



Consultation Paper | CP9/21

Remuneration: Correction to the definition of ‘higher paid material risk taker’

April 2021





BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

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The response will be assessed to inform our work as a regulator and central bank, both in the public interest and in the exercise of our official authority. We may use your details to contact you to clarify any aspects of your response.

The consultation paper will explain if responses will be shared with other organisations (for example, the Financial Conduct Authority). If this is the case, the other organisation will also review the responses and may also contact you to clarify aspects of your response. We will retain all responses for the period that is relevant to supporting ongoing regulatory policy developments and reviews. However, all personal data will be redacted from the responses within five years of receipt. To find out more about how we deal with your personal data, your rights or to get in touch please visit bankofengland.co.uk/legal/privacy.

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Responses are requested by Wednesday 26 May 2021.

In light of current measures to help prevent the spread of COVID-19, please address any comments or enquiries by email to: CP9_21@bankofengland.co.uk.

Alternatively, please address any comments or enquiries to:

Robert Collins
Prudential Regulation Authority
20 Moorgate
London EC2R 6DA

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1 Overview

1.1 This Consultation Paper (CP) sets out the Prudential Regulation Authority's (PRA) proposal to correct an error in the definition of 'higher paid material risk taker' in the PRA Rulebook. The purpose of this proposal is to align the 'higher paid material risk taker' definition with the PRA's intention of continuing the approach outlined in Supervisory Statement (SS) 2/17 'Remuneration'.¹ This CP follows the PRA statement published on Thursday 25 February 2021, which explained the PRA's position in relation to the definition of 'higher paid material risk taker'.²

1.2 The proposals in this CP would result in changes to the Remuneration Part of the PRA Rulebook (Appendix 1) and SS2/17 (Appendix 2).

1.3 This CP is relevant to PRA-authorised banks, building societies, and PRA-designated investment firms. This CP is not relevant to credit unions or PRA-authorised insurers.

Implementation

1.4 The PRA proposes that the implementation for the changes resulting from this CP would take effect upon publication of the final policy. In order to avoid retroactivity, the PRA proposes that firms would not be required to apply the corrected definition to remuneration that has been paid, vested, or is subject to an obligation to pay or vest created before that date in respect of the first performance year beginning on or after Tuesday 29 December 2020. The PRA intends to publish its final policy in Q2 2021.

Responses and next steps

1.5 This consultation closes on Wednesday 26 May 2021. The PRA invites feedback on the proposals set out in this consultation. Please address any comments or enquiries to CP9_21@bankofengland.co.uk.

1.6 The proposals set out in this CP have been designed in the context of the UK having left the European Union and the transition period having come to an end. Unless otherwise stated, any references to EU or EU derived legislation refer to the version of that legislation which forms part of retained EU law.³ The PRA will keep the policy under review to assess whether any changes would be required due to changes in the UK regulatory framework.

¹ April 2017: <https://www.bankofengland.co.uk/prudential-regulation/publication/2017/remuneration-ss>.

² <https://www.bankofengland.co.uk/prudential-regulation/publication/2021/february/pru-statement-definition-of-higher-paid-material-risk-taker>.

³ For further information please see: <https://www.bankofengland.co.uk/eu-withdrawal/transitioning-to-post-exit-rules-and-standards>.

2 Proposals

2.1 The PRA has identified an error in the definition of 'higher paid material risk taker' in Rule 1.3 in the Remuneration Part of the PRA Rulebook. This definition affects the interpretation of Remuneration 15.17, 15.20, 15.20A, 15.22, and 15.23. The error was introduced when the final rule instrument 'PRA RULEBOOK: CRR FIRMS: REMUNERATION (CAPITAL REQUIREMENTS DIRECTIVE V) INSTRUMENT 2020' was published as part of Policy Statement (PS) 29/20 'Capital Requirements Directive V (CRD V)'.⁴

2.2 The erroneous definition states that 'higher paid material risk taker' is defined as an individual (a) whose annual variable remuneration exceeds 33% of their total remuneration; **and** (b) whose total remuneration exceeds £500,000. This implies that an individual would need to meet **both** of these conditions in order to be considered a higher paid material risk taker. However, the PRA intended that the definition capture individuals who meet **either** of these conditions.

2.3 Therefore, this CP is proposing to change the '**and**' in the definition to '**or**'. It also proposes to make a consequential amendment to Table G in SS2/17, to reflect the updated definition in the table heading.

2.4 In order to avoid retroactivity, the PRA is also proposing an addition to the Remuneration Part to make clear that firms would not be required to apply the corrected definition to remuneration that has been paid, vested, or is subject to an obligation to pay or vest created before that date in respect of the first performance year beginning on or after Tuesday 29 December 2020.

2.5 PS26/20 'Capital Requirements Directive V (CRD V)'⁵ explained that the changes it made to the Remuneration Part 1.3 were intended to:

- reflect changes to proportionality required under CRD Article 92;
- match the conditions set out in SS2/17, paragraph 2.20, for the disapplication of remuneration rules at an individual level;
- enable the continued application of stricter PRA standards in relation to deferral and clawback for 'higher paid material risk takers'; and
- apply CRD V minimum deferral and clawback requirements to other material risk takers.

2.6 The proposals in this CP would ensure that the definition of 'higher paid material risk taker' matches what the PRA had originally intended, as set out in PS26/20.

⁴ December 2020 (see Appendix 13): <https://www.bankofengland.co.uk/prudential-regulation/publication/2020/capital-requirements-directive-v-further-implementation>.

⁵ December 2020 (see paragraphs 3.19 and 3.24): <https://www.bankofengland.co.uk/prudential-regulation/publication/2020/capital-requirements-directive-v-further-implementation>.

3 The PRA's statutory obligations

3.1 In carrying out its policy making functions, the PRA is required to comply with several legal obligations. Before making any rules, the Financial Services and Markets Act 2000 (FSMA)⁶ requires the PRA to publish a draft of the proposed rules accompanied by:

- a cost benefit analysis;
- an explanation of the PRA's reasons for believing that making the proposed rules is compatible with the PRA's duty to act in a way that advances its general objective,⁷ insurance objective⁸ (if applicable), and secondary competition objective;⁹
- an explanation of the PRA's reasons for believing that making the proposed rule is compatible with its duty to have regard to the regulatory principles;¹⁰ and
- a statement as to whether the impact of the proposed rules will be significantly different to mutuals than to other persons.¹¹

3.2 The Prudential Regulation Committee (PRC) should have regard to aspects of the Government's economic policy as recommended by HM Treasury.¹²

3.3 The PRA is also required by the Equality Act 2010 to have due regard to the need to eliminate discrimination and to promote equality of opportunity in carrying out its policies, services and functions.¹³

Cost benefit analysis

3.4 The PRA considers that the amendments proposed in this CP would introduce little additional cost. This is because, as far as the PRA is aware, firms have been following the rules as intended rather than as worded. The intention of this CP is to ensure that the PRA Rulebook correctly reflects the PRA's intended position, as set out in PS26/20. In fact, the definition of 'higher paid material risk taker' was introduced to continue applying the PRA's previous regime in relation to deferral and clawback to certain material risk takers, following the introduction of individual proportionality thresholds in CRD V. The PRA therefore expects that addressing the error in the 'higher paid material risk taker' definition should help avoid any confusion.

Compatibility with the PRA's objectives

3.5 The PRA has a statutory objective to promote the safety and soundness of PRA-authorized persons. The PRA considers that the proposals in this CP are compatible with this objective. The PRA continues to consider that longer requirements for remuneration structures relating to deferral and malus/clawback are necessary for material risk takers who are either paid total remuneration in excess of £500,000, or whose variable remuneration exceeds 33% of their total. The PRA considers

⁶ Section 138J of FSMA.

⁷ Section 2B of FSMA.

⁸ Section 2C of FSMA.

⁹ Section 2H(1) of FSMA.

¹⁰ Sections 2H(2) and 3B of FSMA.

¹¹ Section 138K of FSMA.

¹² Section 30B of the Bank of England Act 1998.

¹³ Section 149.

that the position where both conditions are required to be met would undermine safety and soundness, because it would enable risk takers paid above £500,000 to avoid stricter requirements by a reduction in the percentage of variable remuneration they receive. Conversely, it would mean that material risk takers who receive a very high percentage of variable to total remuneration, but who paid under £500,000 in total, would avoid longer requirements. Sound remuneration policies and processes enhance the safety and soundness of firms, in line with the PRA's objectives.

3.6 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 considers that the proposals in this CP do not have a material impact on competition in such markets, as they restore the threshold for stricter requirements on deferral and malus/clawback that operated under SS2/17 prior to CRD V transposition.

Regulatory principles

3.7 In developing the proposals in this CP, the PRA has had regard to the regulatory principles. In particular, in light of the principle that a burden or restriction should be proportionate to its benefits, considered in general terms, the PRA considered whether it would be more proportionate to remove the stricter requirements or to set a different threshold for their application to the one set out in SS2/17. However, given that the PRA continues to consider the stricter requirements appropriate to individuals captured by this threshold, and that firms have previously been implementing it, the PRA considers that the proposals in this CP are the most proportionate option.¹⁴

Impact on mutuals

3.8 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.

HM Treasury recommendation letter

3.9 HM Treasury has made recommendations to the Prudential Regulation Committee (PRC) about aspects of the Government's economic policy to which the PRC should have regard when considering how to advance the PRA's objectives and apply the regulatory principles.¹⁵

3.10 The aspects of the Government's economic policy most relevant to the proposals in this CP are:

- (i) growth; and
- (ii) competitiveness.

Growth

3.11 The PRA considers that the proposals ensure that material risk takers are not able to avoid stricter requirements in respect of their remuneration. This ensures that economic growth is

¹⁴ Further detail of the PRA's analysis of the proportionality of applying stricter requirements to 'higher paid material risk takers' is set out in paras 3.54-56 of PS26/20.

¹⁵ Information about the PRC and the recommendations from HM Treasury are available on the Bank's website at: <https://www.bankofengland.co.uk/about/people/prudential-regulation-committee>.

sustainable by ensuring that material risk takers are subject to CRD V remuneration requirements and have incentives that are appropriately aligned with prudent risk taking.

Competitiveness

3.12 The PRA considers that the proposals contribute to maintaining robust institutions and a resilient financial system by ensuring that incentives are appropriately aligned with prudent risk taking at firms. The proposals therefore contribute to the competitiveness of the UK as an attractive domicile for internationally active financial institutions.

Equality and diversity

3.13 The PRA considers that the proposals do not give rise to equality and diversity implications.

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1 Draft Remuneration instrument

PRA RULEBOOK: CRR FIRMS: REMUNERATION INSTRUMENT 2021

Powers exercised

- A. The Prudential Regulation Authority ("PRA") 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);
 - (3) section 137T (General supplementary powers);
 - (4) section 192V (Rules imposing consolidated requirements);¹⁶ and
 - (5) any other relevant rulemaking powers or related provisions.
- B. The rule-making powers referred to above are specified for the purpose of section 138G(2) (Rule-making instrument) 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.

PRA Rulebook: PRA RULEBOOK: CRR FIRMS: REMUNERATION INSTRUMENT 2021

- D. The PRA makes the rules in the Annex to this instrument.

Commencement

- E. This instrument comes into force on [DATE].

Citation

- F. This instrument may be cited as the PRA Rulebook: CRR Firms: Remuneration Instrument 2021.

By order of the Prudential Regulation Committee

[DATE]

¹⁶ If at the time this instrument is made section 192V has been replaced by another power to apply PRA rules to holding companies by the Financial Services Act 2021, the PRA anticipates exercising the new power.

Annex A

Amendments to the Remuneration Part

In this Annex new text is underlined and deleted text is struck through.

1 APPLICATION AND DEFINITIONS

...

1.3 In this Part, the following definitions shall apply:

...

higher paid material risk taker

means a *material risk taker*:

- (a) whose annual variable *remuneration* exceeds 33% of their total *remuneration*, ~~and~~ or
- (b) whose total *remuneration* exceeds £500,000.

...

2 APPLICATION DATES AND TRANSITIONAL PROVISIONS

...

2.5 ~~Subject to 2.7 and 2.8 a firm~~ must apply this Part to *remuneration* awarded in respect of a performance year starting on or after 29 December 2020.

...

2.7 Subject to 2.8, for *remuneration* awarded in respect of a performance year starting on or after 29 December 2020 a firm must apply this Part in accordance with the definition of *higher paid material risk taker* in 1.3.

2.8 For *remuneration* awarded in respect of the first performance year starting on or after 29 December 2020, and where:

- (a) the *remuneration* has been paid or vested before [DATE],¹⁷ or
- (b) the firm has before [DATE] created an obligation to pay or vest the *remuneration* before [DATE]

a firm may instead apply this Part to that *remuneration* on the basis of the definition of *higher paid material risk taker* which was set out in 1.3 on the earlier of:

- (i) the date the *remuneration* was paid or vested; or

¹⁷ The date in square brackets in this rule will be the date of publication of the final rule.

(ii) the date the *firm* has created the obligation to pay the *remuneration* or for the *remuneration* to vest.

...

2 Draft amendment to Supervisory Statement SS2/17 – Remuneration

...

Table G: Minimum deferral and clawback rules applicable to MRTs

Firm category	MRT category	Higher paid MRT (Total rem >£500,000 and or variable rem >33% of total rem, Rule 1.3)		Non-higher paid MRT (Total rem ≤£500,000 and variable rem ≤33% of total rem, Rule 1.3)		MRT below proportionality threshold (Variable rem ≤£44,000 and variable rem ≤one third of total rem, Rule 15.A1(3))	
		Minimum Deferral (years)	Minimum Clawback (years)	Minimum Deferral (years)	Minimum Clawback (years)	Minimum Deferral (years)	Minimum Clawback (years)
Significant firms (as defined in Rule 1.3)	MRT who performs a PRA senior management function (SMF)	7	7 ¹	5	1, 6 ²	0	1, 6 ²
	Non-SMF members of the management body and senior management	5	7	5	1, 6 ²	0	1, 6 ²
	MRTs: (i) who meets the criteria in Remuneration Rule 3.1(1)(b); or (ii) whose professional activities meet the qualitative criteria set out in Article 6(1), 6(2) or 6(5) of the RTS	5	7	4	1, 5 ²	0	1, 5 ²
	Other MRTs	4	7	4	1, 5 ²	0	1, 5 ²
Other firms	MRT who performs a PRA SMF	7	7 ¹	4	1, 5 ²	0	1, 5 ²
	Non-SMF members of the management body and senior management	5	7	4	1, 5 ²	0	1, 5 ²
	MRTs: (i) who meets the criteria in Remuneration Rule 3.1(1) (b); or (ii) whose professional activities meet the qualitative criteria set out in Article 6(1), 6(2) or 6(5) of the RTS	5	7	4	1, 5 ²	0	1, 5 ²
	Other MRTs	4	7	4	1, 5 ²	0	1, 5 ²

Firm category	MRT category	Higher paid MRT (Total rem >£500,000 and or variable rem >33% of total rem, Rule 1.3)		Non-higher paid MRT (Total rem ≤£500,000 and variable rem ≤33% of total rem, Rule 1.3)		MRT below proportionality threshold (Variable rem ≤£44,000 and variable rem ≤one third of total rem, Rule 15.A1(3))	
		Minimum Deferral (years)	Minimum Clawback (years)	Minimum Deferral (years)	Minimum Clawback (years)	Minimum Deferral (years)	Minimum Clawback (years)
		¹ Extendable to 10 years in line with Rule 15.20A (2) [subject to rule finalisation]					
		² Minimum clawback of 1 year if the variable remuneration is not deferred.					