

CP5/23 – Remuneration: Enhancing proportionality for small firms

Consultation Paper 5/23

Published on 27 February 2023

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Responses are requested by Tuesday 30 May 2023.

Please address any comments or enquiries by email to:

CP5_23@bankofengland.co.uk

Alternatively, please address any comments or enquiries to:

Governance, Remuneration and Controls Policy Team,

Prudential Policy Directorate

Prudential Regulation Authority

1. Overview

1.1 This Consultation Paper (CP) sets out the Prudential Regulation Authority's (PRA) proposed changes to the current rules and expectations to enhance the proportionality of the remuneration requirements which apply to small CRR firms and small third-country CRR firms ('small firms').

1.2 The proposals in this CP would result in:

- changes to the Remuneration Part of the PRA Rulebook (Appendix 1); and
- updates to Supervisory Statement (SS) 2/17 – 'Remuneration' (Appendix 2).

1.3 The policy proposals included in this CP would:

- define small firms in line with the proposed Simpler-regime size threshold, and with reference to selected other Simpler-regime criteria under the 'Strong and Simple' framework (set out in CP5/22 – ['The Strong and Simple Framework: a definition of a Simpler-regime Firm'](#) and chapter 2: Scope and levels of applications of CP16/22 – ['Implementation of the Basel 3.1 standards'](#));
- remove the requirement for small firms, as defined in this CP, to apply rules on malus, clawback, and buyouts; and
- provide clarity on how disclosure requirements apply for all proportionality levels.

1.4 This CP should be read in conjunction with the PRA and the FCA's joint CP on the removal of the bonus cap (CP15/22 – ['Remuneration: Ratio between fixed and variable components of total remuneration \('bonus cap'\)'](#)), which proposes to remove the current requirements concerning the ratio between the fixed and variable components of total remuneration ('bonus cap') for all firms currently in scope of the cap, including small firms.^[1] It should also be read in conjunction with the PRA's consultations on the Strong and Simple framework (CP5/22 and CP16/22).

1.5 The PRA's proposals aim to increase proportionality of the remuneration regime by reducing the regulatory burden on small firms to a level more appropriate to the benefits arising from lowering risks to these firms' safety and soundness and to the UK financial system. The PRA considers that risks to safety and soundness for the proposed firms in scope can be mitigated sufficiently by other remuneration rules that the PRA is not proposing to modify, including those set out in paragraph 2.13.

1.6 This CP is relevant to banks, building societies, and PRA-designated investment firms, including third-country branches which are subject to the Remuneration Part of the PRA Rulebook. This CP is not relevant to credit unions or insurers.

1.7 The PRA has a statutory duty to consult when changing rules (FSMA s138J). When not making rules, the PRA has a public law duty to consult widely where it would be necessary for fairness to do so or to satisfy a legitimate expectation.

1.8 In carrying out its policy making functions, the PRA is required to comply with several legal obligations. Appendix 3 lists the statutory obligations applicable to the PRA's policy development process. The analysis in this CP explains how having regard to these matters has affected the proposals.

Background

1.9 The PRA's remuneration regime aims to ensure greater alignment between risk taking and individual reward, to discourage excessive short-termism, and encourage more effective risk management – thereby supporting regulatory objectives of safety and soundness. The regime applies to all CRR and third-country CRR firms (banks, building societies, and designated investment firms).

1.10 The PRA applies the remuneration regime in a way that seeks to be proportionate to firms' size, internal organisation, and the nature and scale of their activities. 'Small firms' are not currently required to apply rules on payment in instruments, deferral, or discretionary pension arrangements (as per Rule 5.3 of the Remuneration Part of the PRA Rulebook).

1.11 The current approach for small firms was introduced in 2020 following the implementation of the EU's Capital Requirements Directive V, as set out in Policy Statement (PS) 29/20 – ['Capital Requirements Directive V \(CRD V\)'](#). CRD V lowered size thresholds to define 'small firms' for the purposes of the remuneration rules, bringing more firms into scope of the full remuneration rules. As a result of CRD V, small firms became subject to the bonus cap, malus (if firms choose to use deferral), and clawback, none of which were applicable under the previous UK regime which implemented the EU's Capital Requirements Directive IV (CRD IV). The UK implemented these changes as they were deemed in line with the PRA's objectives, in particular given the UK's legal obligations at the time during the EU withdrawal 'implementation period'. Based on industry feedback to the CRD V consultation, the PRA noted that these changes could be reviewed post EU-exit. In implementing the final CRD V policy, the PRA acknowledged the costs for small firms and highlighted the relief that modifications/waivers could provide on a firm-specific basis.

1.12 Under both CRD V, and the preceding CRD IV regime, small firms are subject to less strict remuneration requirements than larger firms. However, since the implementation of CRD V, the PRA has seen increasing evidence that the regime has been costly or burdensome for some small firms, including through waiver applications and firms' responses

to a survey. This CP, therefore, sets out proposals to amend the requirements and supervisory expectations to reflect this evidence and to enhance the proportionality of the regime for small firms.

Implementation

1.13 The proposed changes resulting from this CP would come into force on the next calendar day after the publication of the final policy, anticipated for Q4 2023, and would apply to firms' performance years starting after that. For most firms, this would likely be performance years starting in 2024. However, the PRA is aware that, across the affected population of firms, performance year start dates span the calendar year. Therefore, it encourages firms that believe they may be disproportionately disadvantaged by the timings of any final policy to respond to this CP. Firms that are defined as small under the current regime would need to assess whether they continue to qualify for the small firm remuneration regime as per the proposed criteria.

Responses and next steps

1.14 This consultation closes on Tuesday 30 May 2023. The PRA invites feedback on the proposals set out in this consultation. Please address any comments or enquiries to CP5_23@bankofengland.co.uk. Please indicate in your response if you believe any of the proposals in this consultation paper are likely to impact persons who share protected characteristics under the Equality Act 2010, and if so, please explain which groups and what the impact on such groups might be.

1.15 Unless otherwise stated, any remaining references to EU or EU-derived legislation refer to the version of that legislation which forms part of retained EU law.^[2]

2. The PRA's proposals

2.1 The proposals set out below are informed by evidence received by the PRA from waiver requests and from a 2022 PRA survey of small firms following the implementation of CRD V in 2020 (PS26/20). This evidence highlighted the costs of the CRD V regime for smaller firms. In the light of this evidence, the PRA proposes to make the remuneration regime much more proportionate for small firms by disapplying a number of the current CRD V requirements. The proposals amend the size threshold and wider conditions to define 'small firms', as well as the rules which apply to these firms, by:

- amending the definitions of a 'small CRR firm' and 'small third-country CRR firm' within Rule 1.3 of the Remuneration Part of the PRA Rulebook;
- setting out conditions that apply in determining small CRR firms, and small third-country CRR firms in new Chapters 2A and 2B in the Remuneration Part;

- amending Rule 5.3. and inserting a new Rule 15.20(1A) in the Remuneration Part to provide that rules on malus, clawback, and buyouts do not apply to small CRR firms and small third-country CRR firms (in addition to the current rules that do not apply);
- amending Rule 15.A1(2) of the Remuneration Part to remove the references to rules on malus and clawback (15.20(2), and 15.21 to 15.23) applying to small CRR firms and small third-country CRR firms in respect of Remuneration Structures in Chapter 15;
- inserting a new Rule 2.10 in the Remuneration Part, which is a transitional provision for remuneration awarded in respect of a performance year starting before the implementation date of the final policy being consulted on in this CP. In that situation, such remuneration would still be subject to current requirements;
- amending paragraph 2.4, Table A: Glossary of terms defined in this statement, and Table B: Proportionality levels – Remuneration Part solo firms of SS2/17 to reflect the proposed change in thresholds;
- amending Table G: Minimum deferral and clawback rules applicable to Material Risk Takers (MRTs), paragraph 4.1, and paragraph 5.35 of SS2/17 to clarify that the PRA expectations on malus, clawback, and buyouts do not apply to small firms; and
- inserting a new expectation on information that small firms should report to their supervisors in a new paragraph 5.48 of SS2/17.

In paragraph 2.18 below, the PRA proposes providing clarification for firms of all proportionality levels on how remuneration disclosure requirements apply for CRR firms and third-country CRR firms by:

- amending paragraph 2.1 and paragraph 2.3(i) of SS2/17 to reflect that SS2/17 no longer provides guidance on remuneration disclosures and proportionality; and
- deleting paragraphs 2.24 through to 2.30 and Table D: Disclosure requirements by proportionality level of SS2/17.

Small firm threshold

2.2 This CP proposes amendments to the definition of ‘small CRR firm’ and ‘small third-country CRR firm’ for remuneration purposes in line with the proposed Simplified-regime size threshold, and with reference to selected other Simplified-regime criteria under the Strong and Simple framework (as consulted on in CP5/22 and CP16/22). In many areas, the proposed criteria are aligned to those for the Simplified-regime, and in particular any firms that meet the simplified-regime criteria under the PRA’s Strong and Simple framework should also benefit from the proposed simplifications to the remuneration requirements. However, the PRA’s proposed simplifications to the remuneration regime would also apply to a wider set of small firms beyond those that qualify for the Simplified-regime under Strong and Simple. This section summarises the proposals for ‘small firms’ (UK banks, building societies, and UK designated investment firms). The way in which the proposed size threshold and wider conditions apply for small third-country CRR firms is summarised in paragraph 2.5 below.

2.3 The PRA proposes that to benefit from the small firm remuneration regime, firms will need to meet the following conditions:

- either conditions 1a or 1b as set out in box A below; and
- condition 2 as set out in box A below.

Box A:

Condition 1: Size threshold and criteria

1a. Average total assets at or under £4 billion (calculated on a 3-year average using the calculation within the Strong and Simple framework proposals);

or

1b. Average total assets (as defined above) over £4 billion and at or under £20 billion, and subject to all the following Simpler-regime criteria:

1. trading book business at or under 5% of the firm's total assets and £44 million.
2. foreign exchange positions at or under 3.5% of own funds and at or under 2% of own funds on average.
3. no commodities or commodity derivatives positions.
4. no provision of clearing, transaction settlement, custody, or correspondent banking services to a UK bank or building society, or non-UK credit institution, including by acting as an intermediary for a UK bank or building society or such a credit institution to access certain facilities.

Firms can meet this criterion if the only entities to which they provide these services are within their immediate group and the services are in Pound Sterling (GBP).

5. is not an operator of a payment system.

Condition 2: Level of application

The firm is not part of a group containing another firm which:

1. is subject to the Remuneration Part on an individual basis; and
2. exceeds £20 billion in average total assets (as defined above) on an individual basis, consolidated basis, or sub-consolidated basis.

2.4 The calculation of whether another firm in the group has average total assets exceeding £20 billion on a consolidated or sub-consolidated basis is assessed at the level of the UK consolidation group. The proposed approach to the calculation of average total assets would align with the proposed approach under the Simpler-regime criteria. For other purposes in the Remuneration Part, the existing approach to identifying total assets would continue to apply.

Overseas firms with UK branches and UK designated investment firms

2.5 The PRA proposes to continue to allow branches of third country CRR firms to benefit from a more proportionate remuneration regime by assessing total assets and the Condition 1(b) criteria in the definition of small third-country CRR firm in relation to the branches' operation in the UK. In addition, the condition 1(b) criteria regarding the size of their trading books and foreign exchange positions are assessed based on a comparison of the branch's operation in the UK to the firm as a whole. The conditions are set out in the definition of 'small third country CRR firm' and Chapter 2B in the instrument being consulted on. UK designated investment firms may also meet the small firm criteria in continuation of the current approach under the Remuneration Part of the PRA Rulebook.

2.6 Beyond the proposed criteria set out in box A and paragraph 2.5, firms would not be required to meet the other Simpler-regime criteria set out in paragraph 2.8 below in order to benefit from the proposed simpler remuneration regime. In effect, the proposed small firm definition for remuneration purposes would likely include the following firms:

- all firms meeting the Simpler-regime criteria under the Strong and Simple framework;
- all firms with total assets not exceeding £4 billion that also meet Condition 2; and
- all firms with total assets over £4 billion and up to £20 billion that meet the subset of the Simpler-regime criteria above and Condition 2, but do not meet the other Simpler-regime criteria set out in paragraph 2.8.

2.7 The PRA's starting point has been to align the definitions of 'small CRR firm' and 'small third-country CRR firm' that apply for remuneration purposes with those Simpler-regime criteria that are relevant for the purposes of remuneration, to avoid complexity and potential cliff edge incentives between different regimes. As set out above, at a minimum, it is expected that all firms satisfying the Simpler-regime criteria would qualify for the proposed small firm remuneration regime. However, the PRA considers that it may also be proportionate to allow some other small firms to qualify for the small firm remuneration regime, although firms are expected to apply the new definitions of small CRR firm and third-country CRR firm before determining this. This includes firms where the additional Simpler-regime criteria may not be justified for remuneration purposes, for example, those firms that currently benefit from being defined as a small firm for remuneration purposes.

Simpler-regime criteria immaterial to remuneration

2.8 The selection of the relevant Simpler-regime criteria has been based on how they compare to the aims of the remuneration regime in supporting safety and soundness. The Simpler-regime criteria also set restrictions on the extent of international activity, location of parent, and use of the internal ratings based (IRB) approach to credit risk. However, the PRA does not consider these to be relevant in the remuneration context, and so does not propose to set these as conditions for small firms to benefit from the proposed more proportionate remuneration regime. The rationale in each case is summarised below.

- **Domestic activity:** The domestic activity criterion may omit internationally headquartered firms that can currently be defined as small firms under the remuneration regime, therefore potentially creating competition issues for talent with other similar size firms in the UK. This criterion has been proposed for the Simpler-regime to prevent internationally active banks from departing from Basel standards. This consideration is not relevant in the remuneration context.
- **Location of parent:** The level of application criterion may omit subsidiaries of internationally headquartered firms that can currently be defined as small firms under the remuneration regime, therefore creating competition issues as set out above.
- **No IRB:** The approach to how firms calculate credit risk is less relevant for remuneration purposes than for other requirements on firms in the Simpler-regime. The PRA consequently considers that this criterion would not be suitable for remuneration purposes.
- **Application of all criteria to members of the UK consolidation group:** The level of application criterion in the simpler-regime requires all banks and building societies in a firm's group to meet all Simpler-regime criteria. The PRA considers that the current remuneration regime's level of application criteria would be more proportionate for firms that currently qualify as small firms and would be more consistent. Therefore, the PRA proposes to continue with the current approach in the Remuneration Part of the PRA Rulebook for firms that are members of a group, as set out in Condition 2 (amended to incorporate the proposed £20 billion average total assets limit).

2.9 The PRA considered alternative options to increase proportionality of remuneration requirements including reverting to the £15 billion CRD IV threshold. However, this would create another size threshold which could increase complexity in the regulatory regime. The PRA also considered allowing all firms below the £20 billion simpler-regime size threshold to benefit from the small firms' remuneration rules with none of the additional Simpler-regime criteria applied. While this would be simpler, it would be less prudent. Since the PRA is also proposing disapplying specific remuneration rules for small firms (as discussed below), this would disapply remuneration requirements for individuals identified as MRTs in small but potentially more complex firms. The PRA considers that this would not advance its safety and soundness objective.

Remuneration rules for small firms

2.10 The PRA proposes that for firms meeting the proposed small firm definition set out above, the following rules in the Remuneration Part of the PRA Rulebook would cease to apply:

- performance adjustment (malus and clawback), as set out in Rules 15.20(2) and (3A), and 15.20A to 15.23; and
- buyouts, as set out in Chapter 15A.

2.11 The proposed removal of the bonus cap, to which small firms are also currently subject, is being consulted on separately for all firms in CP15/22. Under the proposals in this CP, as under the current regime, rules on deferral, payment in instruments, and discretionary pension arrangements would not apply to small firms. The remainder of the Remuneration Part would continue to apply to small firms in full, except for the specific rules amended by the rule instrument being consulted on in this CP.

2.12 Given that aligning individual incentives with risk taking through remuneration requirements can be helpful in enhancing safety and soundness, under the proposals in this CP, firms would still be subject to some remuneration requirements, but not requirements on malus, clawback, and buyouts. However, firms may choose to maintain these elements voluntarily, where they see benefits for risk management and incentive setting purposes.

2.13 Small firms, specifically, would still be subject to the remaining provisions in the Remuneration Part of the PRA Rulebook including:

- MRT identification (Chapter 3);
- Group application (Chapter 4);
- Remuneration Policies (Chapter 6);
- Governance and Controls (Chapters 7 and 8);
- Remuneration and Capital (Chapter 9);
- Exceptional Government Intervention (Chapter 10);
- Risk Adjustment (ex-ante) (Chapter 11);
- Personal Investment Strategies (Chapter 13);
- Performance assessment and guaranteed remuneration (Rules 15.4-15.7); and
- High Earners Reporting Requirement (Chapter 18).

2.14 Rule 6.5 of the Remuneration Part requires all firms within scope of the Remuneration Part to ensure that their remuneration policies, practices, and procedures are clear and documented. To record these policies, practices, and procedures, and assess their

compliance with the rules, firms should put in place a Remuneration Policy. Small firms can do so using the [Remuneration Policy Statement template for Proportionality Level Three firms](#).

2.15 Incentive setting continues to be an important part of risk management within firms. While the PRA proposes to be less prescriptive on requirements that apply to MRTs in small firms (namely rules on malus, clawback, and buyouts), it remains important that firms do not engage in practices that could cause harm to their safety and soundness. Therefore, the PRA proposes that a new paragraph 5.48 should be added to SS2/17 to create an expectation that small firms should disclose any material changes to their remuneration structures to their supervisors, especially on:

- the ratio of the maximum payout of bonus and executive incentive schemes when compared to fixed remuneration; and
- the performance measures and the risk adjustment used to determine whether and how much their bonus schemes and executive incentive schemes will pay out.

This is in line with Fundamental Rule 7 which requires a firm to 'deal with its regulators in an open and cooperative way, and must disclose to the PRA appropriately anything relating to the firm of which the PRA would reasonably expect notice.'

2.16 The PRA will continue to review and monitor small firms' compliance with all applicable remuneration rules, and any effects on incentives and behaviours through requests for completed Remuneration Policy Statements. The PRA will take supervisory or enforcement action if appropriate.

Remuneration disclosures

2.17 This CP does not address any remuneration disclosures for small remuneration firms. The PRA is consulting separately on elements of the disclosure regime for the Simpler-regime in CP4/23 – 'The Strong and Simple Framework: Liquidity and Disclosure requirements for Simpler-regime Firms'. The PRA intends to consider the interaction of the disclosure proposals in CP4/23 and the remuneration proposals in this CP further. This will include considering the remuneration-related disclosures that should be made by small firms. The PRA intends to consult on its approach to remuneration disclosure requirements in the near future.

2.18 The PRA also proposes to delete paragraphs 2.24 to 2.30 and Table D of SS2/17 as requirements on remuneration disclosures are set out in the Disclosure (CRR) Part of the PRA Rulebook. The Disclosure (CRR) Part requires certain firms subject to the

Remuneration Part to disclose a series of qualitative and quantitative information relating to remuneration, relevant provisions include Articles 433 to 433c on frequency and scope of disclosures and Article 450 on disclosure of remuneration policy.

PRA objectives analysis

2.19 The PRA considers that the combination of the remuneration regime and the proposed changes set out in this CP would advance the PRA's safety and soundness objective by maintaining minimum firm-wide remuneration policies and practices, while also reducing the burden on small firms in proportion to the risk they pose to the UK financial system. The PRA is proposing amending and disapplying additional rules for small firms that were introduced by the EU's CRD V and transposed into the PRA Rulebook in 2020, in line with the UK's obligations at the time. Evidence received since implementation suggests higher than expected costs and complexity for firms. Overly complex prudential requirements for small firms could increase their costs, which could undermine their safety and soundness. The proposed expectation for firms to notify the PRA of any material changes in their remuneration practices provides a more proportionate approach for monitoring potential risks to firms' safety and soundness as a result of changes in incentive structures.

2.20 The PRA considers a simpler prudential regime would facilitate effective competition, thereby supporting its secondary competition objective. Potential higher costs due to overly complex remuneration requirements could deter new entrants, and lead to an excessive cost burden on existing small firms. Providing greater flexibility for small firms in how they design their remuneration structures may also support them in competing for talent in the UK, and also giving new entrants in the UK market greater flexibility over their cost base, thereby promoting competition in the sector.

2.21 The Financial Services and Markets Bill 2022-23 includes measures to amend the PRA's objectives by introducing a new secondary competitiveness and growth objective. At the point that this Bill receives Royal Assent, this new secondary objective would require the PRA (in discharging its general functions in a way that advances its primary objectives in so far as reasonably possible) to act in a way that facilitates (subject to aligning with relevant international standards): (a) the international competitiveness of the economy of the UK (including, in particular, the financial services sector through the contribution of PRA-authorized persons); and (b) its growth in the medium to long term.

2.22 The PRA considers that the proposals set out in this CP would facilitate competitiveness and growth as they would support the attractiveness of the UK as a place to do business by reducing the regulatory burden on firms entering the UK market. The PRA's proposals would mean that the simpler remuneration regime for small firms would also be available to small UK subsidiaries and branches of international firms. Existing internationally headquartered firms operating in the UK market may also be incentivised to grow their UK operations given

the higher proposed threshold for the small firms' remuneration regime. Giving small firms in the UK room for growth by adopting a more proportionate approach to the application of remuneration requirements can also support growth as it would reduce ongoing implementation costs of the PRA's remuneration regime.

Cost benefit analysis (CBA)

2.23 This CBA draws on the results of a voluntary PRA survey sent to small firms in August 2022. The survey was aimed at PRA-supervised banks, building societies, and designated investment firms which meet the small CRR firm or small third-country CRR firm definition. The survey asked questions on the impact of the extension of the remuneration regime to small firms following the implementation of CRD V. It was completed by 64 firms. This CBA also draws on responses to CP12/20 – 'Capital Requirements Directive V (CRD V)' and waiver applications by firms received since the implementation of CRD V.

Benefits of the proposals

2.24 The benefits of the proposals are as follows:

- **Reduced complexity within the prudential framework:** The PRA considers its proposal to align the remuneration small firm definition with the Simpler-regime size threshold and other relevant criteria would reduce complexity for firms in understanding and interpreting thresholds within the prudential framework. Therefore, the PRA considers its proposals would benefit firms by reducing resource and costs that would otherwise be allocated to undertaking very different assessments to assess eligibility for the remuneration small firm and Simpler-regime frameworks.
- **More proportionate regime for small but growing firms:** The PRA considers its proposals to increase the size threshold to align with the Simpler-regime size threshold would give some further headroom to growing firms eg those close to the current £13 billion total assets size threshold. This would also allow additional firms that are larger in size within the proposed maximum size threshold for a Simpler-regime firm to benefit from a more proportionate remuneration regime compared to the current and previous regimes.

Figure 1: Impact of varying size thresholds on firms



This chart covers total assets of UK firms, subsidiaries of internationally headquartered firms, and the UK branches of internationally headquartered firms as at 31 December 2021. Although most small firms cluster under the current £4 billion threshold, a significant number are in between £4 billion and £13 billion. Five firms have three-year average total assets between £13 billion and £15 billion, and two firms have three-year average total assets between £15 billion and £20 billion. Considering that this is a static picture of firms' total assets, the introduction of a higher threshold might benefit small and growing firms that are currently under £15 billion.

- **Greater flexibility in determining own remuneration policies:** The proposals would permit firms to choose to alter their remuneration structures, or to leave them unchanged. Small firms would be free to choose whether to opt for a change if they believed the benefits outweighed the costs of changing remuneration structures.
- **Reduced costs for firms in applying clawback and malus:** Since the implementation of CRD V, some small firms have submitted applications to waive or modify remuneration rules, specifically highlighting the cost of malus and clawback. These costs are also evident in findings from the PRA's 2022 survey among small firms on costs and benefits of different aspects of the CRD V regime. None of the surveyed small firms 'strongly agreed' that the current rules on malus and clawback were proportionate for small firms. Thirty-nine percent of respondents said that malus had some impact (low, medium, or significant) on the overall compliance costs of CRD V implementation. Eight percent of all respondents said that rules on malus have a 'significant' or 'medium' impact. Similarly, 51% of all respondents said that clawback had some impact and 12% of all respondents said that this impact was medium or significant.
- **Reduced costs for small firms in applying buyout rules:** As noted in Policy Statement 26/20, applying buyout rules to small firms can expose them to an administrative burden.

Buyout awards represent a practice whereby firms buy out outstanding deferred bonus awards for staff that have been cancelled by their previous employer. However, unvested remuneration structures from larger firms can be more complex than those of smaller firms. For instance, while the former are subject to deferral requirements, the latter are not; conditions around instruments are also more complex for larger firms. Therefore, if a small firm wants to attract an MRT from a larger firm, it will need to mirror those rules, which is costly and complex in practice. Alternatively, if firms are not able to match the rules, senior individuals may be dissuaded from moving into the smaller firms as they would then forfeit their unvested remuneration from their former employer. Removing requirements on buyouts may therefore make small firms more attractive to MRTs from other financial service firms, which may help sustain healthy competition in the industry.

- **Increased ability to attract new staff:** The proposals could improve the ability of small firms in the UK to compete with other firms (including investment managers and technology firms) that do not have a CRR firm or an Investment Firms Prudential Regime (IFPR) firm in the group and are consequently not required to apply PRA requirements such as malus, clawback, and buyout rules to MRT remuneration. The PRA considers that the proposed new rules should help increase broader labour mobility for senior executives and other MRTs.
- **Enhanced UK competitiveness:** By reducing costs for small firms, as outlined above, the proposals could enhance UK competitiveness. The proposed new regime could increase the attractiveness of the UK as a base for small firms and attract key talent to the UK banking sector. Second, the changes could help small UK firms more effectively compete if doing business in jurisdictions where there are no prescriptive rules for small firm MRTs, thereby promoting UK competitiveness in global financial markets.
- **Reduced administrative burden on firms and the PRA:** Since the implementation of CRD V, the PRA has assessed a number of waivers where proportionality was a relevant consideration. The PRA considers that the rules under consideration in the CP impose an administrative burden on firms and on the PRA itself, both at the time of application, and when reviewed at the point of expiry and potential renewal, which is not proportionate to the benefits.

Costs of the proposals

2.25 The PRA recognises that a firm will need to calculate the measures that underpin the proposed scope criteria to determine whether it is, or continues to be, eligible for the small firm remuneration regime. The PRA considers that firms will regularly monitor whether they fall under the criteria each year and are therefore unlikely to incur additional costs over and above costs already normally incurred as a result.

2.26 The PRA does not consider that there would be significant additional costs for firms in assessing eligibility because:

- the PRA has sought as far as possible to use existing definitions and measures as proposed within the Simpler-regime criteria (as set out in CP5/22 and CP16/22);
- the proposed size criteria are based on measures that all PRA-authorized firms are required to calculate;
- the proposed limited trading activity criterion is based on measures that all firms are required to calculate;
- all firms should know their foreign exchange and commodities positions;
- all firms should know whether they are providing clearing, settlement, and custody services to third party banks and building societies in currencies other than Pound Sterling; and
- all firms should know whether they are operating a payment system.

2.27 If firms choose to apply the changed remuneration requirements set out in the proposals, that could introduce some one-off and ongoing costs of adapting small firms' remuneration structures, particularly given that current arrangements would have already been implemented into policies and practices. The proposed policy changes may trigger firms to review the remuneration structures of their MRTs, and to decide whether to keep them, remove all aspects of malus and clawback, or keep some aspects only. However, small firms can choose to pursue these changes only if they believe the benefits outweigh the costs.

2.28 At the time of the extension of remuneration rules to small firms in CRD V (CP12/20), the PRA considered that increasing coverage of the remuneration requirements would further reduce the contribution of UK banks to systemic risk, 'although the size of the benefit is highly uncertain and the PRA does not consider it is reasonably practicable to provide a monetary estimate of the likely benefit.'^[3] As such, removing specific requirements for small firms could potentially increase the risk that these firms pose. However, these requirements did not apply to small firms prior to the implementation of CRD V, and the PRA does not consider that increasing the size threshold of small firms for remuneration purposes would lead to a significant change in risk taking on its own. Moreover, in selecting criteria for eligibility for the small firms' regime, the PRA has specifically chosen to exclude from scope those firms whose activities and complexity could give rise to greater risk.

2.29 In addition, other firm-wide remuneration rules that ensure risk management (including consideration of current and future risks) as well as affordability around remuneration decisions, would continue to apply (see paragraph 2.13). The effective application of these rules should support the necessary control environment in relation to incentive setting and support the safety and soundness of UK regulated firms.

2.30 The PRA considers the costs of this proposal to be small, particularly in light of the remaining requirements and expectations of the remuneration regime that support the desired outcomes of the broader framework. The PRA thereby considers that the benefits of

its proposals would outweigh their costs.

'Have regards' analysis

2.31 In developing these proposals, the PRA has had regard to the FSMA regulatory principles, and the aspects of the Government's economic policy set out in the HMT recommendation letter from December 2022. During the development of these proposals, the PRA also had regard to the aspects of the Government's economic policy set out in the HMT recommendation letter from March 2021 and the supplementary recommendation letter sent in April 2022. Where the proposed new rules are rules applying to holding companies under section 192XA of FSMA, in accordance with section 192XB(2), the PRA has also taken into consideration the matters to which it is required to have regard when making CRR rules under section 144C. The following factors, to which the PRA is required to have regard, were significant in shaping the PRA's proposals.

- 1. Proportionality (FSMA regulatory principles):** In proposing the use of the Simpler-regime size threshold and selected additional criteria, the PRA has had regard to proportionality. The proposed size threshold for eligibility for simpler rules is aimed at reducing ongoing compliance costs for small firms. The PRA considers this to be important because small firms may lack the economies of scale to operationalise more detailed prudential requirements, which are often designed with larger firms in mind. To further promote proportionality, the PRA has preserved the existing total assets definition for third-country firms (adapted to a 3-year average) to avoid imposing the costs of completing a new reporting template.
- 2. Recognition of different business models (FSMA regulatory principles):** By reducing the number of requirements that firms are subject to and consequently reducing the regulatory compliance burden for small firms, the PRA has considered different business models of smaller firms which, as set out above, may lack economies of scale.
- 3. Sustainable economic growth (FSMA regulatory principles and HMT recommendation letters):** The PRA considers that its proposals remove a regulatory constraint on small firms, providing these firms with greater flexibility over the design of remuneration structures. The PRA considers this would provide incentives to expand existing and new business lines, and more broadly support the attractiveness of the UK as a place to do business. The PRA considers the proposals could support labour mobility – into and across the UK financial services sector (from other sectors and jurisdictions). The increase in the size threshold used to define small firms would provide more headroom for small firms to grow and still benefit from more proportionate remuneration requirements.
- 4. Competitiveness (HMT recommendation letters):** The PRA considers its proposals would increase the attractiveness of the UK as a domicile for small, internationally active financial institutions, and help retain its position as a leading international financial centre. The trading book and foreign exchange criteria may also be potentially more

advantageous for branches of third-country firms as they are able to compare the branch's position with the position of the firm as a whole.

5. **The likely effect of the rules on the relative standing of the United Kingdom as a place for internationally active credit institutions and investment firms to be based or to carry on activities:** There are no relevant standards issued by the Basel Committee on Banking Supervision but the PRA considers its proposals are fully in line with the international principles and standards on sound compensation practices set out by the [Financial Stability Board](#) which are intended to apply to all significant financial institutions.
6. **Efficient and economic use of PRA resources (FSMA regulatory principles):** The PRA has considered the regulatory principles of transparency and the efficient and economic use of resources in proposing the adoption of a number of the Simpler-regime criteria for the purposes of identifying small firms for purposes of remuneration rules. Raising the size thresholds for small firms may reduce the number of waivers that the PRA receives. This reduces resource pressure that creating a new threshold or processing waivers would place on the PRA.

2.32 The PRA has had regard to other factors as required. Where analysis has not been provided against a 'have regard' for this set of proposals, it is because the PRA considers that 'have regard' to not be a significant factor for this set of proposals.

Impact on mutuals

2.33 The PRA considers that the impact of the proposed rule changes on mutuals is expected to be no different from the impact on other firms, as the proposals would apply equally to all CRR and third-country CRR firms, including mutuals. Therefore, the PRA considers that the impact of the proposals on mutuals would be no different from the impact on other firms.

Equality and diversity

2.34 In making its rules and carrying out its policies, services, and functions, the PRA is required by the Equality Act 2010 to have due regard to the need to eliminate discrimination, to promote equality of opportunity, and to foster good relations between persons who share a protected characteristic and those who do not.

2.35 The PRA has considered the equality and diversity issues that may arise from the proposals in this CP. The PRA considers that the proposals do not give rise to material equality and diversity implications because the remuneration requirements being removed for small firms only impact the structure of payments and adjustments to individuals' remuneration rather than the quantum of remuneration. Given that the quantum of remuneration is not directly impacted by the proposals, the PRA does not consider that this raises equality or diversity implications.

2.36 The FCA has existing requirements for dual-regulated firms to ensure their remuneration policies and practices are gender neutral. Firms are also reminded that the Equality Act 2010 prohibits discrimination on the basis of an individual's protected characteristics. Firms should ensure that when they assess individual performance, the assessment process and any variable remuneration awarded does not discriminate on the basis of the protected characteristics of the individual. Supervisors may follow up directly with their firms on how they are managing and monitoring this.

1. The consultation for CP15/22 closes on 31 March 2023.
2. For further information please see [Transitioning to post-exit rules and standards](#).
3. Paragraph 7.7.

Appendices

[Draft small firms remuneration proportionality instrument \(PDF\)](#)

[Draft amendments to Supervisory Statement 2/17 – 'Remuneration' \(PDF\)](#)

[PRA statutory obligations \(PDF\)](#)