

Finalised guidance

Remuneration Code FAQs

August 2011



Remuneration Code FAQs

Since amending our Remuneration Code to implement CRD3 in December 2010 (as described in *PS 10/20 – Revising the Remuneration Code* and *PS10/21 – Implementing CRD3 requirements on the disclosure of remuneration*), we have received numerous questions about the Code from firms, consultants and legal advisors. This document collates those questions into a series of FAQs which we hope will be of assistance to firms and other stakeholders.

Many of the answers are complex, but we hope that explanations and references to the relevant parts of the Handbook text will be useful. FAQs which amount to general guidance¹ are clearly indicated by the following symbol . FAQs which do not display that symbol may include guidance, but should not be relied on to provide a ‘safe harbour’. While they may make reference to certain of our existing rules and guidance on remuneration, they may not provide a complete summary. We give a disclaimer that firms should not rely simply on the FAQs and should instead refer to the existing rules and guidance.

Important Note:

Many of these FAQs refer to or summarise existing rules and guidance made by the FSA. Firms should refer to that material, rather than simply relying on these FAQs.

FAQs which include new material are indicated by the symbol .

Topic	Frequently Asked Questions and Answers
Scope of the Code	<ul style="list-style-type: none"> ○ How can I tell if my firm is within the scope of the FSA’s Remuneration Code? <p>The FSA’s Remuneration Code (the Code), contained in SYSC 19A, applies directly to firms within the scope of the Capital Requirements Directive (CRD), such as banks, building societies and CAD investment firms. It also applies to third country BIPRU firms in relation to activities carried on from an UK establishment (i.e. third country branches). Exempt CAD firms are not directly within the scope of the Code.</p> <p>The application of the Code within groups is considered in SYSC 19A.3.1R, SYSC 19A.3.2G</p>

¹ Given under section 157(1) of the Financial Services and Markets Act 2000

and SYSC 1 Annex 1.2.13R(2) and 12.14G.

- **My firm is within the scope of the Remuneration Code. What steps should I take to ensure we are compliant?**

As a starting point, you should do the following:

- 1) Read the relevant sections of the FSA Handbook, including:
 - SYSC 19A
<http://fsahandbook.info/FSA/html/handbook/SYSC/19A>
 - BIPRU 11 (in particular, the technical criteria in BIPRU 11.5.18R to BIPRU 11.5.21G)
<http://fsahandbook.info/FSA/html/handbook/BIPRU/11/5>
 - General guidance on Proportionality (December 2010)
<http://www.fsa.gov.uk/pubs/policy/proportionality.pdf>
- 2) Identify the firms within your group that the Code applies to directly and determine which proportionality tier they fall into.
- 3) Where applicable, review how the Code applies more widely within your group (in accordance with SYSC 19A.3.1R, SYSC 19A.3.2G and SYSC 1 Annex 1.2.13R(2) and 12.14G).
- 4) Review the specific requirements connected to your tier and assess how your firm's remuneration practices meet those requirements. We recommend that you use the FSA's template for a remuneration policy statement (issued as guidance alongside these FAQs) to record the findings of your review.
http://www.fsa.gov.uk/Pages/Library/Policy/final_guides/index.shtml
- 5) Create an action plan to address any short-falls before 1 July 2011 at the latest.

- **Which parts of the Code should be applied on a firm-wide basis and which parts only need to be applied to Code Staff?**

In complying with the Remuneration Code's general requirement (SYSC 19A.2), we give guidance (SYSC 19A.2.3G) that we expect at least the following remuneration principles (contained in SYSC 19A.3) to be applied on a firm-wide basis:

- Principle 1: Risk management and risk tolerance
- Principle 2: Supporting business strategy, objectives, values and long-term interests of the firm
- Principle 3: Avoiding conflicts of interest
- Principle 4: Governance
- Principle 8: Profit-based measurement and risk adjustment
- Principle 9: Pension policy
- Principle 10: Personal investment strategies
- Principle 12 (c): Guaranteed variable remuneration
- Principle 12 (e): Payments related to early termination
- Principle 12 (g): Deferral

All other remuneration principles are only required to be applied to Remuneration Code Staff (see SYSC 19A.3.3R).

<p>Remuneration Code Staff</p>	<ul style="list-style-type: none"> ○ Who are Remuneration Code Staff? Remuneration Code Staff (Code Staff) comprises “categories of staff including senior management, risk takers, staff engaged in control functions and any employee receiving total remuneration that takes them into the same remuneration bracket as senior management and risk takers, whose professional activities have a material impact on the firm’s risk profile.” (SYSC 19A.3.4R) It is up to each firm to determine and record who its Code Staff are (SYSC 19A.3.5R(1)). We have given guidance in SYSC 19A.3.6G that, within the categories of staff set out above, we would normally expect firms to include all individuals holding significant influence functions (SIFs), as described in SUP 10; and all senior managers (as defined in the FSA Handbook Glossary). <i>General guidance on proportionality</i> (December 2010) gives further guidance on persons who are only Code Staff for part of the year (e.g. new appointees; existing staff members who are promoted to Code staff roles, etc). http://www.fsa.gov.uk/pubs/policy/proportionality.pdf For a UK-headquartered group, the guidance on Code staff should be applied to all SIFs, senior managers and risk takers even if based overseas. ○ Should we classify all employees earning more than £500,000 as Code Staff? This is not a requirement of the Code. We recognise that some firms may have confused the Code Staff definition (SYSC 19A.3.4R to SYSC 19A.3.6G) with the guidance available under SYSC 19A.3.34G(1)). The latter does not identify Code Staff. It only provides guidance on which Code Staff may not need to apply certain prescriptive rules within Principle 12. ○ All of our Code Staff have remuneration structures which meet the conditions set out in SYSC 19A.3.34G(1). Do we still have to maintain a Code Staff list? Yes – this is required by SYSC 19A.3.5R(1). ○ My firm is in proportionality tier 3 / tier 4 and therefore is not applying the rules on payment in shares or deferral for Code Staff. Do we still have to maintain a Code Staff list? Yes – this is required by SYSC 19A.3.5R(1). ○ Is there a template we can use for our Code Staff list? Yes – there are templates for remuneration policy statements (issued as guidance alongside these FAQs) available on the FSA website, tailored to the requirements for different proportionality tiers. These include a template for a Code Staff list. http://www.fsa.gov.uk/Pages/Library/Policy/final_guides/index.shtml ○ If an individual, who appears to satisfy the Code Staff definition (SYSC 19A.3.4R), is based overseas and spends only a limited amount of time on issues related to the UK entity, does he/she still have to be classified as Code Staff? This will depend on the details of the individual's employment. For example, in the following two situations, a firm may be able to make a case for specific individuals not to be treated as
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Code Staff:

- The group is headquartered overseas. The UK firm is a UK subsidiary. The individual is a SIF of the UK firm, but is employed by another group company incorporated overseas and spends only a limited amount of time working on issues related to the UK firm.
- The group is headquartered overseas. The UK firm is a branch of a group company incorporated overseas (company A). The individual is a SIF of the UK firm, but is employed either by another group company incorporated overseas or in an office of company A other than the UK branch. He/she spends only a limited amount of time working on issues related to the UK firm.

Any decision related to an individual's treatment as Code Staff should be based on whether the individual is a material risk-taker in relation to the UK firm within the scope of the Code, rather than the percentage of their earnings derived from a particular jurisdiction.

G Firms in proportionality tier 1 should discuss any relevant examples with their supervisors as part of the annual review process. Firms in proportionality tiers 2, 3 and 4 should note their reasons for not including specific individuals on their Code Staff list and discuss these with their supervisors if/when this information is requested.

G In situations where these individuals are treated as Code Staff, the Code's requirements (in line with the four-tiered proportionality framework) should be applied to the individual's whole pay, rather than just the proportion earned in connection with the UK firm.

- **Within asset management firms, do all fund managers have to be classified as Code Staff?**



G The onus is on firms to identify Code Staff in accordance with the definition in SYSC19A.3.4R. We recognise that for solo asset management firms, the assessment of what is a risk-taking role may differ from that which is appropriate for asset management firms that are part of a group.

Where a fund manager is part of an asset management firm which forms a group containing other higher tiered entities (such as banks or full scope investment firms), he may be a risk taker where his management of a portfolio is capable of causing significant losses to the group. Two situations exemplifying this are:

- Where the fund managed by the individual benefits from an explicit guarantee from the asset management firm for whom the individual works, its parent or any other undertaking within the group.
- Where the fund managed by the individual includes a significant amount of funds sourced from the parent company or other firms within the group. This may include amounts borrowed from the parent or other group members, and any amounts provided under an arrangement that could result in losses to the parent or other group members as a result of the performance of the fund managed. Firms may make reasonable representations as to what constitutes a significant amount in the light of their specific circumstances.

For solo asset management firms, there is no requirement that all fund managers should be classified as Code staff. Nonetheless, such firms should ensure that they have identified their Code staff consistently in line with SYSC19A.3.4R.



Where a fund manager fills a significant influence function or a senior management role, he/she should be listed as Code Staff under SYSC 19A.3.4R, regardless of whether he/she is employed by a solo entity or a firm that is part of a group. A firm should still consider in all

	<p>the circumstances whether particular members of staff satisfy the Code staff definition.</p> <ul style="list-style-type: none"> ○ My firm is a limited liability partnership (LLP) and many staff are partners (CF1). As CF1 is a significant influence function, does this mean that all of these staff have to be classified as Code Staff? <p> Where a firm with a partnership structure can genuinely demonstrate that a member who is a CF1 has no material impact on the firm's risk profile despite holding CF1 status, we will consider permitting the firm to treat that member as not being Code Staff. We would generally expect all of the more senior partners to be identified as Code Staff. If you choose not to treat a specific CF1 as Code Staff, you should record your reasons for doing so on your Code Staff list and ensure this information is kept up to date and is available if the FSA requests it.</p>
<p>Proportionality Framework</p>	<ul style="list-style-type: none"> ○ How does the Remuneration Code apply proportionately to different types and sizes of firm? <p>The proportionality principle (as expressed in CRD3 and SYSC 19A.3.3R(2)) requires firms to comply with the Code's requirements "in a way and to the extent that is appropriate to its size, internal organisation and the nature, the scope and the complexity of its activities".</p> <p>Guidance on the proportionate application of the Code is provided in the provisions of SYSC 19A and in our <i>General guidance on proportionality</i> (December 2010). The latter sets out a four-tiered proportionality framework that is designed to implement the Code proportionately and consistently across more than 2,500 firms. It provides a starting point to help firms understand which rules are likely to apply to them and which ones normally apply only to firms in the higher tiers.</p> <p>In very broad terms, firms in proportionality tier 1 are subject to full application of the Code, whilst firms in proportionality tiers 3 and 4 would not normally be expected to comply with some of the more prescriptive rules, e.g. deferral and retained shares.</p> <ul style="list-style-type: none"> ○ Where can I find out more about the FSA's approach to proportionality? <p>In SYSC 19A and in our <i>General guidance on proportionality</i> (December 2010).</p> <p>http://fsahandbook.info/FSA/html/handbook/SYSC/19A</p> <p>http://www.fsa.gov.uk/pubs/policy/proportionality.pdf</p> <ul style="list-style-type: none"> ○ My firm is in proportionality tier 3 / tier 4. Do I have to explain our reasons for not applying the Principle 12 rules on deferral and retained shares? <p> We do not expect firms to provide a justification to the FSA for not applying these rules. We have given general guidance that, in our view, it will normally be appropriate for a firm in proportionality tiers 3 and 4 to disapply these rules (<i>General guidance on proportionality</i> (December 2010), paragraph 34).</p> <ul style="list-style-type: none"> ○ How does the proportionality framework apply to groups? <p>See <i>General guidance on proportionality</i> (December 2010), Part C. The first section of this guidance explains how firms are divided into proportionality tiers based on their individual characteristics. The second section (paragraphs 27 to 28) addresses firms which are part of groups containing one or more other firms subject to the Code.</p> <p>In broad terms, firms that are part of a group containing one or more other firms that are</p>

	<p>also caught by the Code will fall into the highest proportionality tier of those entities, where tier 1 is the highest and tier 4 is the lowest. Firms that are not part of a group, or that are the only entity directly caught by the Code within a group, will fall into the tier that corresponds with that firm's individual circumstances.</p> <p>You can request individual guidance to request that a firm within the group changes proportionality tier. Further information on this process is available here: http://www.fsa.gov.uk/pages/About/What/International/remuneration/application/index.shtml</p> <ul style="list-style-type: none"> ○ Are EU parents of UK subsidiaries included in the proportionality tiers? <p>No. In relation to firms headquartered in other EU countries, the proportionality tiers only cover the UK subsidiaries of those groups. Group application of the Code is considered in SYSC 19A.3.1R, SYSC 19A.3.2G and SYSC 1 Annex 1.2.13R(2) and 12.14G (including group application within the consolidation group).</p> <ul style="list-style-type: none"> ○ When determining which tier a third country branch falls into, should we use the total assets of the firm or just the UK branch operations? <p>In broad terms, you should only use the total assets of the UK branch operation. The methodology to be applied is explained in <i>General guidance on proportionality</i> (December 2010), paragraph 26. http://www.fsa.gov.uk/pubs/policy/proportionality.pdf</p> <ul style="list-style-type: none"> ○ My firm is an exempt BIPRU commodities firm. How can I determine its proportionality tier? <p>If your firm is an exempt BIPRU commodities firm (within the meaning of the FSA Handbook Glossary) and its proportionality tier is not easy to determine, contact your supervisor to discuss your firm's individual circumstances and to request individual guidance in relation to your firm's proportionality tier.</p>
<p>Proportionality – Process for changing tiers</p>	<ul style="list-style-type: none"> ○ Firms in our group fall into proportionality tier 1 or tier 2, but our group also includes subsidiaries that would fall into tier 3 or tier 4 if they were solo firms. Can we treat these subsidiaries as if they were solo tier 3 / tier 4 firms? <p>If your firm believes that an entity within the group should fall into a lower tier than the one indicated by paragraph 27 of the <i>General guidance on proportionality</i> (December 2010), you can request individual guidance to vary that firm's tier. The application for such guidance needs to be supported by reasons explaining why you consider this to be justified, with reference to the proportionality principle (SYSC 19A.3.3R(2)). Following receipt of this information we will determine whether to give the individual guidance.</p> <p>You can request individual guidance by following the process outlined here: http://www.fsa.gov.uk/pages/About/What/International/remuneration/application/index.shtml</p> <p>Our decisions on whether to issue individual guidance will be based on quantitative and qualitative factors related to the specific firm/group in question.</p> <ul style="list-style-type: none"> ○ Our firm is not part of a group and it falls into proportionality tier 1 / tier 2. We believe it should be in tier 3 and would like to request individual guidance to change tiers. How do we do this? <p>See our <i>General guidance on proportionality</i> (December 2010), paragraph 11, Part C, and</p>

	<p>Appendix 1, paragraphs 5 and 6.</p> <p>http://www.fsa.gov.uk/pubs/policy/proportionality.pdf</p> <p>The process for applying for individual guidance is described here:</p> <p>http://www.fsa.gov.uk/pages/About/What/International/remuneration/application/index.shtml</p> <p>Our decisions on whether to issue individual guidance will be based on quantitative and qualitative factors related to the specific firm/group in question.</p>
Guarantees	<ul style="list-style-type: none"> ○ Do the Code’s provisions on guaranteed variable remuneration have to be applied on a firm-wide basis? <p>Yes. Firms should, in complying with the Code’s general requirement (SYSC 19A.2), apply certain principles on a firm-wide basis, including the rules and guidance on guaranteed variable remuneration. This is required by SYSC 19A.2.3G(2). Further clarification is available in our <i>General guidance: Guaranteed Variable Remuneration</i>.</p> <p>http://www.fsa.gov.uk/Pages/Library/Policy/final_guides/index.shtml</p>
Retained shares	<ul style="list-style-type: none"> ○ Where can I find more guidance on retained shares? <p>Further guidance is available here:</p> <p>http://www.fsa.gov.uk/Pages/Library/Policy/final_guides/index.shtml</p> <ul style="list-style-type: none"> ○ Is the rule on retained shares expected to be applied on a firm-wide basis? <p>No. We normally expect this rule (SYSC 19A.3.47R) to be applied only to Code Staff in firms which fall into proportionality tier 1 or tier 2. See SYSC 19A.2.3G for a list of the principles which should be applied on a firm-wide basis in the context of the Remuneration Code’s general requirement.</p> <p>Further to this, we do not generally consider it necessary for firms to apply this rule to Code Staff which meet both conditions in SYSC 19A.3.34G(1), i.e. earning no more than £500,000 total remuneration and with variable remuneration making up no more than 33% of total remuneration.</p> <p>Note: A firm’s proportionality tier may depend on the other members of its group, rather than on its individual characteristics.</p> <ul style="list-style-type: none"> ○ How will the retained shares or other instruments rule be applied to unlisted firms including mutuals? <p>We have extended the transitional period to allow certain qualifying firms up to a further 12 months to implement the rule to pay variable remuneration in shares or other instruments. Such firms must still take reasonable steps to comply as soon as possible and, in any event, by 1 July 2012. See pages 7-8 of the following link:</p> <p>http://www.fsa.gov.uk/pubs/handbook/hb_notice111.pdf</p> <ul style="list-style-type: none"> ○ Who will the extended transitional guidance apply to? <p>The guidance applies to building societies, mutuals and other unlisted entities meeting our criteria. These proposals may be applied to firms that were previously in scope of the Remuneration Code <u>and</u> those that came into scope from 1 January 2011. Firms that have listed parent entities do <u>not</u> have access to the extended transitional guidance.</p>

<p>Alternative instruments</p>	<ul style="list-style-type: none"> ○ What is the FSA’s view on the use of contingent capital instruments (CoCos) as part of remuneration? <p>G SYSC19A.3.47R broadly describes the two categories of instruments that may be used to pay the non-cash portion of variable remuneration. Sub-paragraph (a) deals primarily with shares and share-linked instruments. Sub-paragraph (b) deals primarily with capital instruments, which must be eligible for inclusion under stage B1 of the calculation in the capital resources table (see GENPRU 2 Annex 2).</p> <p>As a first step, firms who propose to pay part of their remuneration in the form of a capital instrument which contains a contingent convertibility clause should ascertain whether the instrument would be eligible for inclusion under stage B1. See also answer to the next question.</p> <ul style="list-style-type: none"> ○ My firm has plans to use an alternative instrument. Do we need FSA approval of the plan? If so, what do we need to provide to gain approval? <p>G We consider that firms should notify us of the intended structure of any instrument they are seeking to use. This will give us the opportunity to provide comments and feedback, and may help to ensure that the instrument meets our expectations under SYSC 19A.3.47R.</p> <p>As a starting point, it would be helpful to receive the following details of any proposed instrument:</p> <ul style="list-style-type: none"> ▪ A brief description of how the firm believes the instrument meets the requirements of SYSC 19A.3.47R. ▪ A term sheet describing key features of the instrument, including (where appropriate) any interest rate or coupon due under the instrument, the tenure or duration of the instrument, and any thresholds or triggers that may affect pay-outs under the instrument. ▪ If the instrument is a share-linked or equivalent non-cash instrument, details of how the instrument is linked to a share-price and/or other performance measures. ▪ If the instrument is a capital instrument, a description of how it adequately reflects the credit quality of the firm as a going concern. <p>Note that we have issued guidance for consultation on the structure of instruments that may be used as alternatives to shares. This guidance, which is part of a proposed Dear CEO letter, is available at:</p> <p>http://www.fsa.gov.uk/pages/Library/Policy/guidance_consultations/index.shtml</p> <p>Also, we have extended the transitional period to allow certain qualifying firms up to a further 12 months to implement the rule to pay variable remuneration in shares or other instruments. Such firms must still take reasonable steps to comply as soon as possible and, in any event, by 1 July 2012. See pages 7-8 of the following link:</p> <p>http://www.fsa.gov.uk/pubs/handbook/hb_notice111.pdf</p>
<p>Deferral</p>	<ul style="list-style-type: none"> ○ My firm is required to defer at least 40% or at least 60% of variable remuneration for a period of not less than three to five years for Code Staff. Can we allow a portion of the deferred awards to vest before the end of the three to five year period? <p>Yes. See SYSC 19A.3.49R(2).</p>

	<p>You can choose to apply a vesting schedule that allows for pro-rata vesting (i.e. equal portions of the deferred awards to vest at the end of each performance year within the deferral period). Alternatively you may choose to apply a vesting schedule that releases the majority of the deferred award towards the end of the deferral period, so long as this is not more generous at any stage than pro-rata vesting. In both of these scenarios our rules and guidance on performance adjustment apply (see SYSC 19A.3.51R to SYSC 19A.3.53G).</p> <p>Any vesting schedule that provides for deferred remuneration to vest more rapidly than on a pro-rata basis (e.g. where the majority of the deferred award is to be released within the initial year(s) of the deferral period) will breach SYSC 19A.3.49R(2).</p> <ul style="list-style-type: none"> ○ When setting up a firm-wide deferral scheme, do we have to use the same 'at least 40% and at least 60% of variable remuneration' deferral hurdles required for Code Staff? <p> No. The use of these deferral rates may be seen a 'good practice', but are only specifically required for Code Staff. When setting up a firm-wide deferral scheme, we have often seen firms using a 'tax-table' approach that defers more as variable remuneration increases.</p> <ul style="list-style-type: none"> ○ My firm is in proportionality tier 3 / tier 4. Are we still required to apply deferral on a firm-wide basis? <p> No. We normally accept that it will be appropriate for firms in proportionality tiers 3 and 4 to disapply the rule on deferral (SYSC 19A.3.49R). We do not expect such firms to set up firm-wide deferral schemes. However, you may of course choose to operate a firm-wide deferral scheme as a form of 'good practice' in aligning your remuneration practices with effective risk management.</p> <ul style="list-style-type: none"> ○ Do LTIPs count towards the deferral requirement? <p>Our current guidance allows LTIPs to be included in the deferral calculation, but only where the upside incentives are adequately balanced by downside adjustments (see SYSC 19A.3.24G). The valuation of the award should be based on its value when the award is granted, and determined using an appropriate technique.</p> <p>We intend to review the current guidance on LTIPs ahead of the 2011 remuneration round, and have issued draft guidance for consultation, as part of a proposed Dear CEO letter. http://www.fsa.gov.uk/pages/Library/Policy/guidance_consultations/index.shtml</p>
<p>Voiding</p>	<ul style="list-style-type: none"> ○ Who do the voiding provisions apply to? <p>Until the end of 2011, the voiding provisions only apply to the firms that were subject to the 2009 Code (see SYSC TP 3.6R). We will be consulting later in 2011 to review the scope of the voiding provisions.</p>
<p>Transitional guidance</p>	<ul style="list-style-type: none"> ○ When does the transitional guidance end? <p>All firms within the scope of the Code should ensure that they are compliant with its requirements as soon as reasonably possible and in any event by 1 July 2011 (see SYSC TP 3).</p> <p>We have extended the transitional period to allow certain qualifying firms up to a further 12 months to implement the rule to pay variable remuneration in shares or other instruments. Such firms must still take reasonable steps to comply as soon as possible and, in any event,</p>

	<p>by 1 July 2012. See pages 7-8 of the following link: http://www.fsa.gov.uk/pubs/handbook/hb_notice111.pdf</p>
<p>Disclosure</p>	<ul style="list-style-type: none"> ○ How do we know what we need to disclose? <p>The requirements for disclosure will vary depending on the proportionality tier your firm is in. Further guidance is provided in <i>General guidance on proportionality</i> (December 2010), Part G and Appendix 2. The latter comprises a table setting out disclosure requirements by proportionality tier.</p> <p>http://www.fsa.gov.uk/pubs/policy/proportionality.pdf</p> <ul style="list-style-type: none"> ○ We are a small firm with a handful of Code Staff and are concerned about the lack of anonymity in aggregate disclosures. Are there any caveats we can seek to apply? <p>BIPRU 11.5.20R(2) allows firms to take account of the Data Protection Directive (Directive 95/46/EC) where appropriate (as transposed in the UK, or, where relevant, in other member states). Our proportionate approach to disclosure also permits firms in lower proportionality tiers to disapply some of the requirements (see <i>General guidance on proportionality</i> (December 2010), Part G and Appendix 2).</p> <p>http://www.fsa.gov.uk/pubs/policy/proportionality.pdf</p>