are clearly communicated to the affected individuals in writing and that the value and reasons for collective adjustments are clearly communicated to affected staff.

Calculating reductions

4.17 All variable remuneration should, in principle, be capable of forfeiture or reduction through performance adjustment.

4.18 Adjustments should be applied robustly but fairly. Paragraphs 4.8, 4.9 and 4.11 do not prevent firms from taking into account culpability or proximity to an incident when deciding the value of individual reductions.

4.19 When deciding the amounts to be adjusted, the PRA expects firms to take into account all relevant criteria, including:

- (a) the cost of fines and other regulatory actions (eg section 166 reviews);
- (b) direct and indirect financial losses attributable to the relevant failure;
- (c) reputational damage;

- (d) the impact of the failure on the firm's relationships with its stakeholders including shareholders, customers, employees, creditors, the taxpayer, counterparties, and regulators;
- (e) the impact on profitability from the event (eg profit before tax) – actual/accounting and provisioned;
- (f) timeframe during which the event occurred and whether losses/costs are still accumulating;
- (g) extent of customer detriment (eg number and value of mis-sold policies); and
- (h) redress costs.

4.20 Firms should ensure that their risk adjustment framework for determining bonus pools is clear and transparent to enable them to quantify and articulate clearly the impact of any performance adjustments they might make prior to them being approved.

4.21 The methodology used to calculate performance adjustments and the value of the adjustments made at individual, business unit and firm levels should be clearly recorded so that it is possible to determine the value of each adjustment per incident and at the individual employee level. The PRA expects firms to be able to provide this information if required.

4.22 Where performance adjustments are made to in-year 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. Should more information come to light, adjustments already made for the event should be considered before further performance adjustment commences.

5 Other elements of remuneration

Governing body and remuneration committee

5.1 Firms are expected to demonstrate that their decisions are consistent with an accurate assessment of their financial condition and future prospects. In particular, practices by which remuneration is paid for with 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 risk function in evaluating the incentives created by the remuneration policies of the firm.

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

5.3 In applying the remuneration rules, a firm should have regard to applicable good practice on remuneration and corporate governance, such as guidelines on executive contracts and severance produced by the Association of British Insurers (ABI) and the National Association of Pension Funds (NAPF). In considering the risks arising from its remuneration policies, a firm will also need to take into account its statutory duties in relation to equal pay and non-discrimination.

5.4 As with other aspects of a firm's systems and controls, in accordance with General Organisational Requirements 2.2 of the PRA Rulebook, remuneration policies, procedures and practices must be comprehensive and proportionate to the nature, scale and complexity of the firm's activities. The actions taken by a firm in order to comply with the Remuneration Part will therefore vary.

5.5 The periodic review of the implementation of the remuneration policy should assess compliance with the Remuneration Part. The PRA may also ask remuneration committees to provide the PRA with evidence of the compliance of any remuneration policies against the rules under the Remuneration Part, together with plans for improvement where there is a shortfall.

5.6 The Remuneration Part is principally concerned with the risks created by the way remuneration arrangements are structured, not with the absolute quantum of remuneration, which is generally a matter for remuneration committees to determine.

5.7 The PRA expects these committees to continue to fulfil the roles and functions required under Remuneration 7.4 and the EBA Guidelines, though within this framework remuneration committees may consider group-wide decisions and policies.

Risk management and control functions

5.8 The PRA expects firms to ensure that the total remuneration package offered to employees in risk management and compliance functions is sufficient to attract and retain staff with the skills, knowledge and expertise to discharge those functions.

5.9 The method of determining the remuneration of relevant persons involved in the compliance function should not compromise the objectivity of firms or be likely to do so.

5.10 The PRA expects firms to ensure that their risk management and compliance functions are involved in determining the remuneration policy for other business areas. This includes 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 undertaken. A lack of involvement from the control function may be relied on as tending to establish contravention of Remuneration 8.1 requiring employees engaged in control functions to have appropriate authority.

5.11 Remuneration 8.1 is designed to avoid potential conflicts of interest which might arise if other business areas had undue influence over the remuneration of employees within control functions. Where such conflicts could arise they should be managed by having in place independent roles for control functions (including, notably, risk management and compliance) and human resources. The PRA considers it good practice to seek input from the human resources function when a firm is setting remuneration for other business areas.

5.12 The need to avoid undue influence is particularly important where employees from the control functions are embedded in other business areas. Remuneration 8.1 does not prevent the views of other business areas being sought as an appropriate part of the assessment process.

Remuneration and capital

5.13 The variable remuneration arrangements at a firm should be sufficiently flexible to allow it to direct necessary resources towards capital building.

5.14 The PRA also expects relevant firms to use the rules in assessing their exposure to risks arising from their remuneration policies, as part of the internal capital adequacy assessment process (ICAAP).

Risk adjustment

5.15 The governing body (or, where appropriate, the remuneration committee) should approve policies for incorporating risk-adjusted performance into calculating the bonus pool and individual awards, including the triggers under which adjustments 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

5.16 The PRA expects firms to adopt 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 how they have adjusted remuneration decisions to account for risk.

5.17 The PRA expects firms to choose the most appropriate risk adjustment technique according 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. The full range of future risks should be covered and firms should be able to provide the PRA with details of all adjustments made, whether through application of formulae or the exercise of discretion. Where discretion has been applied, the firm should be able to provide a clear explanation and quantification of such adjustments.

Accounting for profit for remuneration purposes

5.18 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.

5.19 Profits for the purpose of determining the initial size of the pre-risk adjusted bonus pool should be calculated by adjusting any profit figure taken from a fair valuation accounting model with the incremental movement in the prudent valuation adjustment (PVA) figure at the end-Q4 prudent valuation return in current year and previous year. All UK dual-regulated firms (including UK subsidiaries of international firms) excluding branches, are required to file quarterly prudent valuation returns with the PRA.

5.20 For UK subsidiaries of international firms that do not have a specific UK bonus pool and where the bonus pool is determined and allocated by the parent company, the PRA, as part of the annual supervisory remuneration review, will require the firm to evidence that the incremental change in the PVA for the UK subsidiary has been applied to the UK-regulated entity's profits that feed into the global bonus pool.

5.21 The PRA expects prudent valuation adjustments to be determined using the Simplified Approach or Core Approach set out in Commission Delegated Regulation (EU) 2016/101 of 26 October 2015 supplementing the CRR with regard to regulatory technical standards for prudent valuation under Article 105(14).¹

5.22 As branches of overseas firms are not required to submit prudent valuation returns, they will be out of scope of this new requirement. However, the PRA will expect those firms to apply an appropriate adjustment to profit based on comparable principles to the extent it is achievable in the jurisdiction in which the global pool is determined.

Use of metrics

5.23 Aligning variable remuneration 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 may incentivise highly-leveraged activities. The PRA expects these earnings-based metrics to form part of the risk adjustment process only if it can be demonstrated that they are used as part of a balanced scorecard of financial and non-financial metrics which gives credible weight to non-profit based measures.

Long-term incentive plans (LTIPs)

5.24 LTIPs are a type of variable remuneration based on prior performance and are measured against forward-looking performance metrics to align the interests of individuals with the long-term interests of a firm.

5.25 The PRA expects firms to use a balance of both financial and non-financial metrics to drive appropriate behaviours. Firms should justify how non-financial measures in the quantitative component of LTIP frameworks are appropriate for the business model and strategy of the firm, and should ensure the measurement process of such non-financial measures is transparent and robust.

5.26 Quantitative criteria should be appropriately risk-adjusted and short term metrics should only be used as part of a balanced and risk adjusted scorecard of metrics. The quantitative criteria should include economic efficiency measures such as risk-adjusted return on capital,

¹ <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016R0101&from=EN>.

return on risk-adjusted capital, economic profit and internal economic risk capital or any equivalent type metric.

5.27 Quantitative risk metrics may not capture all the risk components, some of which can be better captured by discretionary approaches. However, if relied on solely, discretionary approaches may weaken the risk-based incentive effect of performance-based incentive frameworks. The PRA expects that such approaches are applied with appropriate controls and in a well-documented and transparent process.

Personal investment strategies

5.28 The circumstances in which the PRA considers 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 a person that are linked to or commensurate with the amounts by which the person's remuneration is subject to reductions.

Remuneration structures

5.29 The non-financial criteria in Remuneration 15.4(2) 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, buy-outs and retention awards

Guaranteed variable remuneration

5.30 Guaranteed variable remuneration is often known as a 'golden hello' or 'sign-on bonus' (which are different to buy-outs, see paragraph 5.35 below). Often these awards are made in cases where an individual will lose the opportunity to receive a bonus entitlement for the current performance year by leaving their employer part-way through the year, and to persuade them to move, the individual is compensated for this 'lost opportunity'.

5.31 Guaranteed variable remuneration awards should not be expected as the norm and should be limited to rare, infrequent occurrences and can only occur where the firm has a sound and strong capital base in accordance with CRD Article 94(1)(e).

5.32 Under paragraph 140-141 of the EBA guidelines, firms are permitted to exclude guaranteed variable remuneration such as sign-on bonuses from the calculation of the ratio between fixed and variable remuneration, where this is awarded in the context of hiring new staff; and disapply malus, clawback, and deferral.

5.33 The PRA, however, expects guaranteed variable remuneration to continue to be subject to the general rules for variable remuneration awarded by the firm including deferral, malus and clawback and the calculation of the fixed to variable ratio, including where the award is made in the context of hiring new staff.

5.34 All guaranteed variable remuneration awarded should be documented and included in a firm's annual remuneration policy statement. Notification of guaranteed variable remuneration is not required except when a retention award is offered to a new hire taking up a material risk taker role. In such cases, the PRA will consider whether the award is appropriate.

Buy-out awards

5.35 Buy-out awards differ from guaranteed variable remuneration and represent a practice whereby firms buy-out outstanding deferred bonus awards for staff that have been cancelled

by their previous employer. The PRA expects firms to structure buy-outs so that they vest no faster than the awards they replace.

5.36 As part of the process for the previous firm deciding whether to apply malus or clawback to the buy-out, the 'determination' under rule 15A.9 refers to the final determination by the approving body or committee of the previous firm.

5.37 The new employer should act solely as an executor in relation to the determination made by the previous employer. As such, the PRA considers that, while all waiver applications will be considered on the basis of the facts of the individual case, in most cases the statutory tests for the modification or waiver of rules set out under section 138A(4) of FSMA are unlikely to be met.

Retention awards

5.38 Retention awards differ from guaranteed variable remuneration and represent awards which are contingent on an individual remaining in employment with the firm for a period of time.

5.39 Retention awards shall form part of variable remuneration for the purpose of Remuneration 15.10 (ratio between fixed and variable components of total remuneration) and should be notified to the PRA when a retention award is offered to an MRT.

Procedure to increase permitted ratio between fixed and variable components of total remuneration

5.40 In circumstances where firms choose to increase the permitted ratio of fixed to variable remuneration, the PRA considers all percentage thresholds referred to in Remuneration 15.11(5) should 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, and which attach to the shares or ownership rights.

5.41 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, and not of the firm's whole issued share capital or ownership rights.

5.42 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 Art. 94(1)(g)(ii), 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 consider what will constitute being represented for the purpose of this vote, within the range of meanings that the word 'represented' could reasonably carry.
- (iii) The PRA expects firms to make clear to shareholders how each voting decision (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.

5.43 In line with Remuneration 15.11(4), 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.

Deferral

5.44 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 quantum of variable remuneration awarded. In line with the specific requirements of Remuneration 15.18, the PRA further expects that where any 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 be applied in cases of variable remuneration below £500,000.

Breaches of the remuneration rules

5.45 In line with the Fundamental Rules, the PRA expects any breach of a rule referred to in Remuneration 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 Remuneration 16.14.

5.46 Remuneration 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 provision.

Firm-wide application

5.47 The PRA expects firms to apply at least the following Remuneration Part rules on a firm wide basis:

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