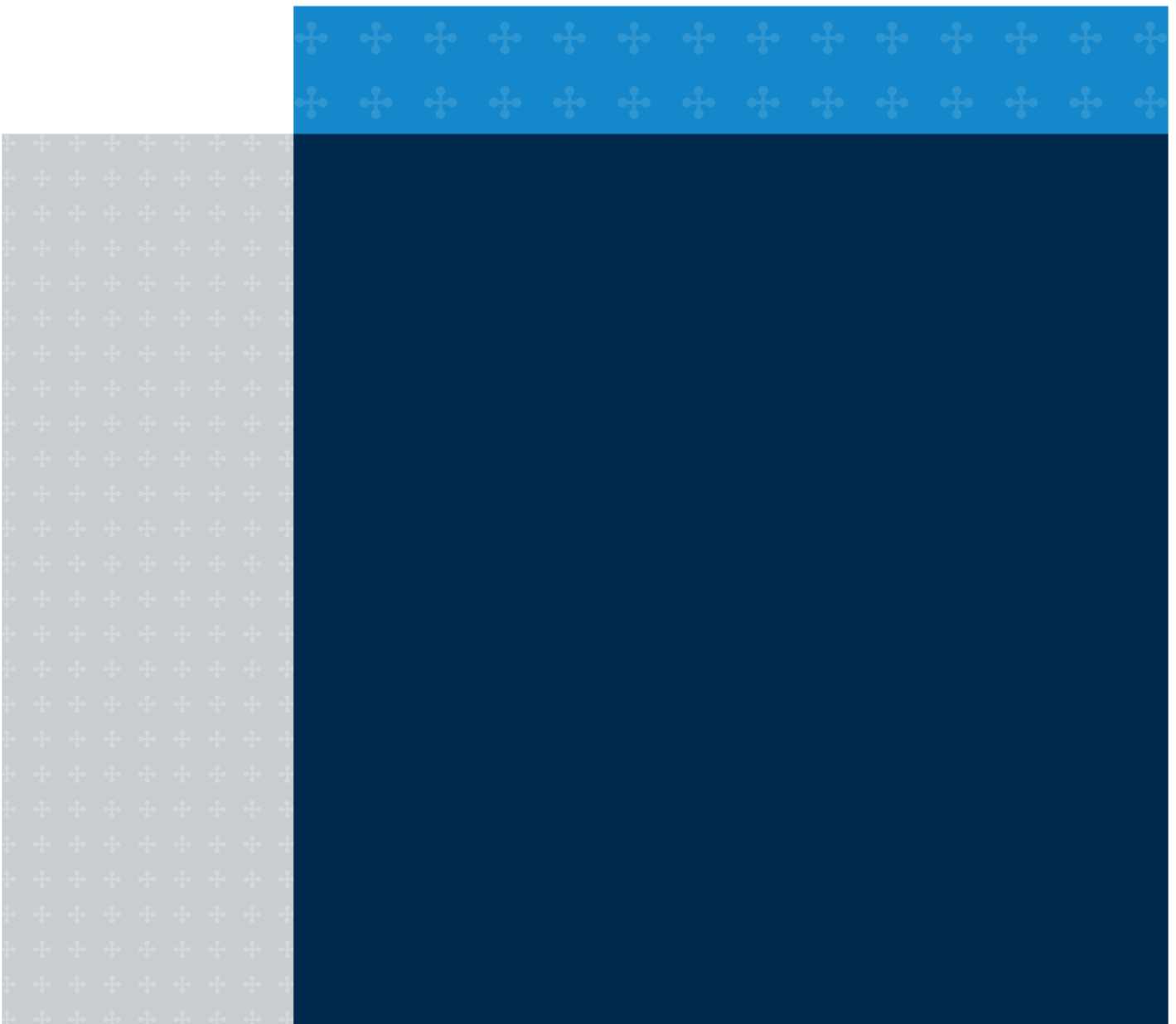




Policy Statement | PS18/21

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

July 2021





BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

Policy Statement | PS18/21

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

July 2021

Contents

1	Overview	1
2	Feedback to responses	3
	Appendices	6

1 Overview

1.1 This Prudential Regulation Authority (PRA) Policy Statement (PS) provides feedback to responses to Consultation Paper (CP) 9/21 'Remuneration: Correction to the definition of 'higher paid material risk taker'.¹ It also contains the PRA's final policy, as follows:

- amendments to the Remuneration Part of the PRA Rulebook (Appendix 1); and
- an updated Supervisory Statement (SS) 2/17 'Remuneration' (Appendix 2).

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

Background

1.3 In CP9/21, the PRA proposed to correct an error in the definition of 'higher paid material risk taker' in the PRA Rulebook. This definition was introduced when the final rule instrument 'PRA RULEBOOK: CRR FIRMS: REMUNERATION (CAPITAL REQUIREMENTS DIRECTIVE V) INSTRUMENT 2020' was published as part of PS29/20 'Capital Requirements Directive V (CRD V): Final policy'.² The purpose of the proposal was to align the 'higher paid material risk taker' definition with the PRA's intentions, as set out in PS26/20 'Capital Requirements Directive V (CRD V)', of matching the conditions set out in SS2/17, paragraph 2.20, for the disapplication of remuneration rules at an individual level.³ In CP9/21, the PRA proposed to:

- as regards the definition of a 'higher paid material risk taker', change the '**and**' to '**or**', thereby ensuring that a 'higher paid material risk taker' is defined as either an individual (a) whose annual variable remuneration exceeds 33% of their total remuneration, or (b) whose total remuneration exceeds £500,000;
- make a consequential amendment to Table G in SS2/17, to reflect the updated definition in the table heading; and
- make an addition to the Remuneration Part of the PRA Rulebook to make clear that firms would not be required to apply the corrected definition to remuneration that has been paid, vested, or is subject to an obligation to pay or vest created before Friday 23 July 2021 in respect of the first performance year beginning on or after Tuesday 29 December 2020. This is in order to avoid retroactivity.

Summary of responses

1.4 The PRA received two responses to the CP. Both respondents made a number of observations on the proposals consulted on, which are set out in Chapter 2. Having considered the responses, the PRA has decided to publish the policy as proposed.

Purpose of rules

1.5 The purpose of the amendments to the rules is to align the 'higher paid material risk taker' definition with the PRA's intentions, as set out in PS26/20 'Capital Requirements Directive V (CRD V)' and ensure that the 'higher paid material risk taker' definition applies to individuals (a) whose

¹ April 2021: <https://www.bankofengland.co.uk/prudential-regulation/publication/2021/april/remuneration-correction-to-the-definition-of-higher-paid-material-risk-taker>.

² December 2020 (see Appendix 13): <https://www.bankofengland.co.uk/prudential-regulation/publication/2020/capital-requirementsdirective-v-further-implementation>.

³ This is in line with the PRA statement published on Thursday 25 February 2021, which stated the PRA's position in relation to the definition of 'higher paid material risk taker': <https://www.bankofengland.co.uk/prudential-regulation/publication/2021/february/pru-statement-definition-of-higher-paid-material-risk-taker>.

annual variable remuneration exceeds 33% of their total remuneration, or (b) whose total remuneration exceeds £500,000. The purpose of this is to ensure that proportionality cannot be applied to material risk takers who also have material monetary incentives to take potentially excessive risk. This in turn promotes the alignment of material risk takers' remuneration and prudent risk-taking.

Impact of CRR rule 'have regards'

1.6 The PRA has considered the matters specified in section 144C(1) of FSMA. Those matters did not have a significant impact on the final rules on account of the PRA's view of their likely impact. The PRA considers that the rules will contribute to maintaining robust institutions and a resilient financial system by ensuring that incentives are appropriately aligned with prudent risk taking at firms. The rules therefore should contribute to the relative standing of the UK as a place for internationally active credit institutions and investment firms to be based or to carry on activities.

Implementation

1.7 All changes outlined in this PS will take effect from Friday 23 July 2021.

1.8 References related to the UK's membership of the EU in the SS covered by the policy in this PS have been updated as part of these proposals to reflect the UK's withdrawal from the EU. Unless otherwise stated, any remaining references to EU or EU-derived legislation refer to the version of that legislation which forms part of retained EU law.⁴

⁴ For further information please see <https://www.bankofengland.co.uk/eu-withdrawal/transitioning-to-post-exit-rules-and-standards>.

2 Feedback to responses

2.1 Before making any proposed rules, the PRA is required by FSMA to have regard to any representations made to it, and to publish an account, in general terms, of those representations and its feedback to them.⁵ Additionally, as the rules apply to holding companies under section 192XA FSMA, the PRA is required to consider certain additional matters and publish a summary of the purpose of the rules and an explanation of how having regard to the specified matters has affected them.

2.2 The PRA has considered the responses received to the CP. This chapter sets out the PRA's feedback to those responses, and its final decisions.

2.3 The sections below have been grouped by the areas raised by respondents as follows:

- disproportionate impact on certain employees; and
- retroactivity and other issues.

Disproportionate impact on certain employees

2.4 The CP proposed to change the erroneous use of 'and' to 'or' in the definition of 'higher paid material risk taker' to ensure that a 'higher paid material risk taker' is either an individual (a) whose annual variable remuneration exceeds 33% of their total remuneration, or (b) whose total remuneration exceeds £500,000.

2.5 The first respondent commented that the amended 'higher paid material risk taker' definition could apply to relatively junior material risk takers with relatively low total remuneration, but whose variable remuneration is above 33% of their total remuneration. The respondent proposed three alternative options:

- i. to retain the 'higher paid material risk taker' definition as it currently (and erroneously) appears in the PRA Rulebook to require both criteria to be met before an individual is considered a 'higher-paid material risk taker' (ie a 'higher-paid material risk taker' is a material risk taker with (a) variable remuneration which exceeds 33% of their total remuneration, **and** (b) total remuneration which exceeds £500,000);
- ii. use two criteria based on variable remuneration (ie a higher-paid material risk taker is a material risk taker with (a) variable remuneration which exceeds 33% of their total remuneration, **and** (b) variable remuneration which exceeds £167,000); or
- iii. remove the 33% criterion from the definition to leave a single criterion relating to total compensation (ie a higher-paid material risk taker is a material risk taker with a total remuneration which exceeds £500,000).

2.6 The PRA considers the respondent's options would excessively reduce the scope of the definition of a higher-paid material risk taker. The PRA considers that two of the respondent's suggestions also perpetuate the identified rule error of requiring both conditions to apply at the same time for PRA rules to apply in full. As a consequence, highly-remunerated material risk takers or material risk takers with a high ratio of variable pay in relation to their total remuneration would be able to benefit from a more proportionate application of remuneration rules intended for situations in which these rules would apply to much lower levels of total and variable remuneration

⁵ Sections 138J(3) and 138J(4) of FSMA.

of a material risk taker. This would therefore extend the application of proportionality beyond what the PRA had originally intended and set out in PS26/20.⁶ The PRA also considers that each of the three options would result in incentive structures that may not be appropriately aligned with firms' prudent risk-taking, potentially undermining firms' safety and soundness.

2.7 The second respondent proposed an alternative approach to the application of certain remuneration rules, including deferral, payment in instruments, and buy-out rules. Their proposal included introducing higher thresholds to the definition of higher-paid material risk takers, and lower percentages of deferred variable remuneration for the material risk takers not captured by that definition, with the aim of allowing payment of a higher unrestricted cash-based bonus to a larger population of material risk takers.

2.8 The respondent further commented that the proposals in the CP could reduce 'lower-paid' material risk takers' mobility between firms, given that a hiring firm would potentially need to buy-out a large amount of deferred remuneration. The respondent asserted their alternative proposal would aid mobility of junior bankers in their careers, and would assist these relatively 'lower-paid' individuals to receive a higher upfront cash bonus. The respondent also suggested that the higher amount of variable remuneration paid upfront (in cash) would, for example, facilitate these individuals' ability to purchase property, or repay their mortgages more quickly.

2.9 The PRA has considered the respondents' comments and has decided to maintain the proposals as set out in the CP. The PRA considers that the thresholds are appropriately balanced and ensure that individuals who are material risk takers as a result of their role (because they have the authority to take decisions that materially impact the risk profile of the PRA-authorized firm that employs them), but whose remuneration is below both the thresholds (and therefore is comparatively lower), are able to benefit from more proportionate requirements. Applying the 'higher paid material risk taker' definition to individuals who meet either of the two criteria also ensures that proportionality cannot be applied to material risk takers who also have large monetary incentives to take potentially excessive risk including where (although the total pay may not be large by industry standards) that incentive is large relative to the individual's total pay.

2.10 One respondent provided comments that exceeded the scope of the consultation, that when considered together, ultimately appeared to seek a more advantageous treatment of material risk takers considered to receive relatively 'lower' remuneration levels. The PRA acknowledges that its proposals could feasibly affect some more junior material risk takers where their individual circumstances bring them within scope. However, the PRA considers such circumstances are likely to be rare. The PRA considers this does not therefore justify amending the proposals. The PRA considers that the 'higher paid material risk taker' definition ensures a proportionate application of Rules 15.17, 15.20, 15.20A, 15.22, and 15.23, and in turn ensures an effective alignment of remuneration and prudent risk-taking by material risk takers.

2.11 Having considered these responses, the PRA has decided to publish the final policy as proposed.

2.12 One respondent also noted that buy-out rules may be dis-applied by individuals, subject to a different and stricter threshold. The PRA considers that this particular issue is beyond the scope of consultation, and will therefore maintain the proposals that were set out in the CP.

⁶ December 2020: <https://www.bankofengland.co.uk/prudential-regulation/publication/2020/capital-requirements-directive-v-further-implementation>.

Retroactivity and other issues

2.13 In order to avoid retroactivity, the CP proposed an addition to the Remuneration Part of the PRA Rulebook to make clear that firms would not be required to apply the corrected definition to remuneration that has been paid, vested, or is subject to an obligation to pay or vest created before the rule publication date in respect of the first performance year beginning on or after Tuesday 29 December 2020 (when the rules implementing CRDV came into effect).

2.14 One respondent welcomed the PRA's proposals to avoid retroactivity. The same respondent also requested the PRA to develop a single source for all UK remuneration rules, commenting that the current configuration requires firms to view multiple sources — including EU directives — to understand the rules. The respondent commented that such a situation adds to the complexity of the regime and increases the risk of inadvertent incorrect application.

2.15 The PRA has considered the respondent's comments, and considers that creating a single source of UK remuneration rules was not part of the proposals consulted on. As a result the PRA does not intend to amend the proposals set out in CP9/21. However, the PRA acknowledges that following the UK's exit from the EU there are areas where technical regulatory material will be held in primary and secondary legislation, while other material will sit in regulators' rules, guidance, and onshored European technical standards. The government has put forward a number of proposals in its Phase II consultation on the Future Regulatory Framework which would, among other things, facilitate the transfer of regulatory requirements in onshored legislation to the regulators.⁷

⁷ <https://www.gov.uk/government/consultations/future-regulatory-framework-frf-review-consultation>.

Appendices

- 1 PRA RULEBOOK: CRR FIRMS: REMUNERATION INSTRUMENT, available at:
<https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/policy-statement/2021/july/ps1821app1.pdf>

 - 2 SS2/17 'Remuneration', available at: <https://www.bankofengland.co.uk/prudential-regulation/publication/2017/remuneration-ss>
-