

13 April 2017



Financial Services – Reward PRA publishes final guidance on remuneration

Overview

Yesterday, the Prudential Regulation Authority (PRA) published its Policy Statement (PS) 7/17 on 'The PRA's expectations on remuneration' and Supervisory Statement (SS) 2/17 on 'Remuneration'. This follows the PRA's consultation paper on its updated guidance which it published in September 2016.

Scope	Banks, building societies and UK designated investment firms subject to the Remuneration Part of the PRA Rulebook.
Effective date	Now

The PRA's papers can be found [here](#).

Key changes from the PRA consultation paper published in September 2016

A summary of the key changes from the draft PRA guidance released in September is as follows:

- **EBA Guidelines**

The PRA has confirmed that the provisions of the EBA Guidelines relating to the structure of variable remuneration apply in relation to awards granted for the performance year 2017 onwards.

The PRA makes it clear that firms should have been compliant with the provisions of the EBA Guidelines relating to governance and remuneration policies, practices and procedures since 1 January 2017, when the EBA guidance took effect.

The PRA confirms that it expects all firms to comply with the EBA Guidelines, although will continue to allow proportionality Level 3 firms to disapply the bonus cap (discussed further below). The PRA considers that it does not need to provide further guidance at this stage on other elements of the EBA Guidelines, such as dividend/dividend equivalents and the structuring of long-term incentive plans.

- **Proportionality**

The PRA in its Supervisory Statement has clarified that it may be appropriate for a Level 3 firm to disapply the new PRA rules on buy-outs, which took effect from 1 January 2017. The PRA notes that this confirmation was not included in PS26/16 'Buy-outs of variable remuneration', but emphasises that the PRA's approach to this issue has not changed.

- **Material Risk Takers (MRTs)**

The PRA has provided further clarity in relation to how firms should determine the fixed component of total remuneration in the case of MRTs who join a firm part-way through the performance year. The fixed component may be determined by an annualised rate which treats the amount of fixed remuneration awarded at the end of the year as having been awarded across the entire performance period.

- **Guaranteed variable remuneration**

The PRA has provided clarification that, where an award is made to compensate a new hire for a 'lost bonus opportunity' at their previous employer, this amount should be included within the variable component of the fixed to variable ratio in the relevant performance period in which the award is made.

Summary of the final PRA Supervisory Statement (SS) 2/17 – 'Remuneration'

Alongside the guidance contained in the Policy Statement, firms should also review the PRA Supervisory Statement on 'Remuneration', as this sets out the PRA's position on proportionality, remuneration structures, performance adjustment, disclosure and governance, and the identification of MRTs.

In part a consolidation exercise, the Supervisory Statement incorporates previous PRA guidance and new provisions which reflect how the PRA's position has developed.

A summary of the key points contained within the final guidance can be found here:

- **Proportionality**

The PRA confirms that, not only will Level 3 firms be able to continue to disapply the bonus cap, such firms are also able to disapply the “pay out process” rules (i.e. the rules on deferral, payment in instruments and performance adjustment, including the rules relating to clawback).

However, firms should note the shift in tone. Previously, PRA guidance stated that “it *will normally be* appropriate” for a Level 3 firm to disapply the pay-out process rules. In the final Supervisory Statement, the PRA states that “it *may be* appropriate” for a Level 3 firm to disapply such rules. Level 3 firms should therefore consider (and document internally) their reasons for considering that the disapplication of these rules is appropriate in their particular circumstances.

The final Supervisory Statement also confirms that all firms can continue to apply the individual *de minimis* threshold, meaning that, where an individual’s variable remuneration is no more than 33% of their total remuneration, and their total remuneration is no more than £500,000, the rules on guaranteed variable remuneration (and buy-outs) and the pay-out process rules can be disapplied.

- **Identification of MRTs**

The final Supervisory Statement reflects the PRA’s continuing emphasis on firms taking a holistic approach to MRT identification.

The PRA explains that it expects all firms to apply the Commission Delegated Regulation which sets out regulatory technical standards (RTS) for identifying MRTs “as a minimum standard”. The PRA makes clear its expectation that firms should exercise discretion in relation to identifying MRTs and that it is 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, the PRA states expressly that its expectations as to the types of roles that should be identified as MRTs “may evolve over time.”

The final Supervisory Statement also provides more detail on how firms should identify staff involved in credit or trading risk. For example, the PRA considers that a staff member should not be identified as both initiating and authorising transactions. In addition, 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 relevant limits stated in qualitative criteria or the quantitative criteria in the RTS (giving, as an example, foreign exchange traders).

For the purposes of identifying staff working in asset management, the PRA sets out a number of specific criteria that should also be considered by dual-regulated firms, such as the extent to which the relevant fund relates to retail clients and the strength of investment risk controls in place.

- **Performance adjustment**

Where there has been a material failure of risk management or misconduct, the PRA expands on the circumstances in which it expects performance adjustment to be applied to include where employees in control functions could be considered to be responsible

for weaknesses and failings in control functions relevant to the failure or misconduct that has occurred.

- **Long-term incentive plans**

The final Supervisory Statement contains a separate section on LTIPs, focusing on the use of different metrics, which reflects the general position taken by the PRA to date. In particular, firms should be able to justify how non-financial measures in the quantitative metrics are appropriate for the business model and strategy of the firm.

- **Guaranteed variable remuneration.**

The PRA confirms that, notwithstanding the position taken by the EBA in its Guidelines in relation to guaranteed variable remuneration paid as a sign-on award (which permits firms to disapply the pay-out process rules and not to count the sign-on award towards the bonus cap), the PRA expects such awards to be subject to deferral and malus and clawback, and to count towards the bonus cap. The final Supervisory Statement remains silent on whether the retained instruments rule must also be applied.

As part of this section, the PRA states that a payment in respect of a 'lost opportunity' to participate in the bonus plan at the previous employer would be classified as guaranteed variable remuneration and, as explained above, also confirms that these awards should be included in the variable component of the fixed to variable ratio for the relevant performance period in which the award is made.

If you have any queries in relation to any of the points discussed in this newsflash, please contact any member of the team listed below.

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