



BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

Andrew Bailey
Deputy Governor
Prudential Regulation Authority

8 December 2014

Dear Remuneration Committee Chair,

Remuneration – PRA expectations

As you will be aware, 2014 is the first performance year subject to the CRD IV remuneration requirements as incorporated into the PRA Remuneration Code. Once the proposed new EBA guidelines are finalised, we intend to publish a Supervisory Statement to clarify key areas of uncertainty that have arisen in relation to the remuneration changes under CRD IV. In the meantime, this letter aims to address particular areas of uncertainty of which we are aware. These positions may be reviewed in light of the final EBA guidelines.

Identification of Material Risk Takers

The European Banking Authority (EBA) published regulatory technical standards (RTS) to harmonise the approach to identification of material risk-takers across the EU. The RTS came into effect on 26 June 2014. Whilst the RTS sets out minimum criteria for the identification of material risk-takers falling within the scope of Article 92(2) CRD IV, the PRA takes the view that individuals carrying out activities which enable them to expose the firm to a material level of harm should be identified by management as material risk-takers, even if these individuals do not fall within any of the mandatory RTS criteria.

Guaranteed variable remuneration

On further consideration of the CRD IV provision relating to guaranteed variable remuneration, the PRA has concluded that when guaranteed variable remuneration is awarded before an employee's first performance period as compensation for forfeited awards, the award should not be counted as fixed or variable remuneration in the calculation of the ratio between the total variable and fixed remuneration for the first performance period. However, guaranteed variable remuneration should continue to be used in exceptional cases only as per rule SYSC 19A.3.40.

Where a buy-out is awarded in compensation for loss of remuneration from a previous employment, SYSC 19A.3.40A still applies.

Determining the fixed component of total remuneration for the ratio

The Code (SYSC 19A.3.44A) follows the approach of CRD IV in describing the bonus cap in terms of the ratio between the fixed and variable components of total remuneration.

The expressions "total remuneration" and "fixed remuneration" in SYSC 19A refer to the actual amount of total or fixed remuneration the employee is awarded in a given period. The maximum amount of variable remuneration a Code staff (or "material risk-taker") employee may be paid in a performance year is therefore to be calculated by reference to the amount of fixed remuneration which the employee has actually received in the relevant period. In the case of a Code staff employee who has been promoted, or who has otherwise been awarded a pay-rise during the performance year, calculating his/her fixed remuneration requires taking account of the proportion of the year spent at each salary level. It has come to our attention that some firms may have decided simply to treat the year-end salary as if that had been the employee's salary for the whole year. We would not regard this as compliant with the Code,

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or with CRD IV. Firms must look at how much fixed remuneration the employee has actually been awarded in the year in question and calculate the permitted amount of variable remuneration by reference to that amount.

There is one qualification to this general approach. This relates to the situation of a new joiner within the performance year. The firm may, in these limited circumstances, calculate the fixed remuneration of the new joiner as if he/she had been remunerated for the period of the performance year prior to joining at the same rate of fixed remuneration that he/she received on joining the firm. Naturally this qualification cannot be relied on where the new joiner has been awarded guaranteed variable remuneration by way of compensation for the loss of a potential bonus award from the previous employment as a result of moving jobs.

Clawback obligations

Our policy statement (PS7/14) published on 30 July sets out the final rules requiring PRA-regulated firms to include a clawback provision that applies to variable remuneration awards for seven years in contractual arrangements with employees identified as Code staff (or "material risk-takers").

SYSC 19A.1.3.3R requires all variable remuneration awarded on or after 1 January 2015 to be subject to clawback. We recognise that the scope for introducing clawback provisions to 2015 bonus awards that relate to the 2014 performance year may raise particular difficulties. The PRA expects firms to introduce clawback terms so as to maximise their enforceability to the extent permitted by law. However the PRA does not, for example, require firms to introduce a provision the enforcement of which would be prohibited by section 15 of the Employment Rights Act 1996, assuming the firm had made all reasonable efforts to introduce a clawback provision in a manner and form that would have minimised or avoided any such difficulties. If relevant circumstances were to arise, we would take these difficulties into account when considering whether the firm has made reasonable efforts to recover a 2015 bonus award relating to the 2014 performance year.

If you need to discuss any of the points covered in this letter, please contact your Supervisor or a member of our Remuneration Team. A copy of this letter will be published on the Bank of England's website.

Yours sincerely,

A handwritten signature in black ink that reads "Andrew Bailey". The signature is written in a cursive, slightly slanted style.

Andrew Bailey