

# Bank of England

## Prudential Regulation Authority

# Appendices to Remuneration: Unvested pay, Material Risk Takers and public appointments

Consultation Paper | CP8/22

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# Contents

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<b>Contents</b>	<b>1</b>
<b>1: Update to SS2/17 'Remuneration'</b>	<b>2</b>
4 Application of malus and clawback to variable remuneration	2
4A Material Risk Takers, conversion of unvested instruments and public appointments	2
5 Other elements of remuneration	5
<b>2: PRA statutory obligations</b>	<b>6</b>

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# 1: Update to SS2/17 ‘Remuneration’

In this appendix, new text is underlined and deleted text is struck through.

## 4 Application of malus and clawback to variable remuneration

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4.24 Table G below presents a summary of the minimum deferral and clawback requirements across MRT categories. It should be noted that more than one MRT category may apply to an individual in which case, as per Chapter 15, the highest minimum deferral or clawback must be applied by firms.

Table G

### 4A Material Risk Takers, conversion of unvested instruments and public appointments

4A.1 The PRA’s rules require that a firm must ensure that a substantial portion (at least 50%) of any variable remuneration payable to a MRT consists of an appropriate balance of:

- i. shares or, subject to the legal structure of the firm concerned, equivalent ownership interests; or subject to the legal structure of the firm concerned, share-linked instruments or equivalent non-cash instruments; and
- ii. where possible, other instruments which are eligible as Additional Tier 1 instruments or are eligible as Tier 2 instruments or other instruments that can be fully converted to Common Equity Tier 1 instruments or written down, that in each case adequately reflect the credit quality of the firm as a going concern, and are appropriate for use as variable remuneration.<sup>1</sup>

4A.2 Additionally, there is a requirement that a firm must not award variable remuneration unless a substantial portion of it (at least 40%) is deferred, for a period varying between at least four and seven years, depending on factors such as whether the relevant MRT is a higher-paid MRT, on the management body and/or performing a Senior Management Function.<sup>2</sup>

<sup>1</sup> See Rule 15.15 in the Remuneration Part.

<sup>2</sup> See Rules 15.17 and 15.18

4A.3 Firms therefore have a degree of choice when they initially determine which instruments comprise that part of a MRT's variable remuneration that must be awarded in instruments. Thereafter, the PRA expects that following an award, changes to the instruments that comprise that award should not ordinarily occur in order to ensure a consistent alignment of the long-term interests of firms and MRTs.

4A.4 There may, however, be exceptional circumstances in which such a conversion is appropriate and consistent with the long-term alignment of the interests of firms and their MRTs. A particular case could arise where a firm is prepared to consider converting instruments that comprise unvested, deferred pay where a MRT or former MRT seeks a senior public-sector appointment linked to financial policy or financial services regulation (a 'public-sector appointment') to address a potential conflict of interest (eg such as could exist where a former MRT continues to have a contingent claim on the equity of a firm while working for a public body exercising these functions).

4A.5 It is the responsibility of a potential public-sector body looking to employ a MRT to consider what mechanisms may be available to it under its own code of conduct to address any conflict of interest (eg declarations, recusal) arising from such unvested remuneration. However, where a firm that has previously awarded unvested, deferred pay wishes to help facilitate a public-sector appointment, the PRA expects that the firm should seek the PRA's non-objection prior to changing the instruments that comprise the awards (eg from equity to other instruments). In considering whether its non-objection is appropriate, the PRA will be guided by whether:

- (i) the conversion is consistent with the aims of the remuneration requirements;
- (ii) the MRT's experience is directly relevant to the role; and
- (iii) it would be appropriate or sufficient for a potential conflict to be avoided or mitigated through other means.

4A.6 Where an unvested, deferred sum is converted from equity to other instruments the same retention period should apply.

4A.7 The PRA (along with the FCA) has a statutory power under s138A FSMA to waive or modify its rules in circumstances where it is satisfied that compliance with the unmodified rules would be unduly burdensome, or would not meet the purpose for which the rule was made, and where the waiver or modification would not adversely affect advancement of its objectives, including promoting the safety and soundness of PRA-authorized persons.

4A.8 On the question of addressing potential conflicts of interest arising in public-sector appointments, a firm may additionally consider requesting a waiver or modification of the remuneration rules to allow an unvested, deferred claim in equity or other instruments to

convert to a cash claim, where this would otherwise be prevented by the PRA's rules. Each waiver or modification decision will be considered on the basis of the facts of the individual case. However, the PRA considers that in wholly exceptional cases, a request by a firm to convert an unvested, deferred claim on equity or other instruments to a claim on cash would be more likely to meet the FSMA test where:

(i) individuals are due to join a public-sector employer in a senior capacity, and where their financial services experience is directly relevant to the role;

(ii) the PRA is satisfied that it would not be appropriate or sufficient for a potential conflict to be addressed through other means (including conversion from an equity claim to one based on other instruments);

(iii) any cash claim would replicate the deferral, malus and clawback provisions that applied to the original claim, and no early payment takes place;

(iv) contractual terms are adopted that replicate the relevant features of other instruments, including: (a) write-down at the relevant Common Equity Tier 1 (CET1) trigger, and (b) a pro-rata reduction where distribution restrictions are triggered under chapter 4 of the Capital Buffers Part of the PRA Rulebook or equivalent s.55M requirement;<sup>3</sup> and

(v) a firm demonstrates how contractually, the alignment of interests between firm and MRT that arises from the relevant retention period for equity or other instruments could be replicated (eg by extending the vesting period).

4A.9 The PRA's expectation is, however, that where a public-sector employer's conflict of interest policy can address a potential conflict of interest without need for any alteration of variable remuneration, this route should be pursued. Therefore, in considering either a request for non-objection or a request for a waiver or modification, the PRA would expect to be provided with a reasoned case outlining why this, together with other measures as appropriate, would reasonably address the conflict of interest identified, including why such conflict cannot otherwise be sufficiently addressed by internal conflicts policies and, in the case of a waiver or modification request, conversion to other instruments. If an adjustment to claims that comprise a variable pay award, along with other measures, is not effective in addressing the conflict, it is unlikely that the PRA would grant an application for waiver/modification.

4A.10 The PRA's expectation applies to all unvested, deferred sums, and does not exclude amounts above any regulatory minima. Where firms, for example, make initial awards weighted towards equity on the basis that this best achieves a better alignment of interests

<sup>3</sup> See chapter 4 of the Capital Buffers Part of the PRA Rulebook, and Section 55M of the Financial Services and Markets Act 2000 (FSMA).

between the firm and the MRT, any proposed changes to this should be notified to the PRA and its non-objection sought.

## 5 Other elements of remuneration

### Governing body and remuneration committee

5.1 Firms are expected to demonstrate that their decisions are consistent with an accurate assessment of their financial condition and future prospects. In particular, practices by which remuneration is paid for with potential future revenues whose timing and likelihood remain uncertain should be evaluated carefully. The governing body or remuneration committee, or both, should work closely with the risk function in evaluating the incentives created by the remuneration policies of the firm.

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## 2: PRA statutory obligations

The statutory obligations applicable to the PRA's policy development process are set out below. This CP explains the policy assessment of relevant considerations.

- Purpose of the policy proposals (FSMA s138J(2)(b)).
- Cost benefit analysis (FSMA s138J(2)(a) and (7)(a)); and an estimate of those costs and benefits (if reasonable) (FSMA s138J(8)).
- Analysis of whether the impact on mutuals is significantly different to the impact on other authorised firms (FSMA s138J(2)(c) and 138K).
- Compatibility with the PRA's primary objectives (FSMA s138J(2)(d)(i), 2B and 2C).
- Compatibility with the PRA's secondary competition objective (FSMA s138J(2)(d)(ii) and 2H(1)).
- Compatibility with the regulatory principles (FSMA s138J(2)(d)(ii), 2H(2) and 3B).
- Have regard to the HMT recommendation letter (BoE Act s30B).
- Have due regard to the public sector equality duty (Equality Act s149).
- Have regard, subject to any other requirement affecting the exercise of the regulatory function, to the principles of good regulation and when determining general policy or principles to the Regulators Code (Legislative and Regulatory Reform Act 2006 s21 & 22)
- Have regard, so far as consistent with the proper exercise of those functions, to the purpose of conserving biodiversity. Conserving biodiversity includes, in relation to a living organism or type of habitat, restoring or enhancing a population or habitat (Natural Environment and Rural Communities Act 2006, s40).
- Consultation of the FCA (FSMA s138J(1)(a)).
- Where the consultation proposals a PRA rule change or amendment to onshored BTS that affects the processing of personal data - consultation with the Information Commissioner's Office (article 36(4) General Data Protection Regulation).
- For UK Technical Standards Instruments only: FSMA s138J(1)(a) is replaced with: consultation of the FCA and/or Bank, where that Regulator has an interest in the technical standards (FSMA s138P(4) and (5)).
- For UK Technical Standards Instruments only: notice given to HMT of the consultation on the UKTS ('best efforts' basis).
- For CRR rules only: subject to certain exceptions, have regard to:
  - relevant standards recommended by the Basel Committee on Banking Supervision from time to time
  - 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. For these purposes, the PRA must consider the United Kingdom's standing in relation to the other countries and territories in which, in its opinion, internationally

active credit institutions and investment firms are most likely to choose to be based or carry on activities

- the likely effect of the rules on the ability of CRR firms to continue to provide finance to businesses and consumers in the United Kingdom on a sustainable basis in the medium and long term

- the target in section 1 of the Climate Change Act 2008 (carbon target for 2050)

(s144C (1) & (2) FSMA – exceptions in s144E FSMA).

- For CRR rules only – explanation of the ways in which having regard to the matters specified above has affected the proposed rules (s144D FSMA).
- For CRR rules only – publication of a summary of the proposed CRR rules.
- For CRR rules only – consideration and consultation with the Treasury about the likely effect of the rules on relevant equivalence decisions (s144C (3) & (4) FSMA).