

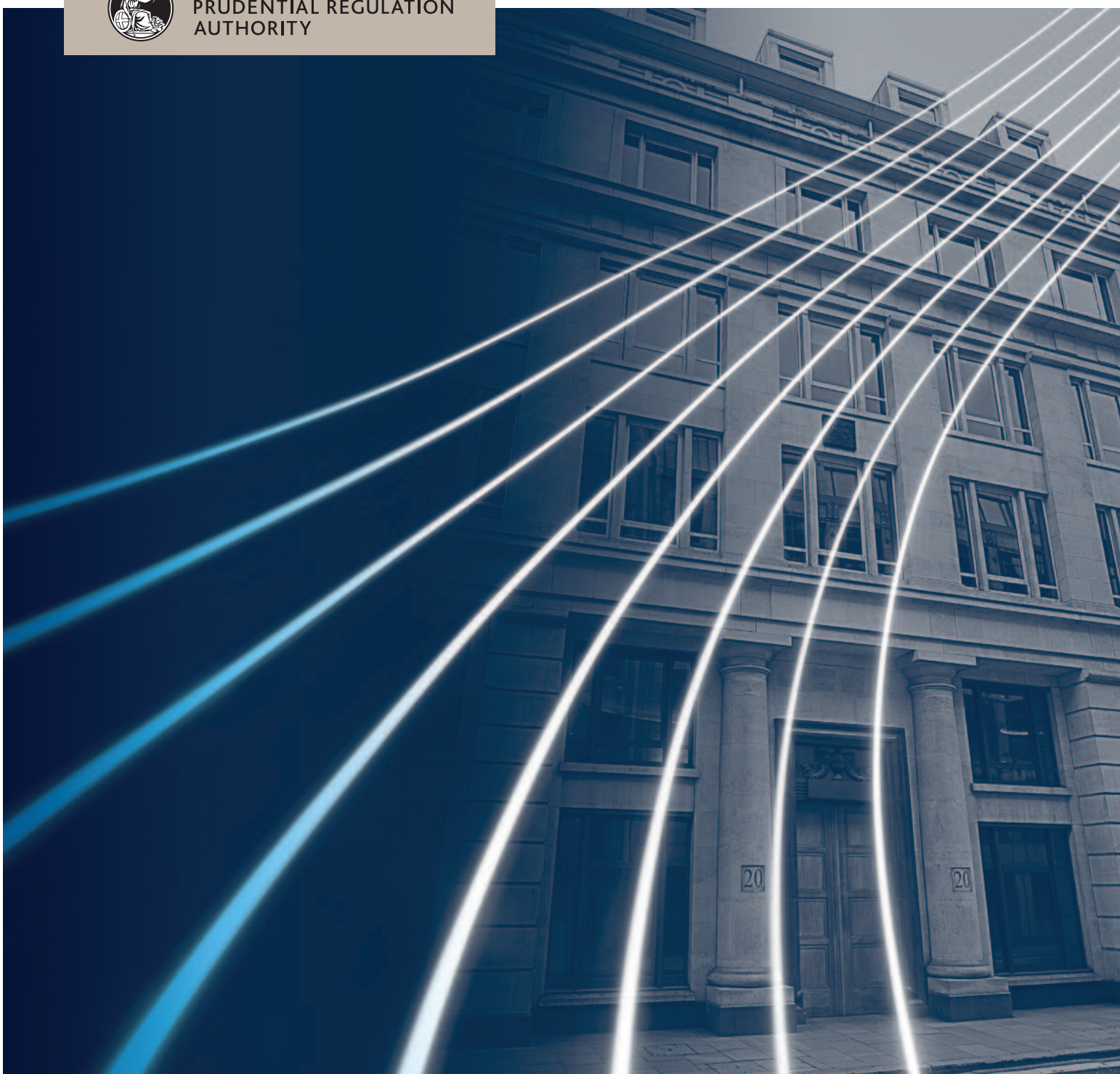
Policy Statement | PS7/14

Clawback

July 2014



BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY



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1 Introduction

1.1 This Policy Statement (PS) sets out the response of the Prudential Regulation Authority (PRA) to feedback received from the Clawback Consultation Paper (CP6/14)⁽¹⁾ as well as the finalised rule on clawback.

1.2 Malus and clawback are both forms of *ex-post* risk adjustment, whereby past awards of variable remuneration may be adjusted to reflect subsequent information about the underlying risks, including emerging evidence of poor risk management. The purpose of clawback is to align better the interests of staff subject to the Remuneration Code⁽²⁾ with the long-term interests of the firm. It does so by extending the risk horizon of the individual, as well as exposing a greater proportion of variable remuneration to the possibility of *ex-post* adjustment. In this way it advances the PRA's general objective to promote the safety and soundness of firms.⁽³⁾

1.3 In CP6/14 the PRA consulted on a proposal requiring firms to be able to apply clawback to vested variable remuneration on a group-wide basis for a period not less than six years from the point of vesting. In accordance with the PRA's existing approach to proportionality, it was proposed that this requirement should apply to level one and two firms only. CP6/14 also included a draft rule that clarified the PRA's position and expectations on the application of clawback.

1.4 The PRA received a number of responses to CP6/14, in the light of which the PRA has revised its proposals. The principal changes are that the minimum period for clawback has been changed to seven years from award, rather than six years from vesting, and the grounds for applying clawback have been narrowed compared with the existing grounds for malus. These changes are explained below.

1.5 The final rules are set out in Appendix 1 of this policy statement.

2 Feedback to responses

Grounds

2.1 On the grounds for applying clawback, which were proposed to be the same as already applied for malus, many noted the potential difficulties of enforcing clawback with the higher burden of proof expected to be required in such cases. This issue was raised in particular with regard to the appropriateness of being required to pursue clawback on the basis of a material downturn in financial performance.

2.2 The PRA agrees that clawback is most appropriate in cases where the individual has some responsibility or culpability for the circumstances giving rise to the grounds for action, and has therefore narrowed the grounds to exclude a material

downturn in financial performance. The final rule also clarifies that firms are able to take a proportionate approach to the enforcement of clawback based on the assessment of individual cases. Firms' approach to clawback, and the way in which they intend to apply the flexibility which the final rules provide, should be included within firms' internal policies so as to inform the regulator of the implementation of clawback policies.

Period

2.3 Some respondents were concerned about the cumulative impact of clawback in combination with deferral and/or similar policies, and the possibility that firms would be discouraged from adopting longer deferral periods as a consequence. The final rule therefore requires variable remuneration to be subject to malus and clawback for an overall period of seven years from the date of an award. This will make the period of clawback marginally longer in relation to the undeferred part of awards, but will reduce its application for most of the deferred portions. This amendment will enable firms to adopt longer deferral periods, lengthening the period subject to malus, but reducing correspondingly the period for which clawback applies. This is in line with the expectation that firms may wish to apply clawback only to the extent that the scope for malus is exhausted or deemed insufficient.

Commencement of the clawback obligation

2.4 A further concern was raised on the requirement to apply clawback to awards made prior to 1 January 2015, but which vest after that date. The concern was that many firms would not have the capacity to introduce such a requirement into existing employment contracts without employee consent and/or might be open to challenge for doing so. In order to ensure a consistent and even application of the clawback requirement across industry, the final rule requires the application of clawback only to awards made on or after 1 January 2015.

3 Commencement

3.1 This rule will come into force on 1 January 2015.

4 Further policy development

4.1 As part of our consultation paper on the remuneration recommendations from the Parliamentary Commission on

(1) www.bankofengland.co.uk/pr/Pages/publications/clawbackcp614.aspx.

(2) The Remuneration Code (The Senior Management Arrangements, Systems and Controls (SYSC) 19A sourcebook of the PRA's Handbook) sets out the standards that banks, building societies and designated investment firms have to meet when setting pay and bonus awards for their staff. It aims to ensure that firms' remuneration practices are consistent with effective risk management. Any amendments will have no impact on the PRA's existing approach to proportionality: www.bankofengland.co.uk/publications/Documents/other/pr/policy/2013/remunerationstandardslss8-13.pdf.

(3) Section 2B(1) and 2B(2) of FSMA 2000.

Banking Standards, we are proposing to introduce a requirement for the possible extension of the clawback period of up to three years for senior managers (as defined in the 'Strengthening accountability in banking: a new regulatory

framework for individuals' consultation paper) if there are outstanding investigations underway at the end of the seven years.

Appendix

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- 1 Senior Management Arrangements, Systems and Controls (Remuneration Code — Clawback) Instrument 2014

**SENIOR MANAGEMENT ARRANGEMENTS, SYSTEMS AND CONTROLS (REMUNERATION
CODE – CLAWBACK) INSTRUMENT 2014**

Powers exercised

- A. The Prudential Regulation 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) section 137G (The PRA's general rules);
 - (2) section 137H (General rules about remuneration); and
 - (3) section 137T (General supplementary powers).
- B. The rule-making powers referred to above are specified for the purpose of section 138G(2) (Rule-making instruments) 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.

Commencement

- D. This instrument comes into force on 1 January 2015.

Amendments to the Handbook

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

Notes and Guidance

- F. In the Annex 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

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

By order of the Board of the Prudential Regulation Authority

25 July 2014

Annex

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

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

SYSC 19A Remuneration Code

...

- 19A.1.3 R (1) A *firm* must apply the *remuneration* requirements in SYSC 19A.3, other than SYSC 19A.3.44R(3) ~~and~~ 19A.3.44AR, 19A.3.51R(2) and (3), 19A.3.51BR and 19A.3.54R(1)(c), 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.
- (2) ...
- (3) A *firm* must apply the *remuneration* requirements in SYSC 19A.3.51R(2) and (3), 19A.3.51BR and 19A.3.54R(1)(c) in relation to *remuneration* awarded on or after 1 January 2015.
- 19A.3.51 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 19A.3.51AR(3) and 19A.3.51B; and
[Note: article 94(1)(n) of CRD and Standards 6 and 9 of the FSB Compensation Standards]
 - (3) variable *remuneration* is subject to clawback for a period of at least 7 years from the date on which it is awarded.

- 19A.3.51A R A *firm* must:
- (1) ~~ensure that any of the total variable remuneration is subject to malus or clawback arrangements; [deleted]~~
 - (2) set specific criteria for the application of malus and clawback; and
 - (3) 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.
- ...
- 19A.3.51B R 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.
- 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.
- 19A.3.54 R (1) Subject to (1A) to (3), the *rules* in SYSC 19A Annex 1.1R to 1.4R apply in relation to the prohibitions on *Remuneration Code* staff being *remunerated* in the ways specified in:
- (a) SYSC 19A.3.40R (guaranteed variable *remuneration*);
 - (b) SYSC 19A.3.49R (non-deferred variable *remuneration*);
and
 - (c) SYSC 19A.3.51R(2) (performance adjustment - clawback); and
 - (ed) SYSC 19A Annex 1.7R (replacing payments recovered or property transferred).

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