

Finalised Guidance

FG20/5 Dual-regulated firms Remuneration Code (SYSC 19D) – Frequently asked questions on remuneration

December 2020

1 Introduction

Overview

- 1.1 This statement is general guidance given under section 139A(1) of the Financial Services and Markets Act 2000 (FSMA).
- 1.2 This guidance uses expressions that are defined in the Handbook Glossary. Where an expression is not defined in the Glossary, it has the meaning (including the plural) given in the following table:

Defined expression	Definition
EBA Guidelines	<u>The European Banking Authority’s published Guidelines on sound remuneration policies</u> under Articles 74(3) and 75(2) of Directive 2013/36/EU and disclosures under Article 450 of Regulation (EU) No 575/2013, 21 December 2015

Defined expression	Definition
FCA's Dual-regulated firms Remuneration Code	The Financial Conduct Authority Dual-regulated firms Remuneration Code under SYSC 19D
Group	Has the meaning given in the Glossary in paragraph (3B)
Material risk takers	Has the meaning of Dual-regulated firms Remuneration Code Staff in SYSC 19D.3.4R
Proportionality Guidance	Means the guidance referred to in paragraph 1.4, bullet points 2, 3 and 4
Proportionality level	Has the meaning given in paragraph 2.2 of the General Guidance on Proportionality: The Dual-regulated firms Remuneration Code (SYSC 19D)

1.3 This guidance statement has effect from 29 December 2020. This guidance applies to all firms that fall within the scope of our Dual-regulated firms Remuneration Code in SYSC 19D, namely:

- banks
- building societies
- UK designated investment firms
- certain overseas firms as defined in SYSC 19D.1.1R(1)(d)

Other firms may also find this document useful to understand our expectations about firms' remuneration policies and practices.

1.4 You should read our guidance on remuneration in conjunction with our other general guidance documents:

- [General guidance on the application of ex-post risk adjustment to variable remuneration](#)
- [General Guidance on Proportionality: the IFPRU Remuneration Code \(SYSC 19A\)](#)
- [General Guidance on Proportionality: the BIPRU Remuneration Code \(SYSC 19C\) and Pillar 3 disclosure on remuneration \(BIPRU 11\)](#)
- [General Guidance on Proportionality: the Dual-regulated firms Remuneration Code \(SYSC 19D\)](#)

1.5 This guidance supersedes any previous frequently asked questions (FAQs) we – or our predecessor the Financial Services Authority – have issued about the Dual-regulated firms Remuneration Code in SYSC 19D.

1.6 Where SYSC TP 9 means that a firm must continue to apply the rules and guidance in SYSC 19D.3 as it stood on 28 December 2020, firms should consider the version of this guidance in effect on that date.

This guidance statement was initially issued on 3 May 2017 as final guidance. On 17 December 2020, the guidance was revised as FG20/5 and has effect from 29 December 2020.

Background

- 1.7 The EBA Guidelines set out requirements regarding remuneration policies that apply to firms in scope of the UK legislation that implemented the CRD. Competent authorities and firms must apply the EBA Guidelines from 1 January 2017. Firms should review the EBA Guidelines to understand the requirements that apply to them and make every effort to comply with them. After the end of the implementation period, firms should continue to comply with these Guidelines to the extent and in the manner set out in our guidance '[Brexit: our approach to EU non-legislative materials](#)'.
- 1.8 This guidance gives firms some practical guidance to understanding how the EBA Guidelines apply to them, and gives additional clarification on our Dual-regulated firms Remuneration Code.
- 1.9 While these frequently asked questions may refer to our existing remuneration rules and guidance or to the EBA Guidelines, they do not provide a complete summary of them. Firms should use this guidance as a supplement to the Dual-regulated firms Remuneration Code, Proportionality Guidance and the EBA Guidelines to help understand how the requirements apply to them.

2 FAQs: Material risk takers

Q1 Who needs to be identified as material risk takers?

- 2.1 Under SYSC 19D.3.4R, firms must identify employees 'whose professional activities have a material impact on the firm's risk profile'. This includes – but is not limited to – employees identified under SYSC 19D.3.4R(1A) and the qualitative and quantitative criteria set out in articles 6 and 7(1) of the Material Risk Takers Regulation 2020.
- 2.2 The types of professional activity and the risks inherent in these are not limited under the UK legislation that implemented the CRD. All types of risk are therefore relevant to this assessment, including those of a prudential, operational, conduct and reputational nature.
- 2.3 Under paragraph 79 of the EBA Guidelines, all firms should first identify their material risk takers, before the Dual-regulated firms Remuneration Code requirements are applied in a proportionate way. Once material risk takers have been identified, the application thresholds for individuals and the dual-regulated firms remuneration principles proportionality rule can then be applied to determine the way in which certain Dual-regulated firms Remuneration Code requirements apply on an individual or firm-wide basis (see 2.4(4) below).

Q2 What is the process for identifying (and excluding) material risk takers?

- 2.4 Firms should follow the steps below (in the order presented) when identifying their material risk takers. These steps reflect the terms of the Material Risk Takers Regulation 2020 for firms to identify their material risk takers using both qualitative and quantitative criteria. They also explain how the identification interacts with the application thresholds for individuals in SYSC 19D.3.35R and the Proportionality Guidance:
 1. **Identify material risk takers using qualitative criteria.**

Firms must identify all staff who meet the qualitative criteria set out in Article 6 of the Material Risk Takers Regulation 2020 and any other additional criteria set by the firm to identify all material risk takers. The Material Risk Takers Regulation 2020 covers a common set of the most relevant risks across the EU; however, the UK legislation that implemented the CRD does not provide an exhaustive categorisation of risks and so firms must consider all types of risk when performing their internal analysis. This includes, but is not limited to, prudential, operational, market, credit, conduct and reputational risks. When identifying material risk takers, firms will need to be able to demonstrate to us

how they have conducted this analysis and considered the relevant categories of risk.

2. Identify material risk takers using quantitative criteria.

Firms need to identify any individuals who have not been captured as material risk takers under the qualitative criteria above (including any additional criteria set by the firms), but who meet the quantitative criteria set out Article 7(1) of the Material Risk Takers Regulation 2020. Firms must be able to show us how they have conducted this analysis.

3. Consider whether any exclusions are appropriate.

After steps 1 and 2, firms may consider excluding an individual from being identified as a material risk taker if they have only been captured based on step 2 above, subject to prior PRA approval under Article 7(3) of the Material Risk Takers Regulation 2020 (see Question 3 below).

4. Apply the proportionality framework.

After steps 1, 2 and 3 above, firms may then consider whether/how to apply the proportionality framework to their material risk takers in line with the application thresholds for individuals in SYSC 19D.3.35R and in accordance with the Proportionality Guidance.

Q3 Who can be excluded as a material risk taker?

- 2.5 Where an individual is caught only by the quantitative criteria, they may be eligible for exclusion from identification as a material risk taker, with the prior approval of the PRA. Firms may apply for approval using the PRA material risk taker exclusions template on the PRA's website.
- 2.6 For those earning more than €1 million, Article 7(4) of the Material Risk Takers Regulation 2020 provides that the competent authority must only give approval in 'exceptional circumstances'. Article 7(5) of the Material Risk Takers Regulation 2020 clarifies that to be deemed 'exceptional circumstances', a situation must be 'unusual and very infrequent or far beyond what is usual'. The exceptional circumstances must also relate to the staff member concerned. It is for the firm to demonstrate the existence of exceptional circumstances.

3 FAQs: Governance

Q4 Does a firm that is part of a group that has a Remuneration Committee at the UK consolidation group level also need to establish a local Remuneration Committee?

- 3.1 Under SYSC 19D.3.1R and SYSC 19D.3.12R, any firm (whether at the individual, parent undertaking or group level) that is 'significant' in terms of its size, internal organisation, and the nature, scope and complexity of its activities, must establish a Remuneration Committee.
- 3.2 'Significant' for these purposes means:
- institutions referred to in the UK legislation that implemented article 131 of the CRD (globally systemically important institutions (G-SIIs) and other systemically important institutions (O-SIIs))
 - any other institutions determined to be significant by us based on their size, internal organisation, and the nature, scope and complexity of its activities
- 3.3 The EBA Guidelines clarify that the test of 'significant' must be assessed on a standalone entity basis (paragraph 46). This means that if a subsidiary meets one of the tests of 'significant' set out above, it should itself establish a Remuneration Committee. It is not enough to rely on the Remuneration Committee at the UK consolidation group level.
- 3.4 If a subsidiary does not meet the 'significant' test, the firm can rely on the Remuneration Committee at the UK consolidation group level.

4 FAQs: Groups

Q5 Do entities that are not in scope of SYSC 19D but are within the same UK consolidation group as a firm which is in scope of SYSC 19D have to apply the rules on pay-out in retained shares or other instruments, deferral, and holding/retention periods for discretionary pension benefits?

- 4.1 Firms that are in the same UK consolidation group as a firm in scope of the Dual-regulated firms Remuneration Code, but are not themselves in scope of that Code, will, subject to limited exceptions, need to apply the Dual-regulated firms Remuneration Code to those staff whose professional activities:
- have a material impact on the risk profile of the UK consolidation group; or
 - have a material impact on the risk profile of a firm within the UK consolidation group which is a firm in scope of the Dual-regulated firms Remuneration Code
- 4.2 Where an individual is employed by a firm that is subject to different sectoral rules (ie a firm subject to SYSC 19A, SYSC 19B, SYSC 19C or SYSC 19E) but their role has a material impact on the group's risk profile, then the consolidating institution will need to ensure that the Dual-regulated firms Remuneration Code is complied with for that individual.
- 4.3 Where there is a conflict between the Dual-regulated firms Remuneration Code and the sectoral requirements, then the sectoral requirements apply. Using as an example an AIFMD firm, this would mean that variable remuneration is paid in the form of instruments in the alternative investment fund concerned.
- 4.4 However, even where the specific sectoral rules are applied, the EBA Guidelines mean firms must still apply the specific ratio between fixed and variable components of total remuneration (bonus cap) in the Dual-regulated firms Remuneration Code.

Q6 Can a firm that is subject to a Remuneration Code which is not the Dual-regulated firms Remuneration Code and is part of a UK consolidation group with a firm in scope of the Dual-regulated firms Remuneration Code apply its own sectoral remuneration principles proportionality rule for all its staff?

- 4.5 No – if a firm subject to SYSC 19A, SYSC 19B, SYSC 19C or SYSC 19E, is part of a UK consolidation group with an entity in scope of the Dual-regulated firms Remuneration Code, they must apply SYSC 19D (and the associated guidance) to relevant individuals in the way explained in FAQ 5.

5 FAQs: Variable remuneration

Q7 How can we measure individual performance in a Long-Term Incentive Plan (LTIP) award?

- 5.1 As an LTIP is a form of variable remuneration, it must be based on an assessment of the financial and non-financial performance of the individual, business unit and the firm as a whole (see SYSC 19D.3.39R).
- 5.2 We do not prescribe the non-financial factors that firms should use to measure an individual's performance. Examples of good practice that we have observed include measures relating to building and maintaining positive customer relationships, reputation, achievement in line with firm strategy or values, and effectiveness and operation of the risk and control environment.

Q8 Do the upfront and deferred components of variable remuneration need to have the same split of cash and instruments?

- 5.3 No. This used to be the case under the previous CEBS Guidelines on remuneration policies and practices (Committee of European Banking Supervisors Guidelines on Remuneration Policies and Practices (published 10 December 2010)), however the EBA Guidelines now provide that firms should consider deferring a higher proportion of instruments (paragraph 240), provided that the minimum of 50% in instruments is still met (SYSC 19D.3.56R). We consider it good practice for the deferred portion of variable remuneration to contain a higher proportion of instruments.

Q9 How can bonus pools include ex-ante risk adjustments?

- 5.4 When measuring performance for the purpose of setting a firm's bonus pool, firms are required under the Dual-regulated firms Remuneration Code to include adjustments for all types of current and future risks (SYSC 19D.3.29R).
- 5.5 For the avoidance of doubt, this applies to financial and non-financial types of risk, including those that are more difficult to measure. Good examples of practice of non-financial criteria we have observed are:
 - building and maintaining positive customer relationships
 - reputation
 - achieving in line with firm strategy and values

- effectiveness and operation of the risk and control environment

This allows firms to recognise and incentivise efforts to increase performance relative to each unit of risk undertaken and boost long-term performance and profitability, even in a year where this does not result in increased financial performance.

- 5.6 While we do not prescribe the process firms should follow when risk-adjusting their bonus pools, under SYSC 19D.3.25R we require firms to have a clear and verifiable mechanism for measuring performance. Firms are then required to apply risk-adjustments in a clear and transparent manner. This is useful in facilitating a consistent approach that is subject to robust challenge.
- 5.7 When communicating their approach to us, firms need to be able to demonstrate how risk-adjustments have been applied in a transparent manner. For example, they can set out the stages involved in determining the final bonus pool, with adjustments separately distinguishable for major risk and performance considerations, and any collective adjustments in relation to ex-post risk adjustment made at the end of the process.