FINANCIAL CONDUCT AUTHORITY

# FG 17/5
# Remuneration Codes (*SYSC* 19A and 19D) – Frequently asked questions on remuneration

May 2017

## 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 An expression in italics that is defined in the Handbook *Glossary* has the meaning given there (GEN 2.2.7R). Where an expression in italics is not defined in the *Glossary*, it has the meaning (including the plural) given in the following table:

| Defined expression | Definition |
|---|---|
| *EBA Guidelines* | The European Banking Authority's published Guidelines on sound remuneration policies under Articles 74(3) and 75(2) of the CRD and disclosures under Article 450 of the EU CRR on 21 December 2015 |
| *FCA's Remuneration Code* | The Financial Conduct Authority Remuneration Code under *SYSC* 19A or *SYSC* 19D |
| *Group* | Has the meaning given in the *Glossary* in paragraph (3A)-(3B) |
| *Material risk takers* | Has the meaning of staff identified in the *Glossary* as *Remuneration Code staff* and *dual-regulated firms Remuneration Code Staff* |
| *Proportionality Guidance* | Has the meaning given 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) and paragraph 2.2 of the General Guidance on Proportionality: The IFPRU Remuneration Code |

| | |
|---|---|
| | (*SYSC* 19A) |
| *Relevant proportionality rule* | Refers to the rules identified in the *Glossary* as the *remuneration principles proportionality rule* (*SYSC* 19A.3.3R); the *dual-regulated firms remuneration principles proportionality rule* (*SYSC* 19D.3.3R) and the *BIPRU remuneration principles proportionality rule* (*SYSC* 19C.3.3R) |
| *Regulatory Technical Standard* or *RTS* | Regulation (EU) 604/2014 of 4 March 2014 |

1.3 This guidance applies to all firms that fall within the scope of the Directive 2013/36/EU (Capital Requirements Directive or CRD IV), namely *banks*, *building societies*, *investment firms* and *overseas firms*, who are required to comply with the *FCA's Remuneration Code*. Questions 6 and 7 are relevant for *BIPRU firms*, and other firms may also find this document useful to understand our expectations about firms' remuneration policies and practices.

1.4 In addition to our *Handbook*, you should read this FCA guidance on remuneration in conjunction with our other general guidance documents:

- General guidance on the application of ex-post risk adjustment[1] 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 in relation to the Remuneration Code in *SYSC* 19A.

1.6 This guidance statement has effect from 3 May 2017.

## Background

1.7 The *EBA Guidelines* set out requirements regarding remuneration policies that apply to *CRD* firms. *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.

1.8 This guidance gives firms some practical guidance to understanding how the *EBA Guidelines* apply to them, and gives additional clarification on the *FCA's Remuneration Code*.

[1] Ex-post risk adjustment refers to the adjustment of variable remuneration to take account of a specific crystallised risk or adverse performance outcome including those relating to misconduct. Ex-post risk adjustments include reducing current year awards, the application of malus (reducing or cancelling deferred incentive awards that have not yet vested), and clawback (recouping already vested awards).

## General Guidance

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 *FCA's 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* 19A.3.4R and *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 the qualitative and quantitative criteria set out in articles 3 and 4(1) of the RTS.

2.2 The types of professional activity and the risks inherent in these are not limited under *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 *FCA's Remuneration Code* requirements are applied in a proportionate way. Once *material risk takers* have been identified, the relevant proportionality rule can then be applied to determine the extent to which certain *FCA 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 requirements under the RTS for firms to identify their *material risk takers* using both qualitative and quantitative criteria, and explain how the identification interacts with the *Proportionality Guidance*:

1. **Identify *material risk takers* using qualitative criteria.** Firms must identify all staff who meet the qualitative criteria under Article 3 of the RTS and any other additional criteria set by the firm to identify all *material risk takers*. The RTS covers a common set of the most relevant risks across the EU; however *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 under Article 4(1) of the RTS. 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 have been undertaken, firms may consider excluding an individual from being identified as a *material risk takers* if they have only been captured based on step 2 above, subject to prior FCA notification or our approval under Article 4(4) of the RTS (see Question 3 below).

4. **Apply the proportionality framework.** After steps 1, 2 and 3 above have been undertaken, firms may then consider whether/how to apply the proportionality framework to their *material risk takers* in line with the FCA's *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*. They can apply via the application and notification template on our website. Applications can only be approved by the FCA where sufficient evidence is provided on the responsibilities of the individual role, supported by clear justification for why these do not amount to material risk. This evidence should include details of the qualitative analysis risk outlined in 2.4(1) above.

2.6 While a firm can request to exclude an individual because they undertake professional activities only in relation to a non-material business unit,[2] we would still require an individual assessment of each role to be carried out in the context of the firm. This is so the firm can demonstrate it has given sufficient consideration to why the individual does not meet any of the qualitative criteria under 2.4(1) above.

2.7 For those earning more than €1 million, Article 4(5) of the RTS provides that an individual can only be excluded from identification in 'exceptional circumstances'. To meet this test, we expect firms to be able to justify why the roles and responsibilities that support this level of remuneration do not correspond to a material impact on the firm's risk profile. The firm also needs to demonstrate how and why the circumstances on which the exclusion is based are 'exceptional'.

2.8 No distinction is drawn between staff in deposit takers and investment banks relative to those in asset management firms. All *CRD* firms are equally required to consider the risks relevant to their firm.

[2] A material business unit is defined in Article 3 (5) of the RTS.

# 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* 19A.3.1R and *SYSC* 19D.3.1R, 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:

- In *SYSC* 19A:
  - institutions referred to in article 131 of the CRD (globally systemically important institutions (G-SIIs) and other systemically important institutions (O-SIIs))
  - *significant IFPRU firms* as defined in IFPRU 1.2 (the condition of significance for this requirement can be waived, as explained in IFPRU 1.2.9G)
- In *SYSC* 19D:
  - institutions referred to in 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 the FCA 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 the pay-out process rules and the bonus cap apply to non-CRD entities within the UK consolidation group?

4.1 Firms that are in the same *UK consolidation group* as a CRD IV firm, but are not themselves subject to *CRD,* will need to apply the *FCA's Remuneration Code* to which the consolidating entity is subject to those staff who:

- have a material impact on the risk profile of the *UK consolidation group*; or
- have a material impact on the risk profile of a *CRD* firm within the *UK consolidation group*

4.2 Where an individual is employed by a firm that is subject to different sectoral rules (for example, an *AIFMD* firm subject to *SYSC* 19B) but their role has a material impact on the group's risk profile, then the consolidating institution will need to ensure that the *FCA's Remuneration Code* is complied with for that individual.

4.3 Where there is a conflict between the *FCA's Remuneration Code* and the sectoral requirements, then the sectoral requirements apply. Using the example of 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 bonus cap under CRD unless they rely on the FCA's *Proportionality Guidance* to disapply the bonus cap.

## Q6 Are BIPRU firms in the same group as a CRD IV firm required to apply *SYSC* 19A or *SYSC* 19D?

4.5 Where a *BIPRU firm* is part of a *UK consolidation group* containing a firm that *SYSC* 19A or *SYSC* 19D applies to, then the *BIPRU firm* will need to apply:

- *SYSC* 19C and associated guidance to staff who are *material risk taker*s of the *BIPRU firm*; and
- *SYSC* 19A or *SYSC* 19D (as relevant) and associated guidance to staff who are *material risk takers* of the *UK consolidation group*

4.6 Our *General Guidance on Proportionality: the BIPRU Remuneration Code* contains more detail on group application for *BIPRU firm*s in CRD IV groups.

**Q7 Can a Level 3 BIPRU firm that is part of a UK consolidation group with a Level 1 CRD IV firm apply the BIPRU remuneration principles proportionality rule?**

4.1 No – if a *BIPRU firm* is part of a *UK consolidation group* with a CRD IV entity, they must apply *SYSC* 19A or *SYSC* 19D (and the associated *guidance*) as relevant.

4.2 If the consolidating CRD IV entity is a *proportionality level* 1 firm under our *Proportionality Guidance,* this means that neither this CRD IV entity nor any of the BIPRU entities within the *group* are permitted to disapply the *FCA's Remuneration Code*. The firm must apply the *FCA's Remuneration Code* in full to those staff identified as *material risk takers* as per question 6.

4.3 If a firm is part of a *UK consolidation group* with a *SYSC* 19A or *SYSC* 19D firm and believes it should fall into a lower *proportionality level*, the firm may apply for individual guidance from us to vary its *proportionality level*. Our policy on individual guidance is set out in *SUP* 9.

4.4 The firm's application must provide sound reasoning, justified with reference to the proportionality principles in *SYSC* 19A.3.3 R (2) or *SYSC* 19C.3.3 R (2). Find more information on how to vary the assigned *proportionality level*, as well as the necessary documentation that must be provided, on our website at www.fca.org.uk/remuneration/apply-vary-firms-proportionality-level.

4.5 Firms should note that we do not automatically approve applications – we review them on a case-by-case basis.

4.6 A *BIPRU firm* that falls outside a *UK consolidation group* may decide to only apply *SYSC* 19C and its related guidance – see paragraph 2.2(3) of our *General Guidance on Proportionality: the BIPRU Remuneration Code.*

# 5 FAQs: Proportionality

## Q8 Can we apply the FCA’s Remuneration Code in a proportionate manner?

5.1 Our *Proportionality Guidance* sets out the circumstances where firms may be able to disapply certain aspects of the *FCA’s Remuneration Code*, such as the pay-out process rules, where this is appropriate and proportionate.

5.2 The FCA has decided to explain non-compliance only in relation to paragraph 79 of the *EBA Guidelines*. This is the requirement that the bonus cap must be applied to all firms subject to the CRD. This means that firms (other than those falling into *proportionality level* 1 or 2 – see 5.4 below) may choose to continue to rely on our domestic *Proportionality Guidance* to disapply the bonus cap where relevant.

5.3 However, in line with our *Proportionality Guidance*, firms will need to ensure that where proportionality has been applied, they can justify that this is appropriate and be able to demonstrate this to us on request.

5.4 Larger firms (ie those falling into *proportionality level* 1 or 2) have no discretion to disapply the bonus cap.

# 6 FAQs: Variable remuneration

## Q9 How can we measure individual performance in a Long-Term Incentive Plan (LTIP) award?

6.1 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* 19A.3.36R and *SYSC* 19D.3.39R).

6.2 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.

## Q10 Do the upfront and deferred components of variable remuneration need to have the same split of cash and instruments?

6.3 No. This used to be the case under the previous CEBS Guidelines on remuneration policies and practices,[3] 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 and *SYSC* 19A.3.47R). We consider it good practice for the deferred portion of variable remuneration to contain a higher proportion of instruments.

## Q11 How can bonus pools include ex-ante risk adjustments?

6.4 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).

6.5 For the avoidance of doubt, this applies to financial and non-financial types of risk, including those that are more difficult to measure. Measures relating to:

- building and maintaining positive customer relationships
- reputation
- achieving in line with firm strategy and values
- effectiveness and operation of the risk and control environment

[3] Committee of European Banking Supervisors Guidelines on Remuneration Policies and Practices (published 10 December 2010).

are examples of good practice of non-financial criteria we have observed. 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 results in increased financial performance.

6.6 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.

6.7 When communicating their approach to the FCA, 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.