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INDIVIDUAL NAME & ADDRESS

11 September 2015

Dear [X]

The 2015/16 Remuneration Round

I am writing to you ahead of the 2015/16 remuneration round to share our view of the importance of the link between individual accountability and remuneration, the role of effective performance management in promoting a strong and effective conduct culture and to inform you of the approach we intend to take to this year's annual review. This letter also shares the FCA's findings and observations from the 2014/15 remuneration round (in Annex 1).

We are sending this letter to all firms that fall into proportionality level 1¹ and it should be considered in the context of the firm-specific feedback you have previously received, which remains valid. I would like to take this opportunity to thank you and your colleagues again for your co-operation during the last remuneration round.

Enhancing the link between individual accountability and remuneration

As you know, the FCA and PRA have recently published rules to improve individual accountability² and to strengthen the alignment between risk and reward³. This follows recommendations made by the Parliamentary Commission on Banking Standards to improve professional standards and culture within the UK banking industry.

Whilst the majority of changes will not be in place for this remuneration round, the aim is clear: to make it easier for firms and regulators to identify who is responsible for what and to drive up standards. Senior managers should be clear about their accountability and areas of responsibility. Where conduct falls below the standards expected, firms should make appropriate adjustments to their variable remuneration. This is important to reinforce the 'tone from the top' and to ensure customers and clients are at the heart of their decisions.

¹ General Guidance on Proportionality: The Dual-regulated firms Remuneration Code (SYSC 19D) - <http://www.fca.org.uk/your-fca/documents/finalised-guidance/remuneration-code-dual-regulated>. The guidance divides firms into three categories, proportionality level one, two and three. Generally proportionality level one covers all UK banks, building societies and investment firms with relevant total assets exceeding £50billion.

² <https://small-firms.fca.org.uk/improving-individual-accountability>

³ <http://www.fca.org.uk/news/policy-statements/ps15-16-strengthening-the-alignment-of-risk-and-reward>

Additionally, individuals working at all levels within relevant firms should be held to appropriate standards of conduct.

Promoting a strong and effective conduct culture

When Clive Adamson wrote to you in November last year, he was keen to emphasise the role of the Remuneration Committee and its Chair in using remuneration as a tool to drive forward and promote positive behaviours and culture within firms, including through the application of malus where appropriate.

We have since observed material adjustments to variable remuneration being applied to an increasingly wide range of individuals for the most significant events such as failings in relation to FX, CASS and mis-selling at the firms reviewed. Full and effective application of ex-post risk adjustment remains important to driving this behavioural change, but for this to be the case, there must be clear communication to staff.

This is only one aspect of effective performance management. The variable remuneration that ultimately vests will also be based on a range of ex-ante risk and performance considerations. We consider it just as important to ensure that these wider considerations are also strongly linked to the embedding of a sound conduct culture – whether or not risks have actually crystallised.

We are, therefore, looking to you and your firm to ensure that the factors considered when setting your firm's bonus pool and assessing individual performance give sufficient prominence and weight to non-financial factors that can support the delivery of a strong and effective conduct culture.

This is key to addressing the underlying causes of poor conduct by ensuring that the financial incentives in place encourage those individuals managing and taking risk to do the right thing in respect of customers and clients and the markets in which their firm operates and to support a reduction in the incidence of misconduct over the longer term.

FCA approach to the 2015/16 Remuneration Round

We will continue to focus our annual review on the potential risk that firms may be incentivising behaviours that are not in the interests of consumers, market integrity or fair competition. We intend to work closely with the PRA throughout the review.

This year, the FCA's review will again concentrate on the application of ex-post risk adjustment (including malus and clawback) to ensure that variable remuneration is only awarded, allowed to vest or retained by staff where justified by performance.

We will also look at your ex-ante risk adjustment and performance assessment methodologies to ensure that the measures used are appropriate to drive appropriate behaviours and conduct culture.

As always, we will look to ensure that you have taken account of recent FCA and European policy developments and will issue our non-objection where we are satisfied that your proposed awards are consistent with the requirements of the dual-regulated firms' Remuneration Code.

Ex-post risk adjustment (performance adjustment)

In June 2015, we published finalised guidance as part of PS15/16 “Application of ex-post risk adjustment to variable remuneration”⁴ to share the good practice we observed in the 2014 remuneration round and to set out our expectations going forward.

In particular, this clarifies our expectations on the following:

Relevant events – Explicit adjustments are made for any material event including where there has been a materially adverse impact on customers and the wider market, reputation, stakeholders and financial position including from fines or regulatory action (paragraph 1.7 of the guidance).

Scope – Individual adjustments are sufficiently wide-ranging to include:

- all those with direct involvement or responsibility;
- those who were aware or could reasonably have been expected to be aware but who failed to act;
- those with indirect responsibility or accountability such as supervisors and senior managers; and
- control functions to the extent that there were failings in their own areas (section 2 of the guidance).

Application – Individual and collective adjustments of up to 100% are applied to reflect the magnitude of the event and the degree of involvement or responsibility. The amount of the adjustment should be effective at driving positive behaviours and culture (section 3 of the guidance).

Communication – the value of ex-post risk adjustments made to an individual’s variable remuneration, and the reasons for the adjustments, are clearly communicated to the affected individuals in writing. The value and reasons for collective adjustments are clearly communicated to staff as a group (paragraph 5.1(j) of the guidance).

Review process

As always, we will look to work closely with you and your colleagues over the course of the remuneration round. The PRA has published an updated review timetable and Remuneration Policy Statement (RPS) questionnaire on its website to be submitted to **both** the FCA and PRA. In order to facilitate the timely completion of our review, it is important that firms work to this timetable, in particular providing substantive information on ex-post risk adjustment at an early stage.

In order to facilitate our review, we would be grateful if you would submit examples of balanced scorecards and long-term incentive plans in place for your firm’s senior management⁵, and the non-financial factors considered when setting your firm’s bonus pool where these are not already provided as part of the supporting documentation to your RPS.

⁴ <https://www.fca.org.uk/your-fca/documents/finalised-guidance/remuneration-code-application-ex-post-risk-adjustment>

⁵ Examples should be provided for your firm’s most senior management layer subject to the Dual-regulated firms Remuneration Code.

We would welcome early engagement with you and your colleagues to discuss cases where you intend to apply ex-post risk adjustment, even where your thinking has not yet been finalised. This will allow us to voice any concerns at an early stage and reduce the risk of delays in you communicating or distributing awards.

[This letter will be of relevance to your [Group] Remuneration Committee Chair so please copy it to him/her as well as any other interested parties.]

If you wish to discuss the contents of this letter further, please contact me or [SUPERVISOR NAME] on your Supervision Team.

Yours sincerely

Director of Supervision – [Retail and Authorisations Division]
[Investment, Wholesale and Specialists]

cc. Head of HR, CRO, Head of Compliance

Annex 1 – Outcomes of the 2014 remuneration round

***Disclaimer:** In many cases, evidence can take years to come to light. Investigations undertaken by firms or by regulators can take months or years to conclude. The information presented below only provides a 'snap shot' of explicit ex-post risk adjustments made in the 2014 performance year and does not include action taken in prior years or still to be taken.*

The 2014 Annual Review

The FCA reviewed the remuneration policies and practices of the 20 proportionality level 1 UK and non-EEA banks, mutuals and investment firms. The focus of the review was the application of ex-post risk adjustment by firms to both current and prior year awards.

Overall, firms submitted details of 154 relevant events where explicit ex-post risk adjustments were considered or applied. The nature and scale of these events varied. These included adjustments for failings in relation to Foreign Exchange (FX), LIBOR, Hedging, Consumer Credit Act (CCA), Anti-Money Laundering (AML), repeat failures and poor personal conduct. Many more events were considered and adjustments applied which fell below the level of materiality for inclusion in this review.

Collective adjustments

Relevant events were identified at 19 firms and ex-post risk adjustment applied. Of these, 8 firms identified cases where it was appropriate to apply collective adjustments at group bonus pool level. The total value of reported collective adjustments at these firms was £1.7bn, equivalent to around 14% of the total 2014 bonus pools for those who reported collective adjustments.

The most material case reported was in relation to FX failings for the six banks⁶ fined by the FCA for failing to control business practices in their G10 spot FX trading operations. Collective adjustments for this event totaled approximately £1.2bn⁷. This represents an average bonus pool adjustment of 10%, equivalent in size to 86% of the value of the £1.4bn in fines imposed by the FCA. Firms also took into account the fines levied by other global regulators when setting their bonus pools.

In many cases, adjustments were concentrated in the business areas where failings occurred, while at some firms adjustments were applied evenly firm-wide.

Individual adjustments

Across all relevant events reported, explicit individual adjustments were applied to around 400 individuals separately from collective action. Adjustments were applied through cancellation of in-year bonuses and the reduction or forfeiture of outstanding deferred awards. We also observed the initiation of clawback proceedings in relation to vested awards ahead of new FCA requirements that come into effect for performance years starting on or after 1 January 2016.

⁶<http://www.fca.org.uk/news/fca-fines-five-banks-for-fx-failings>; <https://www.fca.org.uk/news/fca-fines-barclays-for-forex-failings>

⁷A number of firms determined the size of their collective adjustment in aggregate for all their relevant events. In this case, the size of adjustment for FX failings is based on an estimated disaggregation following discussions with the firms.

Action to reduce and cancel awards was taken across the full range of possible adjustments. Adjustments of 100% were commonplace for those directly involved in misconduct while adjustments for indirect involvement or responsibility were more varied across the range of events reported by each firm and the roles in question. This included action at senior management level and in control areas.

FCA non-handbook guidance "Application of ex-post risk adjustment to variable remuneration" shares the good practice we observed in the 2014 remuneration round and sets out clearly our expectations going forward.