

FG 17/6

GENERAL GUIDANCE ON PROPORTIONALITY

The IFPRU Remuneration Code (SYSC 19A)

May 2017

1 Part A: Introduction and interpretations

Introduction and status of guidance statement

- 1.1 This statement is general guidance given under section 139A(1) of the Financial Services and Markets Act 2000 (FSMA). It relates to the *Remuneration Code* of SYSC 19A of the *Handbook*.
- 1.2 Paragraphs 1.13 and 1.14 make provision about the interpretation of this *guidance* statement. Expressions in italics either bear the meaning given in the *Handbook Glossary*, or in Table 1.
- 1.3 This *guidance* statement was initially issued on 12 December 2013, and revised on 9 January 2014 and 23 June 2015. On 3 May 2017 the guidance was revised as FG 17/6 and has effect from 3 May 2017.

Remuneration principles proportionality rule

- 1.4 The *remuneration principles proportionality rule* is set out in SYSC 19A.3.3R (2).
- 1.5 The *Remuneration Code* requires (amongst other things) a firm to apply requirements in SYSC 19A.3 to *Remuneration Code staff*. The *remuneration principles proportionality rule* requires a *firm*, when establishing and applying the total remuneration policies for *Remuneration Code staff*, to comply with SYSC 19A.3 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.

Guidance on the remuneration principles proportionality rule

- 1.6 General *guidance* is given in relation to specific aspects of the *remuneration principles proportionality rule* in SYSC 19A.3 itself.¹
- 1.7 Part D of this *guidance* statement provides additional general *guidance* in relation to the application of the *remuneration principles proportionality rule* to different types of *firms*.
- 1.8 Part E of this *guidance* statement provides additional general *guidance* in relation to the application of the *remuneration principles proportionality rule* to *Remuneration Code staff* who have, in relation to a given performance year, been *Remuneration Code staff* for only part of the year.
- 1.9 This *guidance* statement represents our *guidance* in a field where requirements relating to remuneration are being implemented within the EEA. We recognise this will be an evolving process, and intend to keep the *guidance* set out here under review.

Individual guidance

- 1.10 We may give individual *guidance* to a *firm*, either on its own initiative or on the application of the *firm*. Our policy on individual *guidance* is set out in SUP 9. In consequence, we may give individual *guidance* to a *firm* in relation to the *remuneration principles proportionality rule* (SYSC 19A.3.3R). Such *guidance* may relate to the application of the *rule* by the *firm* generally, or in specific areas.

Arrangement of guidance statement

- 1.11 This general *guidance* statement is divided into five Parts:
 1. This Part, Part A: Introduction and interpretation;
 2. Part B: Proportionality levels;
 3. Part C: Division of firms into proportionality levels;
 4. Part D: Guidance to firms in particular proportionality levels; and
 5. Part E: Guidance about part-year Remuneration Code staff.
- 1.12 It is supplemented by Annex 1 – Supplemental guidance on dividing firms into proportionality levels.

¹ The main provisions of guidance which specifically refer to the *remuneration principles proportionality rule* are SYSC 19A.3.34G (giving guidance in relation to *Remuneration Code staff* and certain rules on remuneration structures).

Interpretation

- 1.13 This *guidance* statement is to be interpreted as if it was an Annex to SYSC 19A.3 R. In consequence, *GEN 2* (interpreting the Handbook) applies to the interpretation of this *guidance* statement.
- 1.14 In particular, an expression in italics which is defined in the *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 given by the following table:

Defined expression	Definition
<i>group</i>	has the meaning given in the <i>Glossary</i> in paragraph (3A)
<i>overseas Remuneration Code firm</i>	an <i>overseas firm</i> that: (i) is not an <i>EEA firm</i> ; (ii) has its head office outside the <i>EEA</i> ; and (iii) would be an <i>IFPRU investment firm</i> if it had been a <i>UK domestic firm</i> , had carried on all its business in the United Kingdom and had obtained whatever authorisation for doing so as required under the <i>Act</i> .
<i>proportionality level</i>	has the meaning given in paragraph 2.2, and references to <i>proportionality level one</i> , etc. are to be construed accordingly.
<i>Remuneration Code firm</i>	a <i>firm</i> specified in SYSC 19A.1.1 R(1)(c) and (d)
<i>relevant total assets</i>	has the meanings given in paragraph 3.4 (3).
<i>relevant date</i>	has the meanings given in paragraph 3.4 (4).
<i>solo Remuneration Code firm</i>	a <i>Remuneration Code firm</i> which is not part of a <i>group</i> containing one or more further <i>Remuneration Code firms</i> .

2 Part B: Proportionality Levels

- 2.1 SYSC 19A.1.1R provides that the *Remuneration Code* applies to a *Remuneration Code firm* and an *overseas Remuneration Code firm*, in relation to the activities carried on from an establishment in the *UK*.
- 2.2 This *guidance* statement provides for the division of *Remuneration Code firms* into three categories:
1. *proportionality level one*;
 2. *proportionality level two*; and
 3. *proportionality level three*.
- 2.3 The process by which firms are divided into *proportionality levels* is provided in Part C (as supplemented by Annex 1), and may also depend on individual *guidance*.
- 2.4 The *proportionality levels* provide a framework for the operation of the *remuneration principles proportionality rule*. *Guidance* is given to *firms* in different *proportionality levels* in Part D.

3 Part C: Process for dividing firms into proportionality levels

Overview

- 3.1 This Part provides the process by which a *Remuneration Code firm* should ascertain the *proportionality level* into which it falls. Annex 1 provides supplementary *guidance* (including examples).
- 3.2 A *Remuneration Code firm*, in order to ascertain its *proportionality level*, must first establish whether it is part of a *group* which contains one or more other *Remuneration Code firms*:
1. If the *firm* is not part of such a *group* (a *solo Remuneration Code firm*), its *proportionality level* will depend on its individual characteristics (as determined in accordance with paragraph 3.4).
 2. If the *firm* is part of such a *group*, its *proportionality level* will depend on a two-stage process (as provided in paragraphs 3.5 to 3.7).

(This requires all *Remuneration Code firms* that are part of the *group* to fall into the highest *proportionality level* that any individual *Remuneration Code firm* in the group would fall into on the assumption that it was a *solo Remuneration Code firm*.)
- 3.3 Individual *guidance* may vary the *proportionality level* into which a *firm* would otherwise fall under paragraphs 3.4 to 3.7.

Solo Remuneration Code firms

- 3.4 The following table shows the *proportionality level* into which a *solo Remuneration Code firm* that is an *IFPRU investment firm* or an *overseas Remuneration Code firm* falls:
1. A *firm* of the description given in the second column falls into the *proportionality level* listed in the first column;
 2. Where applicable, the *firm's proportionality level* will further depend on whether it held *relevant total assets* on the *relevant date* of the amount listed in the third column of the table;
 3. In (2) –

- (a) 'relevant total assets' means:
- (i) for *IFPRU investment firms*, the average of the *firm's total assets* on the *firm's last three relevant dates*; and
 - (ii) for an *overseas Remuneration Code firm*, the average of the *firm's total assets* that covered the activities of the branch operation in the *United Kingdom* on the *firm's last three relevant dates*.
- (b) 'relevant date' means:
- (i) for *IFPRU investment firms*, an accounting reference date; and
 - (ii) for overseas *Remuneration Code firms*, 31 December.
4. We consider that a *firm* which needs to ascertain its *relevant total assets* should apply the valuation requirements set out in the *EU CRR*.

Table 2: Proportionality levels: solo Remuneration Code firms and overseas Remuneration Code firms

Proportionality level	Type of firm	Relevant total assets on relevant date of firm
Proportionality level one	<i>IFPRU 730k Investment firm that is a full scope IFPRU investment firm</i>	Exceeding £50bn
Proportionality level two	<i>IFPRU 730k Investment firm that is a full scope IFPRU investment firm</i>	Exceeding £15bn, but not exceeding £50bn
Proportionality level three	<i>Any full scope IFPRU Investment firm that does not fall within proportionality level one or proportionality level two (in accordance with this Table)</i>	Not applicable
	<i>IFPRU limited licence firm</i>	
	<i>IFPRU limited activity firm</i>	

Groups with more than one Remuneration Code firm

- 3.5 This paragraph applies where a *Remuneration Code firm* is part of a group containing one or more other *Remuneration Code firms*:
1. Each *Remuneration Code firm* in the group must determine the *proportionality level* into which it would fall on the assumption it was a solo *Remuneration Code firm*.
 2. Where each *Remuneration Code firm* falls into the same *proportionality level* on the assumption that it was a solo *Remuneration Code firm*, each firm falls into that *proportionality level*.

3. Where the *Remuneration Code firms* fall into different *proportionality levels* on the assumption that they were solo *Remuneration Code firms*, each firm falls into the highest *proportionality level*.
 4. For the purposes of (3), *proportionality level one* is the highest and *proportionality level three* is the lowest.
- 3.6 Annex 1 provides examples of this approach. A *firm* which has a higher *proportionality level* as a result of the *guidance* in paragraph 3.5 than would have been the case had the *firm* been a *solo Remuneration Code firm* should note the scope to apply for individual *guidance* to vary its *proportionality level* (as discussed in paragraphs 6.5 and 6.6 of Annex 1).
- 3.7 Where a *Remuneration Code firm* is part of a *group* to which SYSC 19D applies is a member, this *guidance* does not apply, SYSC 19D and its applicable general *guidance on proportionality* apply instead.

4 Part D: guidance to firms in particular proportionality levels

Purpose of proportionality levels

- 4.1 In relation to the *remuneration principles proportionality rule*, the *proportionality levels* provide the following:
1. A framework for our supervisory approach, and a broad indication of our likely expectations; and
 2. Guidance on which remuneration principles may be disapplied under the *remuneration principles proportionality rule*.

Firms to continue to consider proportionality in their individual circumstances

- 4.2 It follows from the nature of the *remuneration principles proportionality rule*, and the limited purposes noted in paragraph 4.1, that the *proportionality levels* do not provide comprehensive *guidance* on how the *remuneration principles proportionality rule* will apply to a particular *firm*. A *firm* will still need to consider the application of the *remuneration principles proportionality rule* to its individual circumstances. This means that, although this *guidance* gives the *FCA's* view of how certain provisions in the *Remuneration Code* could be applied in light of the *remuneration principles proportionality rule*, it is the responsibility of the *Remuneration Code firm* to assess its own characteristics and to develop and implement remuneration policies and practices that appropriately align the risks faced and provide adequate and effective incentives to its *Remuneration Code staff*. If requested, *Remuneration Code firms* should be able to explain to the *FCA* the rationale for how they apply the *remuneration principles proportionality rule*, particularly where they have concluded that it is appropriate for certain *rules* to be disapplied.
- 4.3 A *firm* should bear in mind that the *Remuneration Code* may require different responses from *firms* that fall into the same *proportionality level*. This is illustrated by the following example:
1. Firm A is a *full scope IFPRU investment firm* with *relevant total assets* of £800bn with complex business operations with substantial foreign exchange exposures. It falls into *proportionality level one*.
 2. Firm B is a *full scope IFPRU investment firm* with *relevant total assets* of £100bn and a comparatively simple, conservative business model. It falls into *proportionality level one*.

3. Firm C is an *full scope IFPRU investment firm*, with *relevant total assets* of £25bn and a comparatively simple, conservative business model. It falls into *proportionality level two*.
4. Remuneration Principle 8 requires, amongst other things, a *firm* to risk-adjust performance measures to take account of all types of current and future risks (SYSC 19A.3.22R(1)(a)).
5. Clearly the processes necessary to identify such risks will need to be more sophisticated for Firm A than for Firm B, despite the fact that they fall into the same *proportionality level*. Indeed, the difference in the necessary sophistication is likely to be greater as between Firm A and Firm B than as between Firm B and Firm C.

Disapplication of certain remuneration principles for firms in particular proportionality levels

- 4.4 The *CRD* can be interpreted such that it may not be necessary for certain *firms* to apply certain remuneration principles at all.²
- 4.5 In our view, it may be appropriate for a *firm* in *proportionality level three* to disapply under the *remuneration principles proportionality rule* one or more of the following *rules*:
 1. retained *shares* or other instruments (SYSC 19A.3.47R)
 2. deferral (SYSC 19A.3.49R)
 3. performance adjustment (SYSC 19A.3.51R – SYSC 19A.3.51AR)
 4. the specific ratio between fixed and variable components of total remuneration (SYSC 19A.3.44R (3)).
- 4.6 It may also be appropriate for *IFPRU limited licence firms* and *IFPRU limited activity firms* to disapply, under the *remuneration principles proportionality rule*, the ratios between fixed and variable components of total remuneration (SYSC 19A.3.44R).
- 4.7 In all cases:
 1. the disapplication of the relevant requirement is not automatic. The *firm* should assess whether each requirement may be disapplied under the *remuneration principle proportionality rule*;
 2. if requested by the *FCA*, the *FCA* expects the *firm's* senior management to be able to demonstrate why the *firm* believes it is reasonable to disapply these *rules* in light of the *remuneration principles proportionality rule*.

² *CRD* Article 92(2) provides that the principles should be applied 'in a manner and to the extent that is appropriate to their size, internal organisation and the nature, the scope and complexity of their activities'.

- 4.8 If a *Remuneration Code firm* is able to completely disapply the *rules* identified in 4.5, that *Remuneration Code firm* may, in its discretion, nevertheless apply all or part of those rules to the remuneration of its *Remuneration Code staff*. Where a *Remuneration Code firm* is not able to disapply any of such *rules* in their entirety, the specific numerical criteria in the relevant *rule* should be adhered to.

5 Part E: Guidance about part – year Remuneration Code staff

Introduction

- 5.1 SYSC 19A.3.34G provides *guidance* on when we do not generally consider it necessary for a *firm* to apply to certain *Remuneration Code staff* certain *rules* relating to remuneration structures. This Part provides supplementary *guidance* on how certain *rules* on remuneration structures might normally be applied to *Remuneration Code staff* who have, in relation to a given performance year, been *Remuneration Code staff* for only part of the year.
- 5.2 In giving this *guidance*, we have taken account of the *remuneration principles proportionality rule*.

Part-year Remuneration Code staff for more than three months

- 5.3 This paragraph applies where an individual (A) has, in relation to a given performance year, been *Remuneration Code staff* for a period more than three months, but less than 12 months.
1. Sub-paragraphs (3) and (4) explain how the *guidance* in SYSC 19A.3.34G (as mentioned in the introduction to this Part) is to be applied in relation to A. Sub-paragraphs (5) and (6) provide that in certain circumstances it may be appropriate to apply certain *rules* to only a proportion of A's variable remuneration. Sub-paragraphs (7) to (9) provide examples.
 2. In this paragraph:
 - (a) 'relevant fraction' means the fraction derived by dividing the number of days in the given performance year for which A has been *Remuneration Code staff* by the number of days in the year;
 - (b) 'qualifying fixed *remuneration*' means A's annual fixed remuneration in A's capacity as *Remuneration Code staff* multiplied by the relevant fraction;
 - (c) 'qualifying variable remuneration' means:
 - (i) in the case where A was an *employee* of the *firm* for the whole of the given performance year, A's variable remuneration in relation to the performance year multiplied by the relevant fraction

- (ii) in the case where A was only ever employed in the given performance year as *Remuneration Code staff*, A's actual variable remuneration;
 - (d) 'total qualifying remuneration' means qualifying fixed remuneration added to qualifying variable remuneration;
 - (e) 'threshold amount' means £500,000 multiplied by the relevant fraction.
3. We do not generally consider it necessary for a firm to apply the rules referred to in (4) where, in relation to A, the following conditions are satisfied:
- (a) Condition 1 is that A's qualifying variable remuneration is no more than 33% of total qualifying remuneration, and
 - (b) Condition 2 is that A's total qualifying remuneration is no more than the threshold amount.
4. The rules referred to in (3) are those relating to:
- (a) guaranteed variable remuneration (SYSC 19A.3.40R)
 - (b) retained *shares* or other instruments (SYSC 19A.3.47R),
 - (c) deferral (SYSC 19A.3.49R); and
 - (d) performance adjustment (SYSC 19A.3.51R - SYSC 19A.3.51AR)
5. Sub-paragraph (6) applies where the conditions in (3) are not satisfied and the firm should apply the rules referred to in (6).
6. Where this sub-paragraph applies, we generally consider that it would be appropriate to apply the following rules to qualifying variable remuneration only:
- (a) retained shares or other instruments (SYSC 19A.3.47R)
 - (b) deferral (SYSC 19A.3.39R)
 - (c) performance adjustment (SYSC 19A.3.51R - SYSC 19A.3.51AR)
7. The examples in (8) and (9) illustrate this guidance. The performance year in each case is 1 January to 31 December.
8. Example 1:
- (a) A1 is an *employee* of the *firm* through the performance year and is promoted to a *Remuneration Code staff* role with effect from 1 September. A1's previous fixed remuneration was £150,000. In his *Remuneration Code staff* role A1's fixed remuneration increases to £250,000. For the performance year, A 1 is awarded variable remuneration of £130,000.

- (b) The relevant fraction is 122/365. A1's qualifying fixed remuneration is £83,560 (£250,000 multiplied by 122/365). A1's qualifying variable remuneration is £43,452 (£130,000 multiplied by 122/365). A1's total qualifying remuneration is £127,012. The threshold amount is £167,120 (£500,000 multiplied by 122/365).
- (c) A1's total qualifying remuneration is below the threshold amount, so condition 2 of (3) is satisfied. But A1's qualifying variable remuneration is more than 33% of A1's total qualifying remuneration, and condition 1 of (3) is not satisfied.
- (d) The rule on guaranteed variable remuneration applies to A1. In addition, the rules on retained shares and other instruments, deferral and performance adjustment must be applied to A1's qualifying variable remuneration of £43,452.

9. Example 2:

- (a) A2 joins the *firm* as a *Remuneration Code staff* member with effect from 1 July. A2's annual fixed remuneration is £450,000. For the period of 1 June to 31 December, A2 is awarded variable remuneration of £50,000.
- (b) The relevant fraction is 184/365. A2's qualifying fixed remuneration is £226,850 (£450,000 multiplied by 184/365). A2's qualifying variable remuneration is £50,000 (the actual amount). A2's total qualifying remuneration is £276,850. The threshold amount is £252,050 (£500,000 multiplied by 184/365).
- (c) A2's qualifying variable remuneration is not more than 33% of A2's total qualifying remuneration, and condition 1 of (3) is satisfied. But A2's total qualifying remuneration is more than the threshold amount, so condition 2 of (3) is not satisfied.
- (d) The rule on guaranteed variable remuneration applies to A2. In addition, the rules on retained shares and other instruments, deferral and performance adjustments must be applied to A2's qualifying variable remuneration of £50,000.

Certain part-year Remuneration Code staff for three months or less

5.4 Paragraphs 5.5 and 5.6 apply where:

- 1. an individual (B) has, in relation to a given performance year, been *Remuneration Code staff* for a period of three months or less, and
- 2. an exceptional or irregular payment (such as a sign-on award) has not been or is not to be made in relation to B's appointment as *Remuneration Code staff*.

5.5 Where this paragraph applies, we do not generally consider it necessary to apply the following rules in relation to B for the performance year in question:

- 1. retained shares or other instruments (SYSC 19A.3.47R)

2. deferral (SYSC 19A.3.49R)

3. performance adjustment (SYSC 19A.3.51R - SYSC 19A.3.51AR)

5.6 Where this paragraph applies, the guidance in paragraph 5.3(2), 5.3 (3) and 5.3 (4)(a) should be applied for the purposes of determining whether or not it will generally be necessary to apply the rule on guaranteed variable remuneration to B (substituting in that paragraph, for references to 'A', references to 'C').

Part-year Remuneration Code staff for three months or less, but where exceptional etc. payments made

5.7 Paragraph 5.8 applies where an individual (C) has, in relation to a given performance year, been *Remuneration Code staff* for a period of three months or less, but where an exceptional or irregular payment (such as a sign-on award) has or is to be made in relation to C's appointment.

5.8 The guidance in paragraph 5.3 applies in relation to C (substituting in that paragraph for references to 'A', references to 'C'). The amount of exceptional or irregular payment is to be added to C's qualifying variable remuneration without pro rating.

6 Annex 1: Supplemental guidance on dividing firms into proportionality levels

Groups with more than one Remuneration Code firm: examples

- 6.1 The following non-exhaustive examples illustrate the operation of the guidance provided in paragraph 3.5 of Part C. (It should be borne in mind that in each case individual *guidance* could vary the outcome provided by the operation of the guidance provided in that paragraph.)
- 6.2 Example 1:
1. Firm A is the *parent undertaking* of Firm B.
 2. Firm A is a *full scope IFPRU investment firm* (that is an *IFPRU 730k investment firm*) that had *relevant total assets* of £800bn on its last accounting reference date. Firm B is a *limited activity firm*
 3. On the assumption that they were *solo Remuneration Code firms*, Firm A falls into *proportionality level one* and Firm B falls into *proportionality level three*.
 4. As a result of the guidance at paragraph 3.5 of Part C, both Firms A and B fall into *proportionality level one*.
- 6.3 Example 2:
1. Firm C is the *parent undertaking* of Firm D.
 2. Firm C is a *limited activity firm* and Firm D is a *full scope IFPRU investment firm* (that is an *IFPRU 730k investment firm*) that had *relevant total assets* of £100bn on its last accounting reference date.
 3. On the assumption that they were *solo Remuneration Code firms*, Firm C falls into *proportionality level three* and Firm D falls into *proportionality level one*.
 4. As a result of the *guidance* at paragraph 3.5 of Part C, both Firms C and D fall into *proportionality level one*.
- 6.4 Example 3:
1. Company E is the *parent undertaking* of Firms F and G and Company H. Company H is the *parent undertaking* of Firm I. Firm J is a member of the *group* because of an *Article 12(1) consolidation relationship*.

2. The *firms* and companies have the following characteristics:
 - (a) Neither Companies E nor H are *Remuneration Code firms*;
 - (b) Firm F is a *full scope IFPRU investment firm* (that is an *IFPRU 730k investment firm*) that is a *CRD full-scope firm* and that had *relevant total assets* of £40bn on its last accounting reference date;
 - (c) Firms G and J are *limited activity firms*; and
 - (d) Firm I is a *limited license* that had *relevant total assets* of £10bn on its last accounting reference date.
3. On the assumption that they were *solo Remuneration Code firms*:
 - (a) Firm F falls into proportionality level two;
 - (b) Firms G and J fall into proportionality level three;
 - (c) Firm I falls into proportionality level three.
4. As a result of the *guidance* at paragraph 3. 5 in Part C, Firms F, G, I and J all fall into *proportionality* level two.

Role of individual guidance

- 6.5 Individual *guidance* may vary the *proportionality level* into which a *firm* would fall under the general *guidance* set out in Part C and supplemented by this Annex. In consequence, the definitions and thresholds provided in Part C do not provide an immutable classification.
- 6.6 The following provide non-exhaustive high level examples of where we might consider providing individual *guidance* to vary a *proportionality level*:
 1. Where a *firm* was just below the threshold for a particular *proportionality level* (as determined in accordance with Part C), but where features of its business model or growth strategy suggest that it should fall within the higher *proportionality level*.
 2. Where a *group* of *firms* contained several *firms* falling into a common *proportionality level*, but where the aggregate prudential risk posed by the *group* suggested that a higher *proportionality level* was more appropriate.
 3. Where a *firm* falls into a higher *proportionality level* as a result of the guidance at paragraph 3.5 of Part C than would be the case on the assumption that it was a *solo Remuneration Code firm*, depending on the particular circumstances of the case.