Privacy statement

By responding to this consultation, you provide personal data to the Bank of England (the Bank, which includes the Prudential Regulation Authority (PRA)), and the Financial Conduct Authority (FCA) (jointly 'the regulators'). This may include your name, contact details (including, if provided, details of the organisation you work for), and opinions or details offered in the response itself.

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.

This is a joint consultation by the PRA and FCA. Responses will be shared between the regulators.

The regulators 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 **Privacy and the Bank of England**. To find out more about how the FCA deals with your personal data please visit the **FCA's privacy page**.

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Please indicate if you regard all, or some of, the information you provide as confidential. If the PRA or the FCA receives a request for disclosure of this information, we will take your indication(s) into account but cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system on emails will not, of itself, be regarded as binding on the PRA or the FCA.

Responses are requested by 13 March 2025.

Consent to publication

In the policy statement for this consultation, the PRA and FCA will publish an account, in general terms, of the representations made as part of this consultation and its response to them. In the policy statement, the PRA and FCA are also required to publish a list of respondents to its consultations, where respondents have consented to such publication.

When you respond to this consultation paper, please tell us in your response if you agree to the publication of your name, or the name of the organisation you are responding on behalf of, in the PRA and FCA's feedback response to this consultation.

Please make it clear if you are responding as an individual or on behalf of an organisation.

Where your name comprises 'personal data' within the meaning of data protection law, please see the Bank and FCA's Privacy Notice above, about how your personal data will be processed.

Please note that you do not have to give your consent to the publication of your name. If you do not give consent to your name being published in the PRA and FCA's feedback response to this consultation, please make this clear with your response.

If you do not give consent, the PRA or FCA may still collect, record and store it in accordance with the information provided above.

You have the right to withdraw, amend or revoke your consent at any time. If you would like to do this, please contact the PRA using the contact details set out below.

Responses can be sent by email to: CP16_24@bankofengland.co.uk.

Alternatively, please address any comments or enquiries to:
Governance, Remuneration and Controls Policy Team, Prudential Policy Directorate
Prudential Regulation Authority
20 Moorgate
London
EC2R 6DA

Chapter 1: Overview

1.1 This consultation paper (CP) sets out the Prudential Regulation Authority's (PRA) and Financial Conduct Authority's (FCA) (jointly, 'the regulators') proposed amendments to the Remuneration part of the PRA Rulebook, supervisory statement (SS) 2/17 – **Remuneration**, the FCA's Handbook chapter: 'SYSC 19D Dual-regulated firms Remuneration Code', and the FCA's associated non-Handbook Guidance relating to remuneration for dual-regulated firms (together the 'remuneration regime').

1.2 The changes proposed in this CP are intended to make the remuneration regime more effective, simple and proportionate while facilitating the regulator's primary objectives. The aim is to ensure accountability for risk taking and appropriate outcomes for consumers and markets. The proposals also support the regulators' secondary objectives; with a particular focus on facilitating the international competitiveness of the UK economy and its growth in the medium to long term. The changes also help to ensure appropriate outcomes for consumers and markets. The proposals complement previous remuneration regime changes **enhancing proportionality for small firms**, and removing the **bonus cap**.

1.3 Under the Financial Services and Markets Act 2000 (FSMA), the PRA is the prudential regulator and the FCA is the conduct regulator for credit institutions and designated investment firms. These firms are described as dual-regulated firms. Although the regulators have considered the proposals in this CP independently and in accordance with their respective statutory objectives, the regulators have decided to consult jointly to avoid unnecessary duplication.

1.4 The proposed policy amendments maintain the remuneration regime's overall structure and objectives - in line with the internationally agreed Financial Stability Board (FSB) **Principles and Standards for Sound Compensation Practices** – while simplifying the regime and tailoring it more to the UK market, by:

- reducing the number of individuals subject to the remuneration rules (known as Material Risk Takers (MRTs);
- simplifying the approach for identifying MRTs, placing more emphasis on firms to own and safeguard the process;
- bringing rules on deferral of variable remuneration ('bonus deferral') more in line with international practice;
- ensuring that variable remuneration (eg 'bonuses') better reflects risk taking outcomes and individual responsibilities; and

- aligning the regulators' rules on buy-outs[1] in relation to small firms.

1.5 Additionally, the FCA is proposing to change the structure of its rules in SYSC 19D (and related guidance) by cross referring to the 'Remuneration Part' of the PRA Rulebook (the 'PRA Remuneration Rules'). The FCA considers the change avoids unnecessary duplication and will ensure greater consistency and alignment of the regulators' remuneration rules. The main effect of this proposed change is that, in future, the detailed Remuneration Rules would mostly be contained in the Remuneration Part of the PRA rulebook. This will help simplify firms' understanding and application of the regulators' requirements and therefore further support the competitiveness of the UK.

1.6 The proposals in this CP would result in:

- changes to the Remuneration Part of the PRA Rulebook (Appendix 1);
- updates to PRA's SS2/17 – Remuneration (Appendix 2);
- changes to the FCA's 'SYSC 19D Dual-regulated firms Remuneration Code' (Appendix 3);
- consequential changes to the FCA's non-Handbook guidance:
    - 'FG23/6: General guidance on the application of ex-post risk adjustment to variable remuneration' (Appendix 4); and
- withdrawal of the following FCA non-Handbook guidance:
    - 'FG23/4: Dual-regulated firms Remuneration Code (SYSC 19D): Frequently asked questions on remuneration';
    - 'FG23/5: General Guidance on Proportionality: The Dual regulated firms Remuneration Code (SYSC 19D)'.

Summary of the regulators' proposed changes

1.7 The policy proposals detailed in this CP have been developed by the regulators collaboratively but agreed by each regulator independently. The proposals specific to each regulator's rules are summarised below.

The PRA's proposals

1.8 The PRA's proposals included in this CP would:

- amend rules and expectations on deferral of variable remuneration by:

[1] Refers to a practice whereby firms buy-out outstanding deferred variable remuneration awards for staff that have been cancelled by their previous employer.

- reducing the 7-year minimum deferral period that applies to certain Senior Management Functions (SMFs) to five years[2];
- allowing deferred remuneration awards to SMFs to vest on a pro rata basis from the time of award, rather than only starting to vest after three years;
- aligning all MRTs[3] who are not SMFs to a deferral period of four years;
- allowing for the payment of dividends or interest on deferred instruments awarded to MRTs as part of variable remuneration; and
- giving firms discretion on what an appropriate retention policy should be for deferred instruments.

- amend rules and expectations relating to MRT identification by:
  - simplifying the quantitative threshold for identifying MRTs;
  - removing the need for the PRA to approve exclusions of individuals identified as MRTs solely due to their remuneration; and
  - enhancing the role of specific individuals within firms (eg Chief Risk Officer) in the MRT identification process.
- amend rules and expectations relating to MRT proportionality thresholds by:
  - increasing the threshold at which firms may disapply specific remuneration requirements for MRTs; and
  - simplifying the rules applicable to MRTs by removing the categories of 'Higher Paid' MRTs and 'Significant firm'.
- improve the link between remuneration and individual accountability by:
  - introducing a rule for firms to consider adjusting remuneration[4] of accountable individuals up the management chain in the event of failures in risk management;
  - introducing a requirement to ensure that senior management are accountable for their performance against PRA supervisory priorities; and
  - clarifying expectations for Remuneration Committees with regards to determining accountability for adverse risk events.

The FCA's proposals

1.9 The FCA's proposals included in this CP would change the structure of SYSC 19D so that it largely cross-refers to the PRA's Remuneration Rules thereby:

- removing the need for the FCA to maintain its own set of parallel remuneration rules;

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2 Firms may disapply deferral requirements for certain MRTs that meet the individual proportionality threshold.
3 Firms may disapply deferral requirements for certain MRTs that meet the individual proportionality threshold.
4 Adjusting remuneration can include application of malus and clawback. Malus refers to an arrangement that permits a firm to reduce the value of all or part of deferred variable remuneration before it has vested. Clawback refers to an arrangement under which the staff member has to return ownership of an amount of variable remuneration paid in the past or which has already vested to the firm under certain conditions.

- ensuring the PRA's proposed rule changes in this CP would automatically apply to firms in scope of the FCA's dual-regulated firms Remuneration Code because of the proposed cross-reference to the PRA Remuneration Rules in SYSC 19D;
- ensuring that where the FCA has decided to keep specific rules relating to remuneration, or where the FCA provides specific guidance explaining how firms in scope should apply the remuneration rules, these will remain in SYSC 19D; and

1.10 The FCA also proposes exempting dual regulated firms that meet the provisions under SYSC 19D.3.2BR in the current rules (hereafter referred to as 'small firms') from requirements related to buy-outs.

Additional Matters

1.11 This CP is relevant to banks, building societies, and PRA-designated investment firms, including third-country Capital Requirements Regulation (CRR) firms which are subject to the Remuneration Part of the PRA Rulebook and to the FCA SYSC 19D: Dual-regulated firms Remuneration Code. This CP is not relevant to credit unions and insurers.

1.12 The CP will also be of interest to firms in scope of the FCA's MIFIDPRU Remuneration Code (SYSC 19G), because the FCA proposes to apply 'FG23/6 General guidance on the application of ex-post risk adjustment to variable remuneration' to firms in scope of SYSC 19G only; this proposal does not result in any policy changes.

1.13 While the policy proposals in this CP do not affect FCA solo-regulated investment firms subject to other FCA Remuneration Codes, it will be of interest to solo-regulated investment firms and firms that are members of a group to which the dual-regulated remuneration regime applies on a consolidated basis.

1.14 The regulators have a statutory duty to consult when seeking to change rules (FSMA s138I – 138J). When not making rules, the regulators also have a public law duty to consult widely where it would be fair to do so.

1.15 In carrying out their policy making functions, the regulators are required to comply with several legal obligations. The analysis in this CP explains how the regulators have had regard to the most significant matters, including an explanation of the ways in which having regard to these matters has affected the proposals.

1.16 The statutory **Practitioner Panel** was consulted by the PRA on the proposals outlined in this CP. The PRA **Cost Benefit Analysis Panel** was also consulted and their feedback is set out in paragraph 10.4 in the cost-benefit analysis section. The FCA consulted its Practitioner Panel and Smaller Business Practitioner Panel on the main proposals outlined in this CP.

Background

1.17 Remuneration practices in the banking sector that incentivised excessive risk taking were one of the contributing factors to the 2008 global financial crisis, which created significant costs for taxpayers, and reduced long-term economic growth. The Treasury Select Committee's **report** on the banking crisis argued that in too many cases, 'the design of bonus schemes in the banking sector were flawed and not aligned with the interests of shareholders and the long-term sustainability of the banks'. These remuneration practices rewarded short-term profits encouraging excessive risk-taking and did not sufficiently consider the long-term risks created for banks and ultimately for society.

1.18 As part of the global regulatory response to the crisis, the FSB issued **Principles for Sound Compensation Practices**. UK regulators contributed to the development of these international standards, which were introduced in the UK through EU legislation – transposed into the regulators' rules in line with the UK's obligations as an EU member state at the time – and through domestic policies, which reflected the specificities of the UK financial sector.

1.19 The UK remuneration regime seeks to meet the regulators' primary objectives of safety and soundness, protecting consumers, enhancing market integrity, and promoting competition. The regime achieves the regulators' objectives by strengthening individual accountability for risk taking, discouraging excessive short-termism and encouraging more effective risk management. This is accomplished through rules and expectations on:

- identification of individuals influencing key decisions to whom remuneration requirements are applied (MRTs);
- linking payment of variable remuneration[5] to risk-adjusted performance;
- promoting greater alignment between the longer-term interests of MRTs and shareholders through payment in instrument (for example shares) requirements; and
- requiring variable remuneration deferral periods for some MRTs. This allows downward adjustments (through malus or clawback) to awards in the event of instances of misconduct, risk management failings or downturns in financial performance that can often take some time to be discovered.

[5] Variable remuneration for some firms includes bonus schemes or long-term incentive plans. Paragraphs 115 to 119 of the **2015 EBA Guidelines on sound remuneration policies** have further details on the 'categories of remuneration'.

1.20 These rules and expectations primarily target the variable remuneration of staff at firms rather than fixed remuneration[6] as it is variable remuneration that can drive incentives for excessive risk taking.

1.21 The UK remuneration regime has been subject to a number of reviews in recent years including an external **FSB peer review** (2021) and reviews by the regulators.[7]

1.22 The FSB review found that the UK remuneration framework is consistent with the 'FSB Principles and Implementation Standards' and that the UK has a set of 'good practice examples for other jurisdictions to consider'. The review also recommended that UK regulators further improve the framework, including by strengthening the link between the remuneration regime and the Senior Managers and Certification Regime (SM&CR), streamlining data collection, and considering additional supervisory approaches to encourage firms to meet the aims of the framework.

1.23 The regulators' reviews have found that the regime is well embedded in firms' practices and is largely working as intended. However, this work has also found areas where the regime may have had unintended consequences, and where changes could be made to help it achieve its original intent, including improving accountability of individuals by strengthening the link between risk-taking outcomes and remuneration, and reducing unnecessary complexity.

1.24 The regulators have also received feedback on the framework from industry in response to recent remuneration consultation papers. Policy statement (PS)16/23 – **Remuneration: Enhancing proportionality for small firms** paragraphs 2.20 to 2.22, and PS9/23 – **Remuneration: Ratio between fixed and variable components of total remuneration ('bonus cap')** paragraphs 2.26 and 2.27 summarise responses relating to elements of the remuneration regime. These responses often focused on UK deferral periods in comparison to other jurisdictions and their impact on total compensation and ability to attract talent, and the number of staff identified as MRTs.

1.25 Several responses to the discussion paper (DP)1/23 – **Review of the Senior Managers and Certification Regime** also related to the remuneration regime. These responses mainly focused on UK deferral periods and ways in which the links between the SM&CR and remuneration regime could be clarified and simplified.

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[6] Fixed remuneration for example can include salary which can reflect the professional experience and seniority of the staff member. Paragraphs 115 to 119 of the **2015 EBA Guidelines on sound remuneration policies** have further details on the 'categories of remuneration'.

[7] These include the PRA's **Evaluation of the Senior Managers and Certification Regime** which considers the link between the Senior Managers Regime (SMR) and remuneration.

1.26 The regulators have used the information above, feedback from their respective statutory panels, and evidence gathered through business-as-usual engagement with firms, other external stakeholders, international comparisons, and best practice observed in firms, to develop the proposals in this CP.

1.27 As highlighted above, the evaluations of the UK remuneration regime have found that the framework is well embedded in firms' practices and broadly works as intended. This is corroborated by feedback received from firms, and as such, there is little evidence to suggest a fundamental revision of the core parts of the framework is needed. The results of the evaluation and feedback received have however highlighted that the remuneration framework has become more complex following its iterations through EU regulations and UK implementation. This complexity has led to undue compliance costs for firms, and potentially decreased the ability of the UK to attract and retain talent.

1.28 There is therefore an opportunity to reduce some of the costs that have become apparent over time and streamline the regime further and consider how it can be made more effective, proportionate, competitive, and tailored to the UK's circumstances. The proposals in this CP are the third phase of remuneration reforms which follow:

- the removal of the 'bonus cap' in 2023 ending the EU mandated 2:1 fixed to variable remuneration ratio cap. The UK had opposed the bonus cap during the EU policy negotiations due to concerns that it could place upward pressure on salaries and allowances (fixed remuneration) that may not be linked to longer-term performance and cannot be reduced or clawed back in the event of later failure and/or previous misconduct coming to light. Its removal gives firms greater flexibility over the design of their remuneration structures and enables firms to ensure that the fixed and variable components of total remuneration are appropriately balanced. The change also enhances the UK's international competitiveness when attracting and retaining talent; and
- enhancements to proportionality for small dual-regulated firms which increased the number of firms that could benefit from remuneration proportionality and decreased the number of requirements that these small firms have to comply with. This simpler framework reduces on-going implementation costs of the remuneration regime, is available for both small UK subsidiaries as well as branches of international firms, and enhances competitiveness and growth of the UK.

1.29 The regulators' current proposals contain a range of measures that further simplify the regime and make it more proportionate. They will give firms more flexibility, greater ownership and further embed accountability – ensuring that individuals with the potential to materially impact the risk profile of the firm are appropriately incentivised. For these reasons combined, it will facilitate firms explaining their approach to remuneration setting and adjustments to their employees, which can support prudent decision making by relevant staff. Overall, the regulators consider that the measures will enhance competitiveness whilst maintaining safety and soundness, consumer protection, market integrity and competition.

Structure of the CP

1.30 This CP is structured into the following chapters. The draft rules and related policy materials are included in the relevant appendices.

- Chapter 1 – Overview
- Chapter 2 – Changes to the FCA Handbook Chapter: SYSC 19D and Buy-outs Rule
- Chapter 3 – Identifying material risk takers
- Chapter 4 – Enhancing proportionality for MRTs
- Chapter 5 – Remuneration and individual accountability
- Chapter 6 – Deferral and retention periods
- Chapter 7 – PRA objectives analysis
- Chapter 8 – PRA 'Have regards' analysis, impact on mutuals and equality and diversity
- Chapter 9 – FCA's objectives and regulatory principles: compatibility statement
- Chapter 10 – PRA cost benefit analysis
- Chapter 11 – FCA cost benefit analysis

Implementation

1.31 The proposed changes in this CP would come into force on the next calendar day after publication of the final policy (anticipated for 2025 H2) and would apply to firms' performance years starting after that date. This approach gives firms sufficient time to consider and implement any changes as a result of this CP. The proposals are not intended to be applied retrospectively as the regulators understand that retrospective application would be overly burdensome for firms[8]. The regulators encourage firms that believe that they may be disadvantaged by the application of the proposals to only future performance years to respond to the CP setting out their views. As discussed in chapter 2, the FCA proposes that its amended rules and non-Handbook Guidance would come into force the day after publication of the relevant policy statement.

[8] For example, the vesting schedule of previously awarded variable remuneration will have already been designed to comply with current requirements.

Responses and next steps

1.32 This consultation closes on 13 March 2025. The regulators invite feedback on the proposals set out in this consultation. Please address any comments or enquiries to **CP16_24@bankofengland.co.uk**, responses will be shared between the regulators. Please indicate in your response if you believe any of the proposals in this CP 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.

1.33 Unless otherwise stated, any remaining references to EU or EU-derived legislation refer to the version of that legislation which forms part of assimilated law.

1.34 As set out in SS2/17, the PRA expects firms to continue to make every effort to comply with aspects of the **European Banking Authority's (EBA) 2015 guidelines on sound remuneration policies** unless a different approach is mandated by the Remuneration Part of the PRA Rulebook or SS2/17. The regulators intend to consult on the onshoring of any relevant European remuneration guidelines or regulations in the future. The proposals in this CP have been prioritised in line with feedback and considerations described above.

1.35 When providing your response, please tell us whether or not you consent to the regulators publishing your name, and/or the name of your organisation, as a respondent to this CP.

Chapter 2: Changes to the FCA Handbook Chapter SYSC 19D and Buy-outs Rule

2.1 This chapter explains the following proposed FCA changes:

- The simplification of the FCA's remuneration rules contained in the FCA Handbook chapter: 'SYSC 19D Dual-regulated firms Remuneration Code'. The FCA intends to do this by cross referring to the 'Remuneration Part' of the PRA Rulebook. The FCA also intends to make changes to the structure of the FCA's related remuneration guidance.
- The removal of the FCA rule on buy-outs as currently contained in SYSC 19D and, instead, cross-referring to the PRA's buy-outs rules (as set out in Chapter 15A in the Remuneration Part of the PRA Rulebook). This is an FCA specific policy proposal.

Making the FCA's dual-regulated remuneration rules simpler

2.2 In addition to the policy proposals set out in chapters 3 to 6, the FCA is proposing to change the format of its remuneration rules for dual-regulated firms contained in its Handbook Chapter: 'SYSC 19D Dual-regulated firms Remuneration Code'.

2.3 Currently, the FCA and the PRA each have a set of remuneration rules which dual-regulated firms must comply with. The two sets of rules largely mirror each other and contain duplicate rules.

2.4 The FCA intends to simplify its rules in SYSC 19D by cross referring to the 'Remuneration Part' of the PRA Rulebook (the PRA Remuneration Rules). Doing this will remove duplicative rules and any current inconsistently drafted rules. Where the FCA has specific rules relating to remuneration, or where the FCA provides specific guidance explaining how firms in scope should apply the remuneration rules, these will remain in SYSC 19D.

2.5 The FCA proposes to make the cross-reference to the PRA Remuneration Rules self-updating ('ambulatory'). Doing this would mean that the FCA's remuneration rules for dual-regulated firms automatically update each time the PRA updates or changes its Remuneration Rules. This also means that firms will have to comply with the PRA Remuneration Rules as they are applied and modified by the FCA rules.

2.6 Firms may already be familiar with the FCA's use of cross-references to the PRA's Remuneration Rules in SYSC 19D. In **PS23/17**, the FCA introduced the use of ambulatory cross-references in some limited areas. Feedback during the consultation phase was positive; respondents welcomed greater alignment between the regulators' rules. The FCA wants to fully extend the use of ambulatory cross-referencing across SYSC 19D to achieve greater alignment between the regulators' rules, which will benefit firms.

What the change will mean for firms

2.7 The FCA's proposal as described in this chapter is not a policy change, and the FCA does not consider that this change will have a material impact on firms beyond making the regulators' rulebooks simpler and avoiding duplication. As is the case now, dual-regulated firms will remain authorised and regulated by both the FCA and the PRA, and both regulators will continue to require firms to comply with the remuneration rules.

2.8 The main effect of the FCA's cross-referencing in SYSC 19D to the PRA Remuneration Rules will be that the requirements contained in the PRA Remuneration Rules will apply to a dual-regulated firm as if they were FCA rules. The FCA may also enforce and supervise against the PRA's Remuneration Rules to which it cross-refers as if they were FCA rules.

2.9 In practice, this change will mean dual-regulated firms will only need to look at one substantive set of remuneration rules (the PRA's Remuneration Rules), except in the handful of cases where the FCA has retained rules in SYSC 19D. The rules the FCA intends to retain are outlined in the table in paragraph 2.17 and illustrated in the FCA's draft instrument accompanying this CP (Appendix 3).

2.10 Largely cross-referring to the PRA's Remuneration Rules in SYSC 19D avoids unnecessary duplication between the regulators' parallel rules and ensures consistency and alignment. Both regulators believe this change will benefit firms because it will help to simplify firms' understanding and application of the regulators' requirements, making it easier to comply and support the competitiveness of the UK as a place for firms to do business.

2.11 The FCA also expects this change would make rule waiver and modification applications more straightforward for firms. Whilst dual-regulated firms will need to continue to apply to both the FCA and the PRA to waive or modify a rule, firms would most likely only need to propose a change to a single version of the rule (contained in the PRA's Remuneration Rules). This will be helpful for firms in reducing time, resource, and administrative burden.

2.12 The FCA's proposal should also make engagement with any future consultations more straightforward for dual-regulated firms. In future, the FCA expects firms will largely need to consider one draft set of rules (as part of a single consultation). This is because where both regulators agree with proposed policy positions, the corresponding rule changes to achieve the policy aim will be made to the PRA's Remuneration Rules only.

2.13 Both regulators will continue to independently assess proposals in relation to their respective regulatory objectives and continue collaborating and jointly agreeing policy changes where possible. If the FCA takes a different policy approach to the PRA on the dual-regulated firms' remuneration rules in the future, it would remain open to the FCA to choose to consult on separate rules.

Proposed format of SYSC 19D

2.14 As presented in the FCA's draft instrument that accompanies this CP (Appendix 3), the FCA has deleted the existing sections in SYSC 19D in their entirety and replaced them with two new sections:

- The first section ('Application and purpose') explains the cross-referencing to the PRA Remuneration Rules and how the FCA's dual-regulated remuneration rules should be applied.
- The second section ('Remuneration requirements and expectations specific to the FCA') contains areas where the FCA proposes to retain its own rules. These retained rules modify the PRA's Remuneration Rules and, for example, contain rules that are specific to the FCA.

2.15 In addition, the FCA is proposing to amend SYSC 19D Annex 1 ('Detailed provisions on voiding and recovery') in line with the specific rule on this subject.

2.16 As firms do now, they will need to comply with all the PRA's Remuneration Rules as well as the FCA's rules in SYSC 19D. Where the FCA believes providing guidance will be helpful to firms, it continues to do so across SYSC 19D.

2.17 The areas which the FCA intends to retain in SYSC 19D are summarised in the table below.

Start

Table 1: Rules and guidance being retained by the FCA in SYSC 19D

Rule / guidance provision	What the Rule / guidance covers	Why the FCA is retaining the Rule or guidance?
SYSC 19D.2A.2G	Notifications	This guidance is specific to the FCA.
SYSC 19D.2A.3G	Individual guidance	This guidance is specific to the FCA.
SYSC 19D. 2A.4R		

Rule / guidance provision	What the Rule / guidance covers	Why the FCA is retaining the Rule or guidance?
SYSC 19D.2A.5G	Gender Neutral policies	These are specific to the FCA.
SYSC 19D.2A.6R	Record Keeping	This Rule modifies the corresponding PRA Rule in relation to the FCA's general record keeping requirements.
SYSC 19D.2A.7G	Exceptional Government Intervention	This guidance is specific to the FCA.
SYSC 19D.2A.8G	Profit-based Measurement and Risk Adjustment	This guidance is specific to the FCA.
SYSC 19D.2A.9G	Assessment of Performance	This guidance is specific to the FCA.
SYSC 19D.2A.10R	Deferral	This Rule modifies the corresponding PRA Rule in relation to 'FCA designated' individuals.
SYSC 19D.2A.11G	Deferral	This guidance is specific to the FCA.
SYSC 19D.2A.12R	Performance adjustment	This Rule modifies the corresponding PRA Rule in relation to 'FCA designated' individuals.
SYSC 19D.2A.13R	Breaches of the Dual-regulated firms remuneration code	This Rule retains the FCA's existing voiding and recovery powers aligned with the PRA Remuneration Rules.
SYSC 19D.2A.14G	Voiding and recovery provisions	This guidance is specific to the FCA.
SYSC 19D Annex 1	Detailed provisions on voiding and recovery	This Annex retains the FCA's existing voiding and recovery provisions aligned with the PRA Remuneration Rules.

End

2.18 The draft FCA instrument illustrates where the FCA intends to delete glossary definitions that will no longer be relevant because of cross-referring to the PRA's Remuneration Rules. Where there are definitions that contain reference to SYSC 19D but also apply to other FCA

Sourcebooks, the FCA will amend these definitions to remove the references to SYSC 19D where appropriate. Where the FCA cross-refers to the PRA's Remuneration Rules, the relevant definitions in the PRA Rules will apply to dual-regulated firms.

Proposed changes to the FCA's non-Handbook Guidance

2.19 The FCA currently sets out its guidance for dual-regulated firms on the application of its remuneration rules or other provisions in the following non-Handbook Guidance:

- 'FG23/4: Dual-regulated firms Remuneration Code (SYSC 19D): Frequently asked questions on remuneration';
- 'FG23/5: General Guidance on Proportionality: The Dual-regulated firms Remuneration Code (SYSC 19D)'; and
- 'FG23/6: General guidance on the application of ex-post risk adjustment to variable remuneration'. Guidance in this document also applies to FCA solo-regulated investment firms in scope of the MIFIDPRU Remuneration Code in SYSC 19G.

2.20 The FCA intends to withdraw FG23/4 and FG23/5. This is because the guidance in these documents largely mirrors expectations contained in the PRA's SS2/17 and withdrawing them would further simplify the FCA's rules and guidance for dual-regulated firms.

2.21 As for FG23/6, the FCA is proposing to make consequential changes to it to make it clear that this guidance only applies to MIFIDPRU investment firms. The changes do not result in any policy changes. This draft Guidance is included with this CP in Appendix 4.

Other Considerations

2.22 The FCA has not published a Cost Benefit Analysis (CBA) for its proposal to change the format of SYSC 19D as detailed in this chapter. Section 138L(3) of FSMA does not require a CBA to be developed where the FCA believes there will be no increase in costs to firms, or if there were any increase it will be of minimal significance. The FCA considers this applies to the proposals it sets out in this consultation. The FCA has also considered the impact of the PRA's CBA as set out in Chapter 10 with regard to the PRA's policy proposals.

2.23 Section 1RB FSMA requires the FCA to set out information about any engagement with the statutory panels. The FCA provided details of the proposal above to the FCA's Practitioner Panel and Smaller Business Practitioner Panel. The panels were supportive of the FCA's proposal.

Proposal to exempt small dual-regulated firms from buy-outs

2.24 This section explains the FCA's proposal to remove its rule on buy-outs as currently contained in SYSC 19D3.45R. Buy-outs represent a practice whereby firms buy out outstanding deferred variable remuneration awards for staff that have been cancelled by their previous employer.

2.25 Following proportionality enhancements in 2023 (as explained in **PS16/23**), the PRA remuneration rules allow firms meeting the definition of a small Capital Requirement Regulation (CRR) firm to be exempt from rules on buy-outs.

2.26 The FCA did not make the corresponding policy change at the same time because there was already some flexibility built into the FCA's rules, meaning the FCA currently has more stringent rules than the PRA. The FCA now proposes to make a change and align with the PRA; this is the only substantive policy change the FCA is specifically proposing.

2.27 The FCA intends to do this by removing the FCA rule on buy-outs in SYSC 19D. The FCA will instead rely on the cross-referencing mechanism (as explained above) so that the PRA's corresponding rules on buy-outs (as set out in Chapter 15A in the Remuneration Part of the PRA Rulebook) and the exemption for small firms (as detailed in the PRA's Rule 5.3) will apply to firms as if they were FCA rules.

2.28 In **CP5/23**, the PRA explained that unvested remuneration structures from larger firms can be more complex than those of smaller firms. For instance, while large dual-regulated firms are subject to deferral, malus and clawback requirements, small dual-regulated firms 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 currently would need to mirror those rules, which can be costly and complex in practice. Additionally, the PRA noted in CP5/23 that it had seen increasing evidence that the dual-regulated regime may have been costly or burdensome for some small firms.

2.29 Respondents to the PRA's CP5/23 were positive about exempting small firms from buy-out rules. Respondents to the regulators' previous consultations also welcomed greater alignment between the regulators' parallel rules. Therefore, making this change would deliver simplicity and more clarity on the expectations on firms in scope of the rule.

2.30 While the FCA's rule on buy-outs is high-level and non-prescriptive, the FCA recognises that in practice, applying the rule for small firms could be complex. Therefore, the FCA think this change, overall, will be beneficial for small firms.

2.31 There may also be other benefits. If small firms are not able to match the rules, senior individuals could be dissuaded from moving to smaller firms. Removing buy-out requirements on small firms may therefore make them more attractive to MRTs from other financial service firms. This could help sustain healthy competition in the industry and increase the mobility of labour and talent.

2.32 This proposed change also helps with the objective of achieving greater alignment and consistency between the regulators’ rules.

2.33 Small firms will still be subject to the rest of the relevant remuneration requirements as in the existing rules. However, small firms may choose to retain elements of the rules they are exempt from, including buy-outs, where they see benefits for risk management and incentive setting purposes.

Other considerations

2.34 In addition to SYSC 19D, the FCA has other Remuneration Codes, including SYSC 19G which applies to MIFIDPRU Investment firms. Having separate Codes for different types of firms has enabled the FCA to tailor each of the codes appropriately. The FCA will keep under review its other remuneration regimes and consider if further changes are needed.

Chapter 3: Identifying material risk takers

Background

3.1 The regulators' remuneration rules primarily apply to individuals identified as MRTs. MRTs are employees whose professional activities have a material impact on a firm's risk profile. The FCA's Dual-regulated firms' Remuneration Code currently cross-refers to the PRA's rules for the identification of MRTs, which set out minimum qualitative (ie role based) and quantitative (ie remuneration based) criteria for identifying MRTs. Firms are also expected to identify as MRTs any other employees who have a material impact on the risk profile of the firm even if these individuals are not captured directly by rules. The **current rules** on MRT identification are based on EU legislation.

3.2 The regulators consider that the framework for identifying MRTs is now well-embedded in firms' practices and that the qualitative criteria broadly identify an appropriate subset of employees with particularly significant influence in decision making within firms. Qualitative criteria are applied proportionately to firms with different business models (eg firms with no trading business do not need to apply the trading MRT identification criteria). Therefore, the PRA is not proposing to change the qualitative criteria.

3.3 By contrast, the regulators consider that the current quantitative criteria are not fit for purpose as they were originally intended to function across a broad range of EU financial markets; not just in the sole context of the UK's financial market. They also lack proportionality as they apply equally to all firms irrespective of business models or remuneration levels. Both of these factors can lead to quantitative criteria identifying a large set of individuals, some of whom may not materially impact a firm's risk profile. Firms can apply to the PRA for a modification by consent to exclude these individuals from MRT categorisation but the process is time-consuming for firms and the PRA. These factors therefore suggest that the quantitative criteria are not appropriate or sufficiently proportionate for the UK market.

Proposals

3.4. The PRA's proposals aim to simplify the MRT identification process by creating a single quantitative threshold to identify MRTs. The PRA also proposes giving firms more flexibility and discretion in the MRT identification process by removing the need to seek regulatory approval to exclude from MRT categorisation individuals solely identified by this quantitative threshold ie who do not also meet the qualitative criteria. In turn, the PRA is also proposing enhanced governance arrangements that embed MRT identification as a risk management tool. This would include an increased role in the MRT identification process by employees with responsibility for the overall management of risk controls, control functions as well as engagement by the management body in its supervisory function of the firm.

3.5 The proposals in this chapter would result in the following changes:

- a new expectation in paragraph 3.3 of SS2/17 which sets out a single quantitative MRT identification threshold whereby firms are expected to consider identifying as MRTs individuals within their 0.3% of highest earners, and the deletion of all other quantitative MRT identification thresholds from the PRA Rulebook;
- the removal of the expectation for firms to seek regulatory approval to exclude any individuals (solely identified by quantitative criteria) from MRT categorisation; and
- enhanced governance expectations for firms to ensure the involvement of the relevant functions throughout the MRT identification process.

Quantitative Criteria and the exclusions process

3.6 Levels of remuneration can be an indicator of the risk-taking impact of a role but not definitively so. Quantitative criteria (rules 3.3A(1) and (2) of the Remuneration Part of the PRA Rulebook) identify as MRTs individuals that earn equal to or greater than £660,000, or individuals within the 0.3% of highest earners within a firm. Rule 3.1(1)(c) of the Remuneration Part of the PRA Rulebook also contains a remuneration threshold identifying high earning key decision makers within material business units. These rules were incorporated into the PRA Rulebook by PS28/21 – **Remuneration: Identification of material risk takers** and reflect EU legislation.[9] These quantitative criteria were intended to function across a broad range of varied financial markets in Europe rather than for the UK specifically.

3.7 Historical EBA high earner reports[10] show that the UK accounted for a large majority of high earners (individuals earning equal to or greater than €1 million) within the EU, indicating that UK remuneration levels may be higher than in some European jurisdictions. Additionally, feedback received through DP1/23 – **Review of the Senior Managers and Certification Regime** and other industry engagement, as well as internal regulatory analysis indicates that the PRA's current quantitative criteria might not be appropriate for UK pay levels. Wider industry feedback and regulatory analysis also indicates that the number of differing thresholds has created complexity as firms must assess employee remuneration against varying criteria.

[9] The PRA published a CP18/21 and PS28/21 where it proposed to transfer the content of the identification criteria set out in EBA regulatory technical standards into the PRA rulebook without substantive changes except as regards currency thresholds.
[10] From 2019, 2018 and 2017.

3.8 The PRA considers that quantitative criteria can, at times, capture individuals who do not materially affect the risk profile of the firm, and do not need to be identified as MRTs. The regulators currently operate an exclusion process for individuals solely identified by quantitative criteria that firms consider are not MRTs, which requires regulatory approval and subsequent publications of modifications by consent. Data from the exclusions requests[11] submitted by firms shows that the majority of requests relate to individuals earning in excess of £660,000, but there are few exclusion requests of individuals who are within the 0.3% of highest earners in a firm. This suggests that the quantitative £660,000 threshold might be disproportionately identifying individuals who should not be MRTs, increasing compliance costs for firms and limiting the ability of these rules to correctly identify MRTs in firms.

3.9 The PRA therefore proposes creating a single pay criterion for identifying MRTs by:

- deleting PRA rule 3.3A(1) capturing as MRTs individuals earning equal to or more than £660,000 because this threshold is not specifically designed to operate in the context of the UK. Additionally, as the threshold is fixed it may not adapt to future market trends in remuneration, resulting, over time, in a threshold which could become more restrictive than intended.
- deleting PRA rule 3.3A(2) capturing as MRTs individuals within the firms' 0.3% of highest earners and moving this to an expectation in SS2/17. Moving the rule-based criterion to an expectation means firms will have discretion to consider whether staff within their 0.3% of highest earners, not already captured by qualitative criteria, should be categorised as MRTs. The PRA views this firm-specific percentage based threshold as appropriate for the UK market, and able to adapt to market variances in remuneration levels.
- deleting PRA rule 3.1(1)(c) capturing as MRTs high earners in a firms' material business units. The PRA considers that these individuals can be identified by other rules that identify MRTs across material business units irrespective of remuneration levels. This duplication of rules creates complexity and similarly reduces the ability of the rules to accurately identify MRTs, ultimately reducing their effectiveness.

3.10 Given the proposed streamlining changes to the quantitative criteria for identifying MRTs set out above, including the removal of quantitative criteria for identifying MRTs from the PRA rulebook, the PRA also proposes removing the requirement for firms to seek regulatory approval to exclude these individuals as MRTs. To reflect this change, the PRA proposes amending paragraphs 3.7, 3.22, and 3.24, and deleting paragraphs 3.6, 3.23, 3.29, 3.31, 3.32, 3.33, and 3.34 of SS2/17.

[11] Data refers to 2023 Table 8 firm submissions for 20 large CRR firms of which 12 firms submitted Table 8 requests.

3.11 As mentioned previously, remuneration levels are an indicator of the risk taking impact of a role, but not definitively so. Given this nuance, the PRA considers the quantitative threshold, set as the 0.3% of highest earners in a firm, to be more appropriate as an expectation within the Supervisory Statement rather than a rule in the PRA Rulebook. Operationally, this approach reduces compliance burden for firms, given they do not need to seek regulatory approval to exclude any MRTs solely identified by the new single quantitative threshold.

Governance of MRT Identification

3.12 The removal of rule-based quantitative criteria from the PRA rulebook would make the identification process the responsibility of firms, allowing for greater ownership and tailoring to the business model of the firm. This shift emphasises the importance of firms having adequate and effective controls in the MRT identification process to ensure that individuals with the potential to materially impact the risk profile of the firm continue to be captured. To enable this, the PRA proposes enhancing the governance around firms' MRT identification processes. Specifically, the PRA's proposals include:

- a new rule 7.3A in the Remuneration Part of the PRA rulebook requiring employees who have responsibility for the overall management of the risk controls of a firm, to annually review the firms' MRT methodology;
- new expectations in paragraphs 3.36 to 3.42 and 5.12A of SS2/17 regarding the governance of the MRT identification process. In particular, the PRA expects that the design and implementation of the MRT identification process and the decisions made under this process would involve:
  - employees who have responsibility for the overall management of the risk controls of the firm, usually the SMF 4;
  - other functions including, but not limited to, control functions, legal, human resources, and risk owners; and
  - the firm's management body in its supervisory function (including remuneration and risk committees).
- a new expectation in paragraph 3.40 of SS 2/17 on the considerations to be applied by functions or individuals involved in determining whether individuals solely identified by the quantitative criteria in SS 2/17 should be excluded from being identified as MRTs. Specifically, the PRA is providing additional non-exhaustive examples of roles that can materially affect the risk profile of a firm. The risk-taking impact of any individuals performing these roles should be carefully assessed and where appropriate, individuals should be categorised as MRTs. The additional examples relate to:
  - roles with responsibility over models;
  - roles with responsibilities over regulatory priorities;

- roles with responsibilities over technology projects that can materially affect the risk profile of the institution; and
- roles with responsibilities over trade structuring or trade strategy; and
- roles that materially affect income or revenue streams of relevant business lines.

This guidance is non-exhaustive and aims to ensure that control functions are reviewing a wide array of factors when reviewing roles that can be excluded from MRT categorisation.

3.13 As set out in 3.10, it is proposed that firms will no longer need to apply to the regulators for approval to exclude individuals as MRTs. This is anticipated to reduce compliance costs for firms and reduce resource pressures for the regulators without materially altering the prudential value of the remuneration regime. Importantly, risk function involvement will ensure that the correct individuals are identified as MRTs thereby strengthening safety and soundness across firms. The PRA further proposes an expectation in paragraph 3.42 of SS2/17 that firms document the MRT identification process including exclusions approved by the firm. Firms will be expected to provide these records to the regulators if requested.

3.14 The PRA's proposals aim to ensure that a firm's MRT identification framework is aligned to the risk profile of the firm. The governance enhancements listed above, in conjunction with the proposals to enhance rules on managerial responsibility (see Chapter 5), aim to incentivise risk owners, including SMFs, to identify MRTs in their teams. This should embed MRT identification as a risk management tool.

3.15 Chief Risk Officers (SMF 4) should also review and if appropriate approve any relevant exclusions, ensuring that all relevant MRTs have been identified. This will give firms a greater degree of autonomy while also ensuring that there are adequate governance guardrails.

Chapter 4: Enhancing proportionality for MRTs

Background

4.1 The regulators apply the remuneration regime in a way that seeks to be proportionate to the size, complexity and business activities of firms, and to the remuneration of individuals. Larger firms and MRTs with significant levels of remuneration are subject to stricter remuneration requirements. Table G of SS2/17 summarises this approach, which was introduced in 2020 following the implementation of Capital Requirements Directive V (CRD V), as set out in PS29/20 – **Capital Requirements Directive V (CRD V)**.

4.2 CRD V implementation required lowering the remuneration threshold at which certain remuneration rules (eg deferral and payment in instrument requirements) could be disapplied to '£44,000 variable remuneration'; from '£500,000 total remuneration'. In the context of UK remuneration levels, this EU set threshold significantly increased the number of MRTs subject to full remuneration requirements.

4.3 The PRA used its discretion, while implementing CRD V, to facilitate a proportionate application of deferral and clawback rules on the MRTs that, given the lower threshold, were now subject to full remuneration requirements. Higher paid MRTs in significant firms are currently subject to stricter deferral and clawback requirements. This approach has created a tiered system that applies deferral and clawback requirements based on a combination of an individual's remuneration level, role, and the category of their firm. For example, higher paid MRTs in significant firms are subject to 4 to 7 year deferral period requirements while non-higher paid MRTs in other firms are subject to 4 year deferral requirements (see Table G of SS2/17).

4.4 The PRA acknowledges that the movement of MRTs across roles, and year-to-year changes in remuneration can lead to significant implementation complexity as firms are required to benchmark their MRTs across the different categories and ensure that their remuneration is subject to the relevant requirements. In addition, the increased number of MRTs subject to full remuneration requirements has resulted, in certain instances, in the application of full remuneration requirements (such as deferral periods, or payment in instrument) to individuals whose variable remuneration may not form a substantial part of their total remuneration. This has limited prudential benefits given some of these MRTs might not have material amounts of variable remuneration that drive risk taking behaviour. Additionally, firms may face increased costs negatively impacting the ability of the UK financial sector to attract and retain talent.

Proposals

4.5 The PRA proposes the following changes to the Remuneration Part of the PRA rulebook which will provide firms and affected staff more clarity in identifying the rules that apply to individual MRTs, creating greater simplicity and promoting prudent incentive setting:

- amending rules 12.2 and 15.A1, to raise the threshold below which firms may disapply certain remuneration rules to individuals meeting conditions outlined in paragraph 4.6 below;
- amending rule 15.18 to raise the variable remuneration threshold, at which at least 60% of variable remuneration must be subject to deferral requirements, from £500,000 to £660,000;
- amending rule 16.7 to update the voiding provision threshold in line with the new threshold proposed for 15.A1;
- deleting the defined term ‘higher paid material risk taker’ in rule 1.3 and making consequential amendments to rules 2.7, 2.8, 15.17, 15.20, 15.20A, 15.22, 15.23, and to supervisory expectations in SS 2/17 paragraphs 3.14, 4.24, 4.7, 4.23, 5.44, 5.44A, Table E, Table G, 4A.2, 5.44A; and
- deleting the defined term ‘significant firm’ in rule 1.3 and making consequential amendments to rules 15.17 and 15.20.

The new MRT proportionality threshold

4.6 The PRA proposes amending the remuneration threshold at which firms may disapply certain remuneration rules (such as deferral or payment in instruments), to MRTs, by reverting to the previous (ie pre-CRD V) individual proportionality threshold of £500,000, adjusted for inflation to £660,000 total remuneration. This means individual MRTs at firms will need to meet the following quantitative conditions to benefit from proportionality:

- total remuneration does not exceed £660,000; and
- variable remuneration does not represent more than 33% of the employee’s total annual remuneration.

4.7 The PRA considers that the £660,000 threshold more accurately reflects remuneration levels in the UK. The PRA does not envisage a weakening of safety and soundness in firms resulting from this change. Employees whose variable remuneration represents a higher proportion of their total remuneration (over 33%) and who might consequently be incentivised to take imprudent decisions are subject to all remuneration requirements. In addition, firms that choose to disapply certain rules (such as deferral or payment in instruments) to MRTs who meet this new threshold are still subject to remuneration rules which seek to align their incentives with the long-term health of the firm including rules on performance adjustment.

4.8 The introduction of a higher threshold at which firms can disapply some requirements for certain MRTs would also facilitate the removal of the 'higher paid MRTs' and 'significant firm' categories that were introduced in CRD V implementation. This will result in two MRT proportionality categories for all types of dual-regulated firms, significantly simplifying the current regime which has a complex matrix due to the interaction of various pay thresholds and firm categories.

4.9 Additionally, as a result of the removal of the defined term 'significant firm', the MRTs currently subject to a 6-year clawback period will instead become subject to a 5-year clawback period. This change results from the simplification of the rules and is illustrated in Appendix 2. The PRA expects that this change will simplify its proportionality framework for individual MRTs and reduce firms' compliance costs.

Chapter 5: Remuneration and individual accountability

Background

5.1 The SM&CR seeks to promote safety and soundness, reduce harm to consumers and strengthen market functioning by requiring that financial services professionals are individually accountable to their employers and to the regulators. At its core is a requirement for firms to identify and set out the responsibilities of their most senior decision-makers. This allows both firms and regulators to hold senior staff to account, and as a result helps embed an effective and proactive approach to risk management. The regime also aims to ensure that all financial services staff meet expected conduct standards.

5.2 The remuneration regime and the SM&CR were set up with different, but complementary, aims. Most individuals identified as MRTs under the remuneration regime will either be an SMF or a certified function[12] under the SM&CR.

5.3 Remuneration requirements seek better alignment between the financial incentives of staff who have a material impact on the firm's risk profile and the long-term interests of their employer and the wider public. The ability to adjust variable remuneration of accountable senior staff to reflect collective and individual performance outcomes, including the ability to stop the payment of deferred variable remuneration, is central to this approach. The regulators' rules on variable remuneration were introduced some years before the SM&CR. While there are links between the two frameworks, they are not fully integrated. **Evidence** from a PRA evaluation of the SM&CR in December 2020 highlighted that 'responsibilities of senior managers are generally reflected in objectives and appraisals as part of a balanced scorecard, rather than a one-for-one link between meeting SMR responsibilities and variable pay'.

5.4 Paragraph 4.8 of SS2/17 sets out that the use of performance adjustment should not be limited to employees directly culpable of malfeasance. However, in engaging with firms, the PRA has found little evidence that remuneration adjustments have consistently been made to accountable individuals up the management chain. PRA staff analysis indicates that in 80% of risk events that led to the application of malus to some bank employees, no SMF's remuneration was affected.

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[12] For further information on the link between the certification regime and the PRA's remuneration rules see SS28/15, paragraphs 3.2 – 3.8.

5.5 The FSB in 2021 **examined** the implementation of the FSB Principles for Sound Compensation Practices and Implementation Standards in the UK. One of the FSB's recommendations was that the UK regulators consider how to further strengthen the financial sector compensation framework by reviewing the interaction between the UK's remuneration regime and the SM&CR.

5.6 Previous remuneration reforms, such as the removal of the bonus cap and the potential for higher variable remuneration reinforce the importance of performance adjustment mechanisms working as intended to ensure accountability.

Proposals

5.7 The PRA proposes changes to the Remuneration Part and to SS2/17 to link the accountability regime with the remuneration regime more closely by:

- introducing a rule and expectations for firms to consider adjusting the remuneration of accountable individuals up the management chain in the event of adverse outcomes;
- introducing a rule and expectations to ensure that senior management are accountable for their performance against PRA supervisory priorities; and
- clarifying expectations for Remuneration Committees with regards to managing adverse risk events.

Managerial accountability through remuneration

5.8 The PRA proposes creating a new rule 11.4A in Chapter 11 of the Remuneration Part of the PRA rulebook, where the PRA would require firms to consider variable remuneration adjustments in situations where it is reasonable that MRTs, by virtue of their role or seniority, could be held responsible for risk events or for failings or weaknesses in relation to risk events. The PRA also proposes a new paragraph 4.8A in SS2/17 which clarifies further the use of the new rule 11.4A. This new rule and expectation should be read in light of the PRA's current expectations set out in SS2/17:

- paragraph 4.8 of which provides guidance on cases involving a material failure of risk management or misconduct where adjustment should not be limited to employees directly culpable of malfeasance but also relevant managers; and
- paragraph 4.19 of which provides a non-exhaustive list of examples where firms should consider making reductions to variable remuneration.

5.9 Despite the above expectations currently applying, as noted above, supervisory work has shown that adjustments have not in practice been made to the remuneration of MRTs holding more senior roles when risk or misconduct events occurred. Therefore, the PRA considers that the creation of the new rule should ensure that firms identify the full range of individuals who are involved in, and/or are accountable for, risk events. The PRA expects that this new rule will result in more effective systems and controls being put in place as senior MRTs with relevant oversight responsibility for the individuals they line manage or oversee, will see outcomes of risk events reflected in their remuneration.

Senior management accountability for PRA supervisory priorities

5.10 The PRA proposes that material or urgent actions requested in a Periodic Summary Meeting (PSM) letter should be reflected in a Senior Manager's Statement of Responsibilities (SoRs).[13] As set out in PSM letters, and described to industry by Sam Woods in his Mansion House speech of 2018, a Senior Manager's variable remuneration should reflect their failure or success when delivering PRA supervisory priorities.[14] The PRA proposes introducing a new rule 11.7 to reflect this link between responsibilities and variable remuneration, aimed at advancing the safety and soundness of firms. The PRA expects that this new rule would incentivise senior management to increase their own internal monitoring when they delegate tasks as well as ensure that actions identified by supervisors are addressed promptly. A new paragraph 4.4B of the PRA's SS2/17 sets out expectations on the use of this rule with regards to Senior Managers.

Clarity on PRA expectations for Remuneration Committees when making variable remuneration adjustments

5.11 The PRA proposes to add expectations in two new paragraphs 4.4.A – 4.4B of SS2/17, to set out how firms should comply with the proposed PRA rule 11.7. These expectations will cover how firms should document the link between senior management variable remuneration outcomes and responsibilities to enhance pay transparency and aid remuneration decisions.

5.12 The PRA proposes to amend paragraph 5.10 and add a new paragraph 4.13A in SS 2/17 to set out its expectations on: (i) how remuneration committees should engage at board level with other committees to improve risk management; and (ii) the information remuneration committees should consider when incidents occur (eg accountability reviews, root cause analyses, and findings from audit and internal or external regulatory reviews). The PRA also proposes consequential amendments to paragraphs 4.1, 4.4 and 4.19 to reflect the

[13] See **SS28/15**, paragraph 2.47E.
[14] The origin of this work comes from **Good cop/bad cop – speech by Sam Woods**: 'But we are going to ask more pointedly and regularly than before: how is the pay of that senior manager who is tasked with delivering a major supervisory priority going to be affected by their success or failure in that task?'. Following the speech the PRA incorporated wording into the PSM letters of Category 1 and 2 Banks: 'We will discuss with the relevant individuals at [FIRM NAME] how success or failure in addressing the Key Risks and delivering the actions outlined in this letter will affect remuneration awards'.

introduction of the proposed rules 11.4A and 11.7. These clarifications are intended to further support the use of remuneration adjustments for MRTs.

5.13 The PRA proposes to amend its expectation in paragraph 4.3 of SS2/17 to set out that performance adjustments should be considered even if an incident does not result in a loss for the firm. For example, if individuals have breached the risk appetite framework of a firm but the firm has managed to hedge the risk and avoid financial loss, the firm should still consider whether to apply performance adjustments to the relevant individuals.

Chapter 6: Deferral and retention periods

Background

6.1 Deferral of variable remuneration helps align individual incentives with the long-term performance of the firm because outcomes from risk-taking often only become clear over time. Deferral periods, together with the application of malus and/or clawback, are often the most practical tools to address the longer time horizon of certain risks.

6.2 When UK deferral rules were introduced, they required a minimum deferral period for variable remuneration of 3 years. The **Parliamentary Commission on Banking Standards** (PCBS) noted that deferral periods needed to be sufficiently long to reflect the timescale over which problems are discovered in banking, whether in the form of high-risk assets turning bad or misconduct being discovered. It concluded that no single longer period was appropriate and flexibility in approach was required to align risk and rewards. The PCBS concluded that regulators should require that a substantial part of remuneration be deferred for up to 10 years.

6.3 In June 2015 as part of implementing CRD IV, the PRA introduced new rules that increased the deferral periods for many MRTs. The rules distinguished between the level of responsibility of MRTs. PRA SMFs were made subject to at least a 7 year deferral, risk managers to a 5 year deferral and all other MRTs to a 3 to 5 year deferral. The decision to apply a 7 year minimum deferral period for PRA Senior Managers reflected in part the PCBS findings, that longer periods of time were needed for the impacts of decisions to emerge. The PRA also considered at the time that the 5 to 7-year timeframe was more closely aligned to the average length of the business cycle and reflected the timeframe during which the outcomes of risk-taking decisions are most likely to crystallise. CRD V implementation increased the minimum deferral period from 3 to 4 years.

6.4 Internationally, a number of jurisdictions[15] and the FSB Principles and Standards for Sound Compensation Practices recognise the need for deferral periods, reflecting the potential impact and time horizon of decisions of material risk takers in firms. However, most jurisdictions have shorter deferral periods than the UK. There are also differences between UK regulators. For example, an MRT who performs a PRA designated Senior Management Function is subject to a minimum deferral period of 7 years, whereas an MRT who performs a FCA designated Senior Management Function is subject to a minimum deferral period of 5 years. In addition to the deferral period, both regulators also have requirements on the

[15] The jurisdictions reviewed include EU, Switzerland, Canada, Australia, Singapore, Hong-Kong and USA.

vesting schedule of deferred remuneration, retention periods, and the payment of dividends or interest on deferred instruments.

6.5 The PRA has received industry feedback that the 7 year deferral period for SMFs constitutes a significant challenge to the competitiveness of the UK. Feedback indicates that long deferral periods can make it difficult for UK banking institutions to attract talent from other financial services firms – in the UK and abroad – and from other sectors, such as the technology sector.

6.6 In addition, findings from an evaluation of the remuneration regime by the PRA, supported by a Bank of England **Staff Working Paper** (Sakalauskaite and Harris, 2022), indicate that longer deferral periods may have resulted in firms compensating affected individuals with higher total remuneration and a larger proportion of that remuneration awarded in fixed pay as opposed to variable remuneration. As set out in **CP15/22**, the PRA considers that an increase in the proportion of fixed pay is undesirable in the context of its statutory objectives for three core reasons:

- it increases firms' fixed costs, thereby reducing their ability to adjust costs to absorb losses in a downturn;
- it limits the relative proportion of remuneration that is performance-based, and subject to regulatory requirements regarding the calibration of performance scorecards; and
- it reduces the relative amount of 'at risk compensation' that other parts of the remuneration regime — eg, performance adjustment — can be applied to, thereby limiting the effectiveness of the remuneration rules on incentive setting.

6.7 As currently set out in paragraph 1.9 of SS2/17, the PRA expects all firms to continue to make every effort to comply with all aspects of the **EBA's Guidelines on Sound Remuneration Policies** (EBA Guidelines), and all existing domestic requirements.[16] According to the EBA Guidelines firms may not pay dividends or interest on deferred variable remuneration awarded in instruments. The regulators have received feedback that the payment of interest or dividends on deferred instruments is a common practice among most listed non-financial services companies. Firms have noted that without the payment of interest or dividends, deferred instruments face a significant erosion in value, for example due to inflation. Feedback has further outlined concerns by firms that the difference in approach between MRTs and non-MRTs (who are eligible to receive dividends or interest on their deferred remuneration awards) potentially creates operational complexity and additional

[16] Following the end of the transition period in line with its Statement of Policy on the Interpretation of EU Guidelines and Recommendations after the UK's withdrawal from the EU, the PRA expects firms to continue to make every effort to comply with EU Guidelines and Recommendations to the extent that they remain relevant when the UK leaves the EU. April 2019: **www.bankofengland.co.uk/paper/2019/interpretation-of-eu-guidelines-and-recommendations-boe-and-pra-approach-sop**.

costs that put UK firms at a disadvantage to global (non-EU) based firms which operate without this restriction.

6.8 The EBA guidelines also expect firms to implement 6 or 12-month minimum retention periods on deferred instruments for MRTs. At the time of consultation, the EBA had received industry feedback that the minimum requirement of the 12-month retention period is inappropriate and disproportionate, as it does not duly consider the length of deferral, which already ensures a long-term perspective, and the decrease in the perceived value of the variable remuneration when retained for longer periods. **Feedback received** by the EBA also highlighted the greater costs for institutions without publicly traded instruments.

Proposals

6.9 In light of the feedback set out above, the PRA is proposing a simplified two-tier deferral framework. Over time the PRA considers that the proposed changes should give firms greater flexibility over the design of their remuneration structures, which would allow them to rebalance more towards the variable component. That would increase the proportion of remuneration that is performance-based, and subject to risk adjustment. The proposals:

- reduce the 7 year minimum deferral period currently applicable to certain SMFs by amending PRA remuneration rule 15.17 (deferral) to reflect that in the case of a non-SMF MRT, variable remuneration awarded should be deferred for 4 years minimum; and in the case of a PRA SMF, 5 years;
- amend PRA remuneration rule 15.17 (deferral) to reflect that deferred awards should vest no faster than on a pro rata basis for SMFs from the time of award. This changes the current approach for certain SMFs for whom vesting currently starts no earlier than year 3 from the time of award;
- insert a new paragraph 1.9A in SS2/17 to reflect that firms are not expected to set a retention period for deferred instruments;
- insert a new expectation in paragraph 1.9B in SS2/17 to set out that firms may pay interest or dividends on deferred instruments; and
- amend Table G in SS2/17 to reflect the changes to deferral period requirements.

6.10 The regulators consider that the proposals set out in this chapter will support growth and make the UK regime more competitive without undermining financial stability.

Deferral periods

6.11 In considering the appropriate length of deferral period requirements the PRA has considered both macro and micro economic and prudential evidence.

6.12 At a macro level, the typical length of business and credit cycles was a key factor supporting longer deferral periods as they indicated the period over which the consequences of risk-taking decisions might emerge.[17] At a micro level, the PRA has also considered the time elapsed between individuals taking decisions in firms and adverse outcomes emerging. These periods are variable but can be long, with some well-known examples of long lags between risk-taking decisions, the emergence of problems and the attribution of responsibility.[18]

6.13 The PRA has recently undertaken internal analysis of the time that has elapsed between individuals taking decisions in firms and adverse outcomes being discovered. Results from this analysis show that 70% of risk events were discovered within 4 years of the incident, and 30% discovered after 4 years[19]. The data could suggest that shorter deferral periods than currently required may allow sufficient time for risk events to crystalise. Conversely, the data also highlights that some risk events do take more time to emerge. In addition, recent PRA research (Sakalauskaite and Harris, 2022), suggests that longer deferral periods appear to have led to a higher proportion of remuneration being fixed, with less variable remuneration at risk of adjustment, which is undesirable for the PRA's safety and soundness objective.

6.14 In light of this, the PRA considers that on balance shortening deferral periods is acceptable from the perspective of safety and soundness as these deferral periods are still long enough to incentivise prudent risk taking. Chart 1 illustrates the prudential impact of the PRA's proposals to move from the current 7 year deferral period applicable to certain SMFs to 5 years, and allow deferred awards for those SMFs to vest no faster than on a pro rata basis from the time of award. In making its proposals, the PRA has also considered the positive impact on the competitiveness of the UK, noting that current UK deferral periods are typically longer than those in some other jurisdictions. The regulators consider that these proposals will support growth and make the regime more competitive without undermining financial stability.

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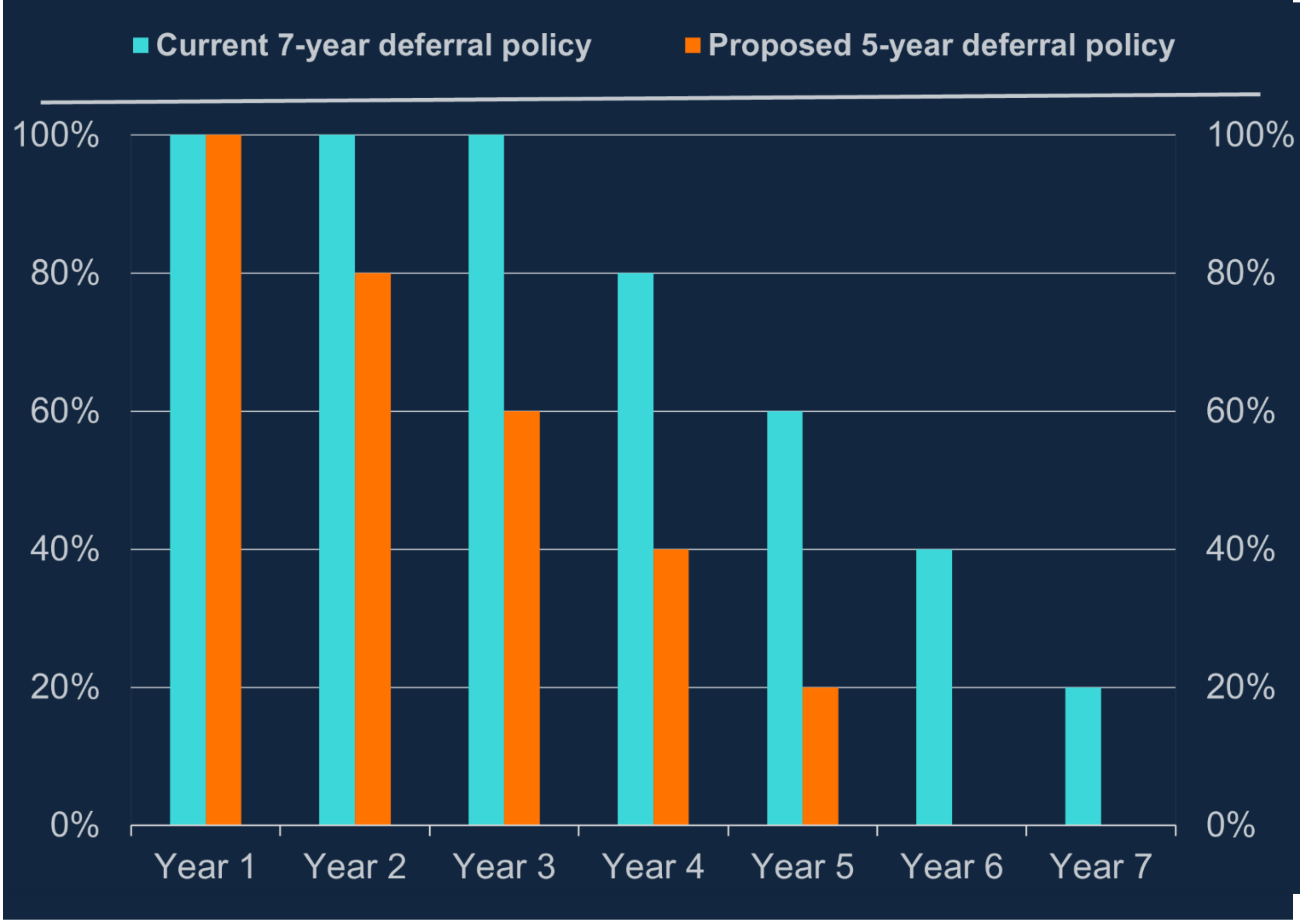
Chart 1: Proposed changes to remuneration rules

[17] For example, the Financial Policy Committee's Financial Stability Report in 2012 noted that deferral periods at the time were only around 3-5 years while the typical business cycle was around 5-7 years and credit cycles 8-30 years.
[18] For example, firms faced fines and redress for misconduct over Payment Protection Insurance (PPI) between 2011-17 relating to activities that were underway at least a decade earlier.
[19] Data analysed refers to Table 7 and Annex 1 provided by large firms in Remuneration Policy Statements during 2018 – 2022. The PRA analysed both quantitative and qualitative data points, which at times required assumptions to be made, and data points from the two reports to be correlated. The findings should therefore be considered indicative rather than definitive.

Deferred variable remuneration on which malus could apply each year under different deferral policies[(a)]



(a) 7-year deferral currently applies to higher-paid Senior Managers; in addition, variable remuneration awarded in the form of instruments is subject to a retention period of up to a year.

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6.15 In designing its proposals, the PRA considers that maintaining differentiation between SMFs and non-SMFs is crucial in ensuring a clear link between seniority and accountability. SMFs are responsible for implementing the overall business strategy of a firm and are ultimately responsible for risk management. The PRA therefore proposes to require longer deferrals for SMFs relative to non-SMFs.

Retention of Instruments

6.16 Retention periods on deferred remuneration do not enhance the ability of a firm to apply “malus” adjustments, as awards will already have vested before a retention period starts. They do, however, prevent the employee from selling the instruments for a specified additional period, aligning the interests of MRTs with the long-term interest of the firm by increasing the period during which materialised risks of a firm can be reflected in its instruments.

6.17 When setting the appropriate retention period, the 2015 EBA Guidelines require firms to consider a range of factors including: the overall length of the deferral and the planned retention period and the impact of the category of identified staff on the institutions’ risk profile, and the length of the business cycle relevant for the category of staff. Paragraph 267 of the EBA Guidelines expects retention periods of between 6 and 12 months for deferred instruments depending on the length of the deferral period.

6.18 In light of current and proposed deferral periods, it is now within the PRA’s risk tolerance that firms are not expected to set a retention period for deferred instruments, thereby departing from the expectation in paragraph 267 of the EBA guidelines.

Prohibition on Payment of Dividends or Interest on Deferred Remuneration

6.19 The PRA considers that the prohibition on payment of dividends on deferred shares was primarily in place to prevent mechanistic breaches of the previous 2:1 bonus cap which the regulators removed in **PS9/23**. Given the removal of the bonus cap, the PRA proposes removing this prohibition.

6.20 The PRA does not anticipate that the removal of the ban on the payment of dividends or interest will negatively impact safety and soundness. This is because the current requirements are overly prescriptive when compared to the limited prudential benefit they bring now that the bonus cap has been removed.

Chapter 7: PRA objective analysis

7.1 The PRA has two primary objectives: with the relevant objective in this context being a general objective to promote the safety and soundness of regulated firms.[20] The PRA also has two secondary objectives:

- A competition objective, which is focused on facilitating effective competition in the markets for services provided by PRA-authorised persons in carrying on regulated activities; and
- The competitiveness and growth objective, which is focused on facilitating, subject to alignment 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-authorised persons); and (b) its growth in the medium to long term.

7.2 The PRA considers that in aggregate the policy proposals advance the PRA's primary objective (safety and soundness), and facilitate the secondary objectives.

Promoting the safety and soundness of regulated firms

7.3 The remuneration regime aims, by more closely aligning risk taking outcomes and reward, to encourage better risk management and the safety and soundness of regulated firms. That in turn is intended to contribute to a better level of resilience within firms and therefore support financial stability. The PRA considers that the proposals would continue to support the PRA's primary objective to promote the safety and soundness of firms as set out below:

- **Enhancements of a firms' governance processes for MRT identification -** aim to ensure that this process is less formulaic, and that firms have ownership of the process with active involvement of control functions (eg risk) and the management body in its supervisory function. The proposed changes may result in firms creating tailored MRT identification methodologies specific to their size and business model increasing the likelihood of more appropriately capturing MRTs. The proposed changes complement the proposals to enhance rules on remuneration and individual accountability (chapter 5). Together they should incentivise risk owners, including SMFs, to more accurately identify risk takers in their teams.

[20] The other PRA primary objective – to contribute to the securing of an appropriate degree of protection for policyholders – relates to insurance firms.

- **Enhancements to the link between individual accountability and remuneration** - aim to ensure that where required firms consider making adjustments to the variable remuneration of senior staff. The proposed changes are intended to achieve greater alignment between risk taking and individual reward. A stronger link between the SM&CR and remuneration regime would support the PRA's primary objective to advance safety and soundness by promoting prudent behaviours among decision makers and a sound risk culture in PRA-regulated firms.
- **Reducing deferral period requirements** could incentivise firms to award more remuneration in the form of variable remuneration as opposed to fixed pay.[21] This could result in a greater proportion of remuneration subject to the regimes' incentive-setting requirements, which can help align remuneration with prudent risk taking. Additionally, potential decreases in fixed costs could improve a firms' ability to manage its costs and absorb losses in a downturn, similarly promoting safety and soundness in firms.

7.4 There are also some proposals that could potentially weaken the safety and soundness in firms, but the PRA does not consider the associated risks to be material and there are appropriate mitigants. The proposals include:

- **Removing the requirement to seek regulatory approval** before excluding an MRT (solely identified by quantitative criteria) from the remuneration regime may lead to firms excluding individuals that may potentially affect the risk profile of the firm. The PRA considers that Chapter 3 in the Remuneration Part of the PRA rulebook already identifies the minimum criteria to identify key risk takers in firms, and the governance enhancements that require control function (amongst others) involvement will mitigate this risk.
- **Changes to proportionality thresholds for MRTs** will increase the number of MRTs who are not subject to certain requirements (such as deferral). Nevertheless, the proposals would advance the PRA's safety and soundness objective because MRTs whose variable remuneration comprises a material amount of their total pay will still be subject to the full remuneration requirements.
- **Shorter deferral periods** could lead to a higher possibility of risk events emerging after the end of the deferral period. The PRA anticipates this can be adequately mitigated by existing regulatory policies:
    - Regulators expect firms to freeze the vesting of all awards made to individuals undergoing internal or external investigation that could result in performance

[21] Recent PRA research (Sakalauskaite and Harris, 2022), suggested longer deferral periods appear to have led to a higher proportion of remuneration being fixed pay rather than variable remuneration.

adjustment until such an investigation has concluded and the firm has made a decision and communicated it to the relevant employee.

  - Firms are also not prevented from applying adjustments to the extent that the relevant individuals have variable remuneration capable of reduction, even where this does not relate to performance in the year in which the misconduct or risk management failure occurred or came to light.
  - Additionally, results from internal risk event analysis shows that 70% of risk events were discovered within 4 years of the incident, and 30% discovered after 4 years.[22] The PRA notes that there is always a risk that any deferral period may not capture all risk events, but the proposed deferral periods could capture a majority of risk events. The 5 year deferral period for SMFs provides a longer time horizon for these individuals, recognising the potential impact of their decisions on firms' risk profiles. Furthermore, clawback – which allows firms to recover vested remuneration from responsible individuals – is applicable for 5 to 7 years following award (see Table G in Appendix 2 for details), which gives firms more time to make remuneration adjustments following risk events and cases of misconduct.
- **The removal of expectations for firms to set a retention period for deferred instruments** may reduce the link between the financial interests of MRTs and the long-term performance of the firm given the period during which materialised risks of a firm can be reflected in its instruments may be shortened. The PRA considers that any adverse impacts on the firms' safety and soundness are mitigated given the proposed deferral periods still maintain alignment between the long-term interests of the firm and an individual MRT's remuneration. For instruments awarded upfront, firms are still expected to set meaningful retention period (eg. 1 year).

7.5 The PRA does not anticipate that its proposals to allow payment of dividends and interest will negatively impact safety and soundness. This is because the current requirements are overly prescriptive when compared to the limited prudential benefit they bring now that the bonus cap has been removed.[23]

Facilitating effective competition

7.6 The PRA assesses that the proposals would facilitate effective competition given the potential high compliance costs associated with the current regime due to overly complex

[22] Data analysed refers to Table 7 and Annex 1 data provided by firms in remuneration policy statements during 2018 – 2022. The PRA analysed both quantitative and qualitative data points, which at times required assumptions to be made, and data points from the two reports to be correlated. The findings should therefore be considered indicative rather than definitive.

[23] The prohibition, in part, aimed to reduce any technical breaches of the bonus cap resulting from the payment of dividends.

remuneration requirements. These compliance costs could deter new entrants, and act as a barrier to growth, reducing competition more widely across the sector.

Facilitating international competitiveness of UK economy and its growth in the medium to long term

7.7 The PRA considers that a number of the proposals will facilitate international competitiveness of the UK economy and its growth in the medium to long term. The proposals maintain alignment with international principles and standards, while also helping make the UK more competitive because of the following proposed changes:

- **Removing 7-year deferral requirements** currently applicable to certain PRA SMFs and allowing pro-rata vesting from the time of the award will align UK deferral requirements for PRA SMFs more closely with other jurisdictions. The PRA considers this will facilitate the movement of senior staff to the UK given that previous industry engagement identified this requirement as a significant deterrent to senior talent acquisition. This will also make the UK a more attractive location for global firms and talent. UK headquartered firms with foreign operations, that must apply remuneration requirements to subsidiaries of the UK legal entity, might also benefit from these changes. It will allow them to attract and retain talent, given deferral periods would be closer to other jurisdictions, supporting UK competitiveness.
- **Simplifications of the quantitative criteria used for identifying MRTs and the exclusions process** would align the remuneration regime to a number of other jurisdictions and give firms more ownership over their approach to MRT identification[24]. This would also help internationally active firms to simplify and align their group-wide remuneration frameworks facilitating the movement of senior staff to the UK enhancing UK competitiveness.
- **Simplifications to MRT proportionality categories** – will ensure that remuneration requirements (such as deferral or payment in instruments) only apply to those MRTs with material levels of remuneration. This limits any potential overreach of the regulations that may hinder firms' ability to attract and retain talent in the UK.
- **Simplifications to the wider remuneration regime;** by removing the ban on payment of interest and dividends and prescriptive retention periods, as well as changes noted above, will all reduce associated compliance costs for firms enhancing the UK's competitiveness.
- **Enhancing the link between accountability and remuneration** could help minimise excessive risk taking and misconduct. A regulatory regime that upholds clear and

[24] Jurisdictions reviewed include Australia, Singapore, Switzerland, Hong-Kong, USA, and EU.

robust standards that limit potential malpractice by senior management could attract potential investors.

Chapter 8: PRA 'Have regards' analysis, impact on mutuals, equality and diversity

8.1 In developing these proposals, the PRA has had regard to its framework of regulatory principles. The regulatory principles that the PRA considers are most material to the proposals include:

Section 3B FSMA Requirement

- **The need to use the resources of the PRA in the most efficient and economic way:** The PRA considers that the proposals to simplify the MRT exclusion process will allow both regulators and firms to use their resources in a more efficient and economic way. Regulators will no longer be required to review individual exclusion requests or publish modifications by consent. For example, supervisors reviewed 450 exclusions[25] during the 2023 performance cycle and between March 2021 and May 2024 a total of 66 modifications by consent were published in respect of quantitative criteria. Removing the need to seek regulatory approval will allow the PRA to deploy resources on other regulatory priorities. Similarly, proposals that clarify and simplify areas of the remuneration regime, such as linking accountability and remuneration, deferral changes, and simplifications to MRT identification could help reduce the volume of compliance queries submitted to regulators by firms. This could also enable the PRA to use its resources on other priorities.
- **The principle that a burden or restriction which is imposed on a person, or on the carrying on of an activity, should be proportionate to the benefits, considered in general terms, which are expected to result from the imposition of that burden or restriction:** The PRA considers the proposals to be proportionate to the benefits. A full assessment of the costs and benefits of the PRA's proposals is set out in Chapter 10. Specific examples of the proportionate nature of the PRA's proposals include the changes which reduce the deferral period from 7 to 5 years for certain PRA SMFs. Some of the PRA's proposed measures impose specific burdens or restrictions on firms. These proposals include measures to enhance firms' MRT identification governance processes by more actively involving control functions such as risk. The PRA considers the burden imposed is relatively modest, and proportionate given that these measures will benefit firms by incentivising the use of MRT identification as a risk management tool. This will help ensure MRT identification practices are tailored to the risk profile of firms and ensure that the right risk takers are identified and subject to relevant remuneration requirements

[25] A total of 12 large firms were in the sample.

which will promote the safety and soundness of firms. Additionally, the proposals that link remuneration with accountability might incur some costs but these are expected to be minimal given the proposals clarify pre-existing expectations and supervisory practice. The PRA similarly views these clarifications as proportionate to the burden imposed as they help ensure that senior management are subject to accountability standards that potentially deter malpractice, and that the management body in its supervisory function can adequately scrutinise performance.

- **The desirability where appropriate of the PRA exercising its functions in a way that recognises differences in the nature of, and objectives of, businesses carried on by different persons (including different kinds of persons such as mutual societies and other kinds of business organisation) subject to requirements imposed by or under FSMA:** The PRA's proposals to amend proportionality criteria so that firms can disapply specific remuneration requirements (such as deferral) for certain MRTs take into consideration the differences in the size, nature and risk profile of businesses. These proposals ensure that the remuneration regime captures businesses which award material levels of remuneration to MRTs. Businesses that award lower levels of remuneration, for example mutuals, could disapply certain requirements reducing their compliance costs.
- **The principle that the PRA should exercise its functions as transparently as possible:** This CP sets out the PRA's policy justification for the proposals, how the proposed policy changes advance the PRA's objectives or 'have regards', and CBA analysis. The consultation is open for 3.5 months and the PRA welcomes responses from all stakeholders. The PRA will consider all responses before deciding whether to proceed to make rules and in the form proposed in this consultation. This is subject to the approval of the Prudential Regulatory Committee. The PRA has engaged with its statutory panels during the policy development process.
- **The responsibilities of the senior management of persons subject to requirements imposed by or under FSMA, including those affecting consumers, in relation to compliance with those requirements:** The PRA's proposals on MRT identification will increase the role of specific control functions (such as risk) and management body in its supervisory function in a firm's remuneration practices. This will enhance the responsibility and the role of relevant Senior Managers. In particular, Chief Risk Officers will be expected to review the design and implementation of the MRT identification methodology. This may result in firms creating tailored MRT identification methodologies specific to their size and business model increasing the likelihood of more appropriately capturing MRTs. Proposals relating to accountability strengthen the link between senior management pay and supervisory priorities as well as provide greater clarity on PRA expectations on variable remuneration performance adjustments when incidents occur. This in part ensures that senior management remain accountable and provides additional

incentive to deter malpractice, and that Boards have adequate tools to scrutinise performance.

HMT's recommendations for the PRC

8.2 The development of the policy content of the remuneration proposals was started and completed before HMT issued a '**remit letter**' on 14 November 2024, under section 30B of the Bank of England Act 1998, making a new set of recommendations about aspects of the government's economic policy to which the PRA should have regard. The PRA acknowledges the new remit letter and the PRA's initial view, as summarised below, is that the intended effects of the proposals are broadly in line with the new recommendations. However, the PRA will consider the recommendations further and have regard to the matters set out by HMT when finalising and making the remuneration rules.

- The proposals seek to create a remuneration regime that is simpler and better tailored to the UK financial services sector, providing firms with more flexibility and ownership over their remuneration policies and practices and reducing undue compliance costs, whilst maintaining alignment with international standards.
- Proposals to remove the 7-year deferral requirements for certain PRA SMFs, and allowing pro-rata vesting from the time of the award will align UK deferral requirements for Senior Managers more closely with other jurisdictions. The PRA considers this proposed alignment has three key benefits: (i) it will facilitate the movement of senior staff to the UK given that previous industry engagement identified this requirement as a significant deterrent to senior talent acquisition; (ii) it will make the UK a more attractive location for global firms and talent; and (iii) UK headquartered firms with foreign operations, that must apply remuneration requirements to subsidiaries of the UK legal entity, will be better able to attract and retain talent (both in their UK and overseas operations).
- Broader proposed changes to wider deferral policies and MRT proportionality changes simplify the remuneration regime and target the application of the strictest rules to those who have capacity to take risks that could impact a firm's risk profile. This will reduce compliance costs for firms and also help attract more talent to the UK, potentially from a wider range of sectors (eg technology). This new talent base could facilitate innovation within firms.
- Proposals to simplify the wider remuneration regime in the form of: removing the ban on dividends and prescriptive retention periods, simplifying MRT identification, and broader deferral simplifications, will all reduce associated compliance costs for firms, which could help to make the UK a more attractive financial hub.

8.3 The LRRA also requires the PRA to adhere to the Regulators Compliance Code. In formulating its proposals, the PRA has considered these requirements and considers that many of the themes overlap with the FSMA requirements to be proportionate, transparent, provide clarity, and use resources efficiently and effectively.

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

Impact on mutuals

8.5 The proposals outlined would apply to all firms in scope of the remuneration rules, which includes some mutuals. The proposals in this CP raise the individual proportionality threshold, meaning that firms may choose to disapply certain remuneration requirements for MRTs meeting this threshold. While all firms may benefit from this proposal, mutuals – due to their size, remuneration levels and structures – are particularly likely to benefit from the associated reductions in compliance costs, with fewer MRTs in scope of the full suite of rules.

Equality and diversity

8.6 The regulators are required under the Equality Act 2010 to 'have due regard' to the need to eliminate discrimination, harassment, victimisation, and any other conduct prohibited by or under the Act, advance equality of opportunity between persons who share a relevant protected characteristic and those who do not, and to foster good relations between people who share a protected characteristic and those who do not.

8.7 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. 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.

8.8 The regulators will also continue to consider the equality and diversity implications of the proposals during the consultation period and will revisit them when making any final rules which result from this consultation.

Chapter 9: FCA's objectives and regulatory principles: compatibility statement

Compliance with legal requirements

9.1 This Chapter records the FCA's compliance with several legal requirements applicable to the proposals in this consultation, including an explanation of the FCA's reasons for concluding that the proposals in this consultation are compatible with certain requirements under FSMA including its statutory objectives.

9.2 When consulting on new rules, the FCA is required by s138I(2)(d) of FSMA to include an explanation of why it believes making the proposed rules: (a) is compatible with its general duty, under s1B(1) of FSMA, so far as reasonably possible, to act in a way which is compatible with its strategic objective and advances one or more of its operational objectives; (b) so far as reasonably possible, advances the secondary international competitiveness and growth objective, under s1B(4A) of FSMA; and (c) complies with its general duty under section 1B(5)(a) of FSMA to have regard to the regulatory principles in s3B of FSMA. The FCA is also required by s138K(2) of FSMA to state its opinion on whether the proposed rules will have a significantly different impact on mutual societies as opposed to other authorised persons.

9.3 This Chapter sets out the FCA's view of how the proposed rules are compatible with the duty on the FCA to discharge its general functions (which include rule-making) in a way which promotes effective competition in the interests of consumers (s1B(4) of FSMA). This duty applies in so far as promoting competition is compatible with advancing the FCA's consumer protection and/or integrity objectives.

9.4 In addition, this Chapter explains how the FCA has considered the recommendations made by the Treasury under s1JA of FSMA about aspects of the economic policy of HM Government to which the FCA should have regard in connection with its general duties. It also includes FCA's assessment of the equality and diversity implications of these proposals.

9.5 Under the Legislative and Regulatory Reform Act 2006 (LRRA) the FCA is subject to requirements to have regard for a number of high-level 'Principles' in the exercise of some of our regulatory functions and to have regard to a 'Regulators' Code' when determining general policies and principles and giving general guidance (but not when exercising other legislative functions like making rules). This Chapter sets out how the FCA has complied with requirements under the LRRA.

9.6 As explained in Chapter 2, the FCA is proposing to change the format of 'SYSC 19D Dual-regulated firms Remuneration Code' by largely cross referring to the 'Remuneration Part' of the PRA Rulebook (PRA Remuneration Rules).

9.7 This change is intended to remove areas of duplication and any inconsistencies. As a result, firms will – except in a handful of cases – only have to comply with one substantive set of rules (the PRA Remuneration Rules) as they are applied (and in some cases modified) by the FCA rules.

9.8 Therefore, the substantive effect of the FCA's remuneration rules is not changing as a result of the proposed change in format. The FCA considers that parallel, duplicative rules create regulatory costs with limited or no consumer benefit.

9.9 On the policy proposals detailed in this CP (Chapters 2 to 6), the FCA believes the changes advance its objectives. There are many parallels with how these proposals advance both regulators' objectives; indeed, there are overlaps with the analyses provided by the PRA in its Objective analysis (Chapter 7). For clarity, the FCA's rationale has been outlined separately below.

FCA's strategic objective

9.10 The FCA considers the proposals in this CP are compatible with its strategic objective of ensuring that relevant markets work well.

9.11 The proposals to enhance individual accountability and firms' governance processes in relation to MRTs is likely to better meet the aims of promoting effective risk management and alignment between risk and individual reward in the long-term interests of the firm and its customers. This in turn should support healthy firm cultures and discourage behaviours that lead to misconduct and poor customer outcomes.

9.12 Coupled with the other proposals that aim to provide greater flexibility to firms in determining their remuneration policies and practices, including the FCA proposal to exempt small firms from buy-out requirements, these changes will ensure that relevant markets function well and that there is reduction in costs and improvement in efficiencies.

FCA's operational objectives

9.13 The FCA considers that collectively, the proposals set out in this CP aim to improve outcomes for consumers and markets by reducing harm and promoting competition and positive change. Improving the remuneration regime will help advance one or more of the FCA's objectives, as set out in this Chapter.

Promoting effective competition in the interest of consumers

9.14 A more flexible, proportionate, and simpler remuneration regime – resulting from the FCA's proposal to simplify its rules, exempt small firms from buy-outs and from PRA proposals to simplify the deferral framework and MRT identification rules – would support competition in the UK market in the interests of consumers. Reduced compliance burden and regulatory costs from the proposals could allow firms to grow or enter new business lines and invest more time and resources on products, services and initiatives to improve their competitive standing, to the benefit of consumers. Some of the cost savings may be passed to consumers.

9.15 The FCA's buy-out proposal – in conjunction with the changes the regulators have already made for small firms in **PS23/17** – could further improve the ability for firms to attract and retain highly qualified individuals, thereby enhancing competition.

Protecting and enhancing the integrity of the UK financial system

9.16 Overall, the proposals should not impact the integrity of the UK financial system. The proposals aimed at enhancing individual accountability should prevent excessive risk taking and contribute to a better alignment of incentives with principles of effective risk management, good conduct, and the long-term interests of the firms. This is likely to foster better market conduct and prudent risk management among material risk takers. Additionally, the FCA's proposed changes to align and simplify the rules (as explained in Chapter 2) will deliver greater clarity in respect of the rules and the regulators' expectations. This could lead to better compliance and increased consistency in the application of the regime across firms, thereby improving the soundness of dual-regulated firms and the wider financial system.

Securing an appropriate degree of protection for consumers

9.17 While it is unlikely that there will be any direct implications for consumers, the FCA considers that the proposals collectively advance its consumer protection objective.

9.18 The FCA's proposed changes to align and simplify the rules will deliver greater clarity in respect of the rules and the regulators' expectations of firms and individuals. This could lead to better compliance and increased consistency in the application of the regime across firms, leading to better consumer outcomes.

9.19 Moreover, as a result of the proposals to enhance individual accountability and governance, the FCA expects this to have a positive effect on the overall robustness of the regime. This would lead to healthier firm cultures and better consumer protection.

FCA's secondary international competitiveness and growth objective

9.20 The FCA considers that the proposals advance the secondary international competitiveness and growth objective while maintaining the robustness of the remuneration regime to ensure high levels of conduct by individuals. This contributes to the UK financial sector's reputation for high standards and the UK's standing as an international financial centre.

9.21 While remaining in line with internationally agreed principles for remuneration practices, including robust individual accountability, the proposals may also help to make the UK more competitive because of the following: simplifying the FCA rules for dual regulated firms by aligning and cross referring to the PRA Remuneration Rules; simplifying requirements for MRTs and increasing the threshold for individual proportionality; and ensuring deferral thresholds and framework are more aligned with international practices while remaining long enough to adequately capture issues and risks. This should enable firms to attract more talent and afford them more flexibility around the necessary governance arrangements.

9.22 The above overall should give firms greater flexibility over their cost base and design of remuneration structures, which in turn could make the UK a more attractive place to do business and an attractive place to work for talented individuals.

The regulatory principles

9.24 In preparing the relevant proposals set out in this consultation, the FCA has had regard to the regulatory principles set out in s3B of FSMA, as further detailed below.

The need to use FCA resources in the most efficient and economical way

9.25 The FCA considers that the proposed measures in this consultation are a proportionate use of our resources. The FCA's proposed changes to align and simplify the rules (by cross-referring to the PRA Remuneration Rules) should help the FCA use its resources more efficiently and economically by reducing time spent updating its rules. Also, firms having a better clarity and understanding of their obligations should help the FCA by reducing time spent resolving issues stemming from firms' approach to and application of the remuneration regime.

The principle that a burden or restriction should be proportionate to the benefits

9.25 The FCA considers the proposals to be proportionate to the benefits. The FCA's CBA considerations are set out in Chapter 11.

The desirability of sustainable growth in the economy of the United Kingdom in the medium or long term

9.26 The proposals seek to apply remuneration requirements that are more appropriate for and tailored to the UK market. They provide firms in scope with greater flexibility over their remuneration policies and practices. A simplified and less complex regime reduces compliance costs for firms. In turn, the FCA anticipates this could improve the attractiveness of the UK as a place to do business, encourage new entrants into the market or support existing firms to enter new business line. The increased flexibility could also help with attracting talent to the sector (both from other sectors and jurisdictions). Any of these outcomes would support the sustainable growth of the UK economy.

The need to contribute towards achieving compliance by the Secretary of State with section 1 of the Climate Change Act 2008 (UK net zero emissions target)

9.27 Overall, the FCA does not consider that the proposals materially contribute to this target.

The general principle that consumers should take responsibility for their decisions

9.28 The proposals are not relevant to the principle of consumer decision-making.

The responsibilities of senior management

9.29 The proposals support the aim of the SM&CR to ensure individuals are accountable for their conduct and competence. In line with their responsibilities under SM&CR and SYSC 19D, relevant Senior Managers are expected to ensure that their firms' remuneration policies and practices are in line with SYSC 19D. As set out in Chapter 5, the proposals aim to enhance the obligations of senior managers.

The desirability of recognising differences in the nature of, and objectives of, businesses carried on by different persons including mutual societies and other kinds of business organisation

9.30 The proposals seek to ensure that dual-regulated firms are subject to a remuneration regime appropriate to the level of risk they pose to the UK financial system. The remuneration regime will continue to be applied proportionately to dual regulated firms according to their size, internal organisation and the nature, scope and complexity of their activities. The effect on mutual societies is explained below.

The desirability of publishing information relating to persons subject to requirements imposed under FSMA, or requiring them to publish information

9.31 The proposals do not require firms to publish information. The FCA does not expect that the proposals will result in firms publishing information regarding persons subject to requirements imposed under FSMA.

The principle that the FCA should exercise its functions as transparently as possible

9.32 This CP sets out the FCA's policy justification for the proposals, considerations of its CBA requirement and compatibility with its legal duties. The consultation is open for 3.5 months and the FCA welcomes responses from all stakeholders. The FCA will consider all responses before deciding whether to proceed to make rules and in the form proposed in this consultation. This is subject to the approval of the FCA Board.

9.33 In formulating these proposals, the FCA has had regard to the importance of taking action intended to minimise the extent to which it is possible for a business carried on: (i) by an authorised person; or (ii) in contravention of the general prohibition, to be used for a purpose connected with financial crime (as required by s1B(5)(b) of FSMA). The FCA does not consider the proposals to be relevant in this regard.

9.34 The FCA engaged with its statutory panels during the policy development process.

Expected effect on mutual societies

9.35 The FCA is proposing changes to SYSC 19D, which applies to dual-regulated firms, including building societies. Building societies are one type of mutual society. While the proposals will have an impact on building societies, the FCA does not expect the proposals in this CP to have a significantly different impact to that on other firms in scope of SYSC 19D.

Compatibility with the duty to promote effective competition in the interests of consumers

9.36 In preparing the proposals set out in this consultation, the FCA has had regard to its duty to promote effective competition in the interests of consumers. The FCA considers that the proposals will support enhancing competition in the UK.

Treasury recommendations about economic policy

9.37 This section explains how the FCA has considered the recommendations made by the Treasury under s.1JA FSMA about aspects of the economic policy of His Majesty's Government to which the FCA should have regard in connection with our general duties.

9.38 The development of the policy content of the remuneration proposals was started and completed before HMT issued (on 14 November 2024) a new set of recommendations about aspects of the Government's policy to which the FCA should have regard, in a 'remit letter'[26] under section 1JA FSMA 2000. The FCA acknowledges the new remit letter, and the FCA's initial view is that the intended effects of the proposals are in line with the new recommendations. However, the FCA will continue to keep this matter under review and have regard to the new remit letter when finalising and making the rules.

Supporting the government's objective of medium to long-term economic growth in the interests of consumers and businesses

9.39 The proposals contained in this paper support the Government's objective of medium to long term economic growth in the interests of consumers and businesses. Reducing compliance and regulatory costs would allow firms to invest more time and resources on developing a wider range of products and services that better meet customer needs. Some of the cost savings may also be passed on from firms to consumers.

Supporting the government's objective to promote the international competitiveness of the UK

9.40 The proposals in this paper should help support the Government's objective to promote the international competitiveness of the UK by enhancing competition and competitiveness (as explained under the heading 'The FCA's objectives' in this chapter). This should increase the attractiveness of the UK as a place to invest and do business, both within the UK and globally. This in turn can help facilitate the medium to long-term growth of the UK economy.

Equality and diversity

9.41 The FCA is required under the Equality Act 2010 in exercising our functions to 'have due regard' to the need to eliminate discrimination, harassment, victimisation and any other conduct prohibited by or under the Act, advance equality of opportunity between persons who share a relevant protected characteristic and those who do not, to and foster good relations between people who share a protected characteristic and those who do not.

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[26] **Recommendations for the Financial Conduct Authority: November 2024**

9.42 The FCA has considered the equality and diversity issues that may arise from the proposals in this CP.

9.43 Overall, the FCA does not consider that the proposals materially impact any of the groups with protected characteristics under the Equality Act 2010 (in Northern Ireland, the Equality Act is not enacted but other antidiscrimination legislation applies). The FCA will continue to consider the equality and diversity implications of the proposals during the consultation period and when making the final rules.

Legislative and Regulatory Reform Act 2006 (LRRA)

9.44 The FCA has had regard to the principles in the LRRA for the parts of the proposals that consist of general policies, principles or guidance and consider that the proposals are:

- transparent – the FCA is consulting on the proposed guidance changes;
- accountable – stakeholders will have an opportunity to respond to this CP and the FCA will consider all evidence received prior to finalising the rules and guidance;
- proportionate – the FCA considers the proposals will result in a more proportionate regime for impacted firms;
- consistent – the proposed changes to FCA guidance will help clarify its expectations of firms, resulting in a more consistent application of the remuneration requirements; and
- targeted only at cases in which action in needed – the FCA considers that these proposals are needed to simplify the application of the remuneration framework.

9.45 The FCA has had regard to the Regulators' Code for the parts of the proposals that consist of general policies, principles or guidance. The FCA considers that our proposals are consistent with the principles of the code. For example:

- The proposals are carried out in a way that supports firms to comply and grow through the FCA's consideration of their feedback via the CP and refining the proposals where necessary; and
- the CP, CBA considerations, draft instrument, accompanying appendices, public communications and communications with firms are provided in a simple, straightforward, transparent and clear way to help firms meets their responsibilities.

Chapter 10: PRA cost benefit analysis

10.1 Evaluations[27] of the UK remuneration regime have found that the framework is well embedded in firms' practices and broadly works as intended. As such, there is little evidence to suggest a fundamental revision of the core parts of the framework is needed. But the evaluations have identified the opportunity to reduce some of the costs that have become apparent over time, including as the framework has become more complex following its iterations through EU regulations and UK implementation. This complexity leads to undue compliance costs for firms, and potentially decreases the ability of the UK to attract and retain talent. The proposals contain a range of measures that reduce the regulatory burden on firms and enhance competitiveness, in some cases with additional measures proposed to ensure that the underlying objectives of the regime are achieved, and that individuals with the potential to have a material impact on the risk profile of the firm are appropriately incentivised.

10.2 Overall, the PRA considers that the proposed changes will reduce operational compliance costs for firms, estimated to be £55 million (present value) over 10 years, given the simplified rules and expectations. There may be some one-off costs for firms to familiarise themselves with the proposals and should firms want to restructure their remuneration arrangements. However, this is discretionary and firms will incur those one-off costs only if they think the changes are net beneficial to them. In addition, the PRA understands that firms looking to remove the bonus cap will be doing so regardless. Some firms may incur small costs where they need to adapt their governance enhancements around MRT identification. The PRA estimates that adapting to the proposed changes will represent a one-off cost to firms of c£5 million (across the whole industry). In aggregate, the measures could lead to a net benefit of c£50 million.

10.3. In addition, there are prudential[28] and competitiveness benefits that are hard to quantify. These benefits include deferral amendments which will support growth by attracting and retaining talent to the UK, and align the remuneration regime closer to international standards. Similarly, the simplification to MRT identification aligns the remuneration regime to other jurisdictions. Prudential enhancements to governance and accountability practices will ensure that key risk takers are better identified and held to account by aligning the outcomes

[27] The PRA has undertaken a number of internal evaluations focusing on the effectiveness of the remuneration regime.
[28] Prudential benefits include the enhanced use of remuneration as a risk management tool.

of their decisions to the remuneration they are awarded. Overall, the PRA considers that the benefits of the reforms outweigh the costs.

Cost Benefit Analysis (CBA) Panel Feedback

10.4 The PRA has consulted the CBA Panel (‘the Panel’) on the preparation of this CBA. The PRA submitted a draft CBA for the Panel to review prior to a meeting to discuss its feedback and advice. The Panel provided feedback on the overall presentation of the CBA assessment, the analysis of risk event data, and the management body in its supervisory function involvement in remuneration matters. Specifically:

- The Panel pointed out that while the draft CBA noted that 70% of risk events were discovered within 4 years, it did not discuss the 30% of risk events that were not identified within 4 years. Paragraph 10.14 of the CBA now sets out more clearly the potential risks with reducing deferral periods, in addition to the wider evidence supporting shorter deferral periods.
- The Panel recommended greater clarity around the benefits of the PRA’s proposals on the use of the MRT identification process as a risk management tool. Paragraph 10.9 reflects this feedback.
- The Panel recommended that the CBA consider the impact of the proposals on employee remuneration in a more systematic way. Paragraph 10.9 sets out how the length of deferral could affect fixed and variable remuneration, based on the findings from the Bank of England’s Staff Working Paper **Measuring the effects of bank remuneration rules: evidence from the UK**.
- The Panel noted that firms’ management body in its supervisory function currently play an active role in remuneration decisions and remuneration committees often review senior managers’ pay package. The Panel noted that as a result the additional costs for firms to comply with remuneration regulation requirements are likely to be lower than cost estimates that assume the management body in its supervisory function are not engaged. The discussion on firms’ costs is amended in para 10.12 to reflect the Panel’s comment.

Benefits

10.5 The PRA considers that the proposals will have a number of benefits outlined below.

10.6 **Reduced ongoing operational compliance costs for firms** given the:

- **Simplifications to quantitative remuneration thresholds** which will ensure firms only need to benchmark employees against one remuneration threshold. Using firm regulatory remuneration reporting[29], the PRA estimates that c.20% of MRTs are solely identified due to quantitative remuneration criteria. The PRA anticipates that the simplifications to quantitative remuneration thresholds could lead to a reduction in the number of MRTs identified by firms. It is hard to estimate what this likely reduction will be for each firm, however, individuals who can materially affect the risk profile of a firm will continue to be captured as MRTs.

- **Removal of the requirement to seek PRA approval for excluding MRTs solely identified by quantitative criteria** resulting in firms having greater ownership of the process and not needing to complete detailed regulatory reporting. Analysis from firms[30] shows that for the 2023 performance year 450 individuals were proposed to be excluded; these firms will no longer be required to complete detailed reporting documents for these individuals, and the PRA will not have to approve or issue modifications by consent.

- **Simplifications to proportionality categories** resulting in fewer and simpler tiers for the purpose of applying rules on deferral and clawback periods, which, in combination with other proposals, will likely reduce firms' cost of compliance.

- **Higher individual proportionality threshold under which some remuneration rules may be disapplied** resulting in fewer individuals subject to certain requirements such as deferral. This should also lower costs of compliance for firms. Using remuneration data submitted from firms[31] around 21% (around 2,180 individuals) of the MRTs in the current sample can currently benefit from the proportionality proposals. Under the new threshold, and modelling the revised threshold on the sample, the regulators estimate an increase of approximately 8 percentage points, or around c.900 individuals, resulting in 29%[32] (around 3,070 individuals) of MRTs no longer being subject to certain requirements such as deferral.

- **Shortening of deferral periods and allowing vesting from the time of the award for SMFs** will align PRA rules closer to other jurisdictions where international firms might operate. This will facilitate the attraction of talent to the UK and also reduce[33] the

[29] Remuneration data refers to performance year 2023, and a total of 20 large firms were in the sample.
[30] Remuneration data refers to performance year 2023, and a total of 12 large firms were in the sample.
[31] Remuneration data refers to performance year 2023, and a total of 21 large firms were in the sample.
[32] In this analysis the PRA did not pro-rate the new total remuneration threshold of £660,000 to account for instances of part year MRTs. This could mean that the number of individuals that meet the threshold is slightly lower than the figures displayed.
[33] Sakalauskaite and Harris, 2022 (**Bank of England Staff Working Paper 1008**) found some evidence indicating that requiring bankers' variable remuneration to be deferred for longer periods was correlated with increases in total compensation and a lower proportion of variable remuneration being deferred.

costs of compliance for firms operating across other international jurisdictions thereby enhancing the UK's competitiveness.

- **Removal of the ban on the payment of dividends and interest** which means firms will no longer discount the value of instruments upon awarding them, thus lowering compliance costs.

- **Removal of the regulatory minimum length of retention periods** for deferred instruments which will lower costs of compliance by giving firms discretion to choose what the appropriate minimum length should be.

10.7 Improved **staff attraction and retention:**

- The proposals will result in a set of MRT identification rules and expectations **tailored to the UK market.** This should lead to firms being able to improve labour mobility of key staff including across and between sectors.

- **Simpler and more internationally aligned rules on deferral** will likely help firms attract and retain talent, including internationally mobile talent. More flexibility to decide on the appropriate length of the retention period and the possibility to pay dividends or interest on deferred instruments will likely reinforce this positive effect.

10.8 Many of the above compliance cost reductions and staff attraction and retention benefits will likely have a particularly positive impact on internationally active firms, which can help simplify and align their group-wide remuneration frameworks and facilitate the movement of senior staff across different parts of the group.

10.9 **Prudential benefits:**

- **Increased role of employees with responsibility for the overall management of risk controls, control functions and the management body in its supervisory function of a firm in the MRT process** can incentivise firms to further embed MRT identification as a risk management tool. The PRA notes that the involvement of management bodies in their supervisory function and control functions, with the remuneration regime, and in MRT identification is increasing, and the proposals may generate greater involvement resulting in firms creating tailored MRT identification methodologies specific to their size and business model increasing the likelihood of more appropriately capturing MRTs. The changes complement the proposals to enhance rules on remuneration and individual accountability (chapter 5). Together, they incentivise risk owners, including SMFs, to identify risk takers in their teams.

- **A new rule for firms to consider adjusting variable remuneration for MRTs when incidents occur under their watch** would present prudential benefits as it would discourage MRTs from taking excessive risks. This change, aimed at MRTs, who by virtue of their role or seniority, could be held responsible for risk events or for failings or weaknesses in relation to risk events, solidifies the intent of existing expectations. The new rule clearly sets out the importance of senior accountability being reflected in remuneration. It is important that variable remuneration adjustments for managers are timely and applied consistently given other proposed reforms – eg, potentially having fewer MRTs and, shorter deferral periods – as well as with expected larger variable remuneration following removal of the bonus cap.

- With **shorter deferral periods**, we expect firms to award a greater proportion of total pay in variable remuneration which will bring a prudential policy benefit, as a greater proportion of MRTs' total pay may be subject to downward adjustments. This expectation aligns with part of the findings in a PRA Staff Working Paper **measuring the effects of bank remuneration rules: evidence from the UK**, which found evidence indicating that variable remuneration deferrals for longer periods of time was correlated with increases in fixed remuneration, and therefore a lower proportion of total remuneration being deferred.

10.10 Overall, the PRA estimates that the measures will enable firms to save c£55 million in ongoing costs of operational compliance (present value of benefits over ten years),[34] representing potential reduction in regulatory compliance costs of c 180 affected firms (18 large firms, 13 medium firms, and 150 small).

Costs

10.11 The remuneration regime has been operational for several years, and firms have established processes and frameworks to ensure compliance. Some proposals may lead to some incremental compliance costs, including:

10.12 **Increased ongoing compliance** costs;

- costs of **governance enhancements** for firms whose risk management processes do not currently incorporate control functions or management bodies in their supervisory function in the MRT identification process. Internal regulatory analysis shows that some firms with advanced risk management processes are already increasing the role

[34] With a discount rate of 3.5%.

of control functions throughout MRT identification. For these firms, the costs of these changes are likely to be minimal.

- following the introduction of the **new rule on the adjustment of variable remuneration for MRTs when incidents occur under their watch**, firms may incur a modest increase in compliance costs. But the regulators expect that firms already have familiarity with the existing expectation which they should be meeting.

- the **new rule on SMF pay adjustments when a supervisory priority is not addressed** may also lead to a limited increase in costs. The regulators consider the increase in costs modest as the rule reflects current supervisory practice, and best practice in firms as suggested by engagement with Remuneration Committees.

10.13 **Increased compliance costs** in the form of one-off familiarisation costs:

- following the **simplification of individual proportionality thresholds,** firms might incur short-term familiarisation costs, as they adapt their internal policies on MRT identification and determine which rules on deferral and clawback periods should apply.

10.14 **Potential erosion of remuneration and risk-taking alignment:**

- Amendments to deferral periods would result in **shorter deferral periods** for some individuals occupying senior positions (including SMFs) and a potential **reduction in retention periods** of deferred instruments awards. This means that potentially less variable remuneration would be available for downward adjustment when a risk event is discovered some years after variable remuneration is awarded which might potentially increase risk taking from MRTs. Results from PRA analysis shows that 70% of risk events were discovered within 4 years of the incident, and 30% discovered after 4 years. The PRA's assessment is that a 5 year and 4 year deferral can capture the majority of events. The PRA also has other tools that can mitigate some of the potential costs associated with this change, namely potentially 30% of risk events crystalising after 5 years. The PRA expects firms to freeze the vesting of all awards made to individuals undergoing internal or external investigation that could result in remuneration adjustment until such an investigation has concluded and the firm has made a decision and communicated it to the relevant employee. Firms are also not prevented from applying adjustments, even where this does not relate to performance in the year in which the misconduct or risk management failure occurred or came to light. The PRA also has clawback requirements which are between 5 and 7 years. This arrangement would allow the firm to ensure that the employee in question returns ownership of an amount of variable remuneration paid out in the past (ie remuneration that has already vested). The PRA considers that all the existing tools would allow for accountability measures to be applied for the potential 30% of risk events that crystalise after 4 years. Therefore, the potential remaining 30% of risk events missed is within the PRA's risk tolerance, and mitigated by the existing regulatory tools previously mentioned.

10.15 The PRA estimates that adapting to the proposed changes could cost firms c.£5 million (across the whole industry and at present value) estimated across c180 affected firms (18 large firms, 13 medium firms, and 150 small firms). The costs are likely to take the form of one-off adaptation costs as changes come into force. The PRA expects there to be no material on-going costs to firms from the proposed changes (eg technological infrastructure changes), in part given the remuneration regime has been operating for several years.

Chapter 11: FCA cost benefit analysis

Background

11.1 FSMA, as amended by the Financial Services Act 2012, requires the FCA to publish a CBA of our proposed rules. Specifically, s138I of FSMA requires us to publish a CBA of proposed rules, defined as 'an analysis of the costs, together with an analysis of the benefits that will arise if the proposed rules are made'. However, s138L of FSMA states that the FCA does not need to provide a CBA where the FCA considers that there will be no increase in costs, or the increases will be of minimal significance. In this chapter we describe why we are exercising the exemption to provide a CBA under s138L of FSMA. The FCA has also considered whether there are any benefits arising from the PRA's proposals as set out in the previous chapter.

Changes to the FCA Handbook

11.2 The FCA intends to simplify the remuneration rules contained in the FCA Handbook chapter: 'SYSC 19D Dual-regulated firms Remuneration Code', by cross referring to the 'Remuneration Part' of the PRA Rulebook and make changes to the structure of the FCA's related remuneration guidance. We expect that this proposal, consisting of rulebook format changes, will bring no increase in costs as it simplifies the regulatory burden faced by firms, so the CBA exemption under s138L of FSMA applies.

11.3 As the FCA will cross-refer to the rules the PRA is proposing to change, as explained in this CP, the impact on firms of the proposed changes is principally driven by the PRA's changes as assessed and explained in the PRA's CBA (Chapter 10). The incremental costs incurred from the FCA's changes will be of minimal significance and of a lesser magnitude than the ones driven by the PRA's changes, therefore, the CBA exemption also applies to the FCA changes.

11.4 The FCA also expects there will be conduct benefits in addition to the benefits described by the PRA in Chapter 10. In particular, the FCA expects that the proposals to enhance individual accountability and governance will have a positive effect on the overall robustness of the regime, leading to healthier firm cultures and therefore, better conduct.

Remuneration buy-outs

11.5 The FCA specifically intends to change the rules within SYSC 19D3.45R to align with the PRA on remuneration buy-outs policy for small firms. Based on the assessment of costs and benefits below, it is expected that the costs of this proposal are of minimal significance, so the CBA exemption (under s138L of FSMA) also applies. Nonetheless, we provide the expected costs and benefits below.

11.6 The proposed rule change to SYSC 19D3.45R aims to reduce the regulatory burden on 'small firms' (as defined in the FCA's dual regulated firms Remuneration Code), by exempting them from the FCA rules on remuneration buy-outs. There are approximately 150 small firms currently in scope.

11.7 At present, small firms must maintain the remuneration structure set out by an MRT's previous employer, if variable remuneration is bought out as part of an employment offer. Unvested remuneration structures at larger firms tend to be more complex. Larger firms are subject to deferral, malus and clawback requirements while small firms are not; conditions around instruments are also more complex for larger firms. Therefore, for a small firm to mirror rules, it may be costly and complex.

11.8 The PRA introduced an identical exemption in 2023 (**PS16/23**). The proposal set out in this consultation re-aligns FCA and PRA rules, simplifying the regime and making regulation more proportionate.

Benefits

11.9 The proposal would reduce the regulatory burden on small firms, as they would no longer be required to match elements of the remuneration rules (such as deferral, malus and clawback) when hiring MRTs and offering buy-out awards. For small firms these schedules are proportionately more time-consuming and complex to administrate, so they often do not offer buy-outs to prospective hires.

11.10 As a result, small firms which could offer buy-outs as part of an employment offer, due to the simplification of the rules, may become more competitive as a hiring employer. This could result in them having access to a wider pool of talent, who may only consider employment offers with a buy-out agreement.

11.11 Respondents to the PRA's **CP5/23** were positive about exempting small firms from buy-outs rules. By reducing the burden, there may be an opportunity benefit where the resources previously used to administrate bought-out vesting schedules can be used for other purposes.

11.12 Alongside the proportionality enhancements we made for small firms in 2023, the buy-out proposal may further enhance the medium to long-term growth and competitiveness of the UK economy, as removing buy-outs requirements from small firms could increase the attractiveness of the UK as a base for small firms, encourage firms to grow or enter new business lines, or encourage new players into the market. The proposals may also attract key talent to the UK financial services sector.

11.13 For the purpose of this analysis, there is no suitable data on the use of buy-outs or the cost of doing so, with which benefits could reasonably be estimated.

Costs

11.14 Small firms may incur a modest compliance cost as a selection of staff will need to read and understand the rule change. However, dual-regulated firms are already expected to be familiar with the PRA's identical rule, so the expected familiarisation cost is minimal.

11.15 Supervisory insights indicate that the use of buy-outs is not common amongst small firms due to the high cost and complexity involved.

11.16 There is a risk that the proposal may incentivise MRTs to move from larger firms, as accepting a buy-out at a smaller firm could give them immediate access to remuneration that would otherwise have a vesting schedule. This may increase a firm's staff turnover and could incentivise an increase in risk-taking behaviour, leading to risk taking costs.

11.17 However, vesting schedules and deferral periods disincentivise excessive risk-taking, so at the time of remuneration being awarded, there should already have been the appropriate reduction in an MRT's risk taking. There are also other mitigations in place as part of SYSC 19D. Therefore, the risk of an increase in excessive risk-taking from these proposals is expected to be low.

11.18 Based on this assessment, the costs associated with the proposal are considered to be of minimal significance.

Monitoring success

11.19 The regulators will continue to monitor the outcome of the changes through their Rule Review Framework and through feedback received from industry.

11.20 The FCA may measure the success of our proposal through measuring an increase in the number of firms who consider small firms' ability to attract and retain talent has increased, and an increase in the number of firms who consider our amended rules to be more proportionate to the risks they pose to consumers and the UK market.