

10/27**

Financial Services Authority

Implementing CRD3
requirements on
the disclosure
of remuneration

November 2010

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List of acronyms used in this Consultation Paper

ARROW	Advanced Risk-Responsive Operating FrameWork
BCBS	Basel Committee on Banking Supervision
BCD	Banking Consolidation Directive
BIPRU	Prudential sourcebook for Banks, Building Societies and Investment Firms
CAD	Capital Adequacy Directive
CBA	Cost Benefit Analysis
CEBS	Committee of European Banking Supervisors
CP	Consultation Paper
CRD3	The Third Capital Requirements Directive
EEA	European Economic Area
EU	European Union
FS	Feedback Statement
FSB	Financial Stability Board
FSMA	The Financial Services and Markets Act 2000
LTIP	Long Term Incentive Plan
MFA	Market Failure Analysis
MiFID	Markets in Financial Instruments Directive
PERG	The Perimeter Guidance Manual (Handbook)
PS	Policy Statement
RemCo	Remuneration Committee
RPS	Remuneration Policy Statement
SIF	Significant Influence Function
SYSC	Senior Management Arrangement, Systems and Controls (Handbook)

The Financial Services Authority invites comments on this Consultation Paper. Comments should reach us by 8 December 2010.

Comments may be sent by electronic submission using the form on the FSA's website at:

www.fsa.gov.uk/Pages/Library/Policy/CP/2010/cp10_27_response.shtml.

Alternatively, please send comments in writing to:

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1 Overview

Purpose

- 1.1 Recent amendments to the Capital Requirements Directive (CRD3) have introduced requirements for firms to make disclosures on remuneration. This paper consults on our proposed approach to implementing these requirements, which CRD3 stipulates should be in force from 1 January 2011.
- 1.2 The final text of the CRD3 amendments was agreed in July 2010, and we have been awaiting draft guidance on the text from the Committee of European Banking Supervisors (CEBS), which has now been issued. We are using CEBS' final **draft** guidance as the basis for our proposals. Please see Annex 1 for the relevant section.
- 1.3 CEBS' **official** guidance will not be published until mid-December 2010 following a separate consultation process. In the area of remuneration disclosure, we do not expect any significant changes between the draft and the official version, although the risk does exist. Given the consultation timetable that we are required to observe however, it would not be practicable to wait until December to consult, as that would not give us sufficient time to implement the requirements by 1 January 2011.
- 1.4 According to CRD3, firms' remuneration disclosures are to be made under the Basel Pillar 3 framework. Our consultation therefore relates to amendments to the Prudential Sourcebook for Banks, Building Societies and Investment Firms (BIPRU), which sets out our requirements for Basel Pillar 3 disclosure.
- 1.5 In July, we published CP10/19¹ which set out our proposed amendments to the Senior Management Arrangements, Systems and Controls (SYSC 19) of the Handbook. It is important to note the difference between CP10/19 and the current paper, which proposes amendments to BIPRU. Nonetheless, as both papers focus on remuneration, we refer to CP10/19 wherever relevant in the course of this consultation.

1 CP10/19: *Revising the Remuneration Code*, (29 July 2010).

Summary of our proposals

1.6 The key proposals on remuneration disclosure set out in this paper are summarised below:

- **Items of information to be disclosed:** in brief, these are:
 - information on the remuneration decision-making process;
 - the link between pay and performance;
 - the most important design characteristics of the remuneration system;
 - performance criteria for assessment of remuneration;
 - main parameters and rationale for variable compensation; and
 - aggregate quantitative information on total remuneration, variable remuneration, deferred remuneration, and sign-on and severance payments, in respect of senior management and staff with a material impact on the firm's risk profile.
- **Form and frequency of disclosure:** we propose to implement CRD3 rules governing how and when firms will need to disclose details of their remuneration. Firms will need to disclose these as soon as practicable and at least annually (please refer to Chapter 4, paragraph 4.4). CEBS guidance indicates that disclosure may take the form of a stand-alone report or may be included in the firm's annual report.
- **Institutions and staff to whom the requirements will apply, and how we intend to take account of proportionality:** we propose to adopt a proportionate approach in applying the rules, reflecting CRD3 which provides that 'credit institutions shall comply with the requirements...in a way that is appropriate to their size, internal organisation and the nature, the scope and the complexity of their activities'. It is intended that this will be broadly in line with our general approach to proportionality with regard to the Remuneration Code. We also invite feedback on extending the disclosure requirements to non-EEA firms operating as branches in the UK. Please see Chapter 4 for full details.

Structure of the paper

1.7 The rest of the CP is set out as follows:

- Chapter 2 explains why we are implementing rules on disclosure of remuneration.
- Chapter 3 focuses on the requirements of CRD3 and how we propose to implement them.
- Chapter 4 looks at practical aspects of implementation, including how we intend to take account of proportionality. The chapter also contains a discussion on extending disclosure requirements to cover non-EEA firms operating as branches in the UK.

- Chapter 5 sets out the next steps.
- Annex 1 states the CRD3 provisions and CEBS guidance on the disclosure of remuneration.
- Annex 2 sets out the relevant excerpts from the Financial Stability Board's (FSB) Principles and Standards.
- Annex 3 sets out details of our proposed approach to proportionality for firms.
- Annex 4 provides a cost-benefit analysis (CBA).
- Annex 5 lists the questions for consultation and discussion.
- Appendix 1 contains the draft text we propose to use to incorporate the revised draft Code into the Handbook.

Next steps

1.8 The timetable for implementing the disclosure requirements is as follows:

- 10 November 2010: Publication of this CP.
- 8 December 2010: The consultation period for this CP closes.
- Mid-December 2010: Publication of the Policy Statement (PS).
- 1 January 2011: Handbook rules on disclosure come into effect.
- February/March 2011: Further consultation on extending disclosure requirements to non-EEA branches.

Who should read this paper?

- 1.9 This CP should be read by all FSA-authorized banks, building societies and Capital Adequacy Directive (CAD) investment firms. This audience corresponds to firms subject to the Markets in Financial Instruments Directive (MiFID), although exempt CAD firms such as credit unions are not included.² This CP should also be read by non-EEA firms operating as branches in the UK. Shareholders, creditors and firms' other stakeholders may also find this paper interesting.
- 1.10 This paper may also be of interest to trade associations and consumer groups.

² See PERG 13 for guidance on the scope of a CAD investment firm.

2 Why we are seeking disclosure on remuneration

Introduction

- 2.1 Disclosure of remuneration has long been a focus of discussion among regulators and industry bodies. The recent financial crisis has, however, spurred regulators to take action:
- In 2009, the Financial Stability Board (FSB) issued high-level principles and standards on remuneration, including a principle on disclosure.
 - The European Union (EU) has incorporated a specific rule in the Third Capital Requirements Directive (CRD3) on the disclosure of remuneration.
 - The Basel Committee on Banking Supervision (BCBS) has prepared for consultation a paper entitled *Proposal for Pillar 3 Disclosure Requirements for Remuneration*, aiming for greater global consistency in this area.
- 2.2 Underlying these recommendations is the view that stakeholders will benefit from greater clarity regarding firms' remuneration practices, notably whether and how these practices support effective risk management. There is also the view that investors should be given the opportunity to understand how a firm's remuneration practices affect its ability to pay an adequate risk-adjusted return on capital.
- 2.3 **The main driver behind our timetable for implementation is CRD3**, which obliges member states to implement disclosure requirements on remuneration by 1 January 2011. In this chapter, we provide an overview of these and other factors which have fed into our proposals.

FSB's principles and standards on remuneration

- 2.4 The FSB published a set of high-level principles in April 2009, which were endorsed by the G20 summit meeting in London. A set of more detailed implementation standards was issued in September 2009 and approved at the G20 meeting in Pittsburgh.
- 2.5 The implementation standards were designed to prioritise and give more detail on areas that firms and supervisors should address in order for the principles to be

implemented effectively on a global basis. We were closely involved in the discussions which led to both the FSB's documents.

- 2.6 The FSB's Principle 9 states that 'firms must disclose clear, comprehensive and timely information about their compensation practices to facilitate constructive engagement by all stakeholders'. Building on this, Standard 15 requires firms to produce an annual report on compensation which should be disclosed to the public on a timely basis. Standard 15 sets out certain key items of information that should be disclosed, including the processes and design characteristics of a firm's remuneration, details of fixed and variable components, and deferral structures. See Annex 2 for the full text of Principle 9 and Standard 15.

Amendments to the Capital Requirements Directive (CRD3)

- 2.7 CRD3 will require firms' policies and practices to take into account several principles covering the structure, amount and timing of variable remuneration payments. CRD3 also introduces requirements about the disclosure of remuneration. The key requirements are summarised in paragraph 1.6 above. Please see Annex 1 for the full text of the CRD3 remuneration disclosure requirements and the Committee of European Banking Supervisors (CEBS) draft guidance on the subject.
- 2.8 As discussed in CP10/19, CRD3 applies to all banks, building societies and investment firms to which the Markets in Financial Instruments Directive (MiFID) rules apply.³ In Handbook terms, CRD3 remuneration requirements apply to firms to which the BIPRU sourcebook applies. We estimate that over 2,500 firms in the UK will be subject to CRD3's remuneration requirements.
- 2.9 In implementing the requirements, CRD3 allows us to consider the size, nature and complexity of the institutions within its scope. This proportionality provision is reflected in CEBS guidance and is discussed in further detail in Chapter 4. At the same time, the question has been raised as to whether the scope of the requirements should be extended to cover non-EEA firms that operate as branches in the UK. In Chapter 4 we discuss and invite feedback on this issue.

Other relevant considerations

- 2.10 The Companies Act 2006 requires firms to disclose selected pay data for executive directors. As part of its annual accounts, a firm must disclose certain financial information relating to directors' remuneration, usually including information on levels of pay awarded including shares. There are no explicit requirements on the level of detail required for disclosure, however.
- 2.11 In March 2010, the Treasury published draft regulations on disclosure of remuneration by financial firms. It was intended that these would be further refined in advance of a full public consultation, to take place after the Financial Services Bill gained Royal Assent. Following the announcement of remuneration disclosure rules under CRD3

3 Excluding exempt CAD firms (see PERG 13).

however, and given that Pillar 3 disclosures come under the remit of the FSA, it was decided by the Treasury that we would assume responsibility for implementing the disclosure requirements of CRD3.

3 Required items of disclosure

Overview

- 3.1 The recitals to the Capital Requirements Directive (CRD3) state that ‘good governance structures, transparency and disclosure are essential for sound remuneration policies’. This is consistent with our view that stakeholders will benefit from greater clarity regarding a firm’s remuneration practices, notably whether and how these practices support effective risk management.
- 3.2 **The items of disclosure that we propose to implement are as set out in CRD3.** These are broadly divided into qualitative and quantitative items, reflecting the approach under Basel Pillar 3 which is the medium of disclosure indicated by the Directive. In implementing these requirements, we intend to adopt the guidance issued by the Committee of European Banking Supervisors’ (CEBS) Internal Governance Task Force on Remuneration. We will also take note of the *Proposal for Pillar 3 Disclosure Requirements for Remuneration* prepared by the Basel Committee on Banking Supervision.
- 3.3 The CRD3 requirements specifically focus on ‘those categories of staff whose professional activities have a material impact on the risk profile’ of the institution. This definition is expressed in very similar terms to the definition of the categories of staff to whom the substantive provisions of CRD3 apply, as reflected in our definition of ‘Code Staff’ in CP10/19 (SYSC 19.3.4R of the draft Handbook text). We consider this further when we discuss implementing the requirements and applying proportionality in Chapter 4.
- 3.4 In the following section, we set out in **bold type** the CRD3 requirements that we intend to implement. Where available, we cite the relevant CEBS guidance (in current draft form) and any links to relevant provisions in our revised draft Code as set out in CP10/19. Where CEBS guidance is not available, we suggest items of information firms may consider disclosing to meet these requirements.

CRD3 disclosure requirements

Governance

- 3.5 We propose to implement the CRD3 requirement for firms to disclose:
- ‘information concerning the decision-making process used for determining the remuneration policy, including if applicable, information about the composition and the mandate of a remuneration committee, the external consultant whose services have been used for the determination of the remuneration policy and the role of the relevant stakeholders’.**
- 3.6 CEBS guidance adds that firms ‘must outline the role of all relevant stakeholders involved in the determination of the remuneration policy. Additionally, the disclosure should include a description of the regional scope of the institution’s remuneration policy, the types of staff considered as material risk-takers and the criteria used to determine such staff’.
- 3.7 Since its inception, our Remuneration Code has included clear requirements on governance. Under Principle 4 of our revised Code, a firm that is significant in terms of its size, internal organisation and the nature, scope and complexity of its activities is required to establish a remuneration committee (RemCo) which must periodically review and implement the firm’s remuneration policies. We expect the Chair and members of the RemCo to be non-executive directors, although executive staff may attend meetings in a non-voting capacity.

Link between pay and performance

- 3.8 We propose to implement the CRD3 requirement for firms to disclose **‘information on the link between pay and performance’**. CEBS guidance advises that such disclosure should include ‘a description of the main performance metrics utilized for the firm, top-level business lines, and for individuals (i.e. scorecards)’.
- 3.9 This is consistent with Principle 12 of our revised Code, which sets out rules and guidance on the link between pay and performance. We clearly state that where remuneration is performance-related, firms should ensure this is based not only on the individual’s performance but also on that of the business unit and the firm as a whole (draft SYSC 19.3.34R). Non-financial performance metrics, including adherence to effective risk management and compliance with the regulatory system, should also play a significant role in the assessment process.
- 3.10 A further point of relevance is Principle 8, which requires firms to ensure that total variable remuneration ‘is generally considerably contracted’ when the firm’s performance is subdued or negative. Firms should take account of this when providing disclosure on the link between pay and performance.

Design and structure of remuneration

- 3.11 We propose to implement the CRD3 requirement for firms to disclose:
‘the most important design characteristics of the remuneration system, including information on the criteria used for performance measurement and risk adjustment, deferral policy and vesting criteria’.
- 3.12 We further propose to implement the CRD3 requirement for firms to disclose:
‘information on the performance criteria on which the entitlement to shares, options or variable components of remuneration is based’.
- 3.13 These are very broad requirements whose component parts relate to several different areas in our revised draft Code, which we consider in greater detail below. CEBS guidance is referred to where relevant.

Risk adjustment

- 3.14 CEBS guidance states that institutions should describe ‘how they take into account current and future risks to which [the firm is] exposed when implementing remuneration methodologies and what these risks are. Also, institutions should describe the measures used to take account of these risks and the ways in which these measures affect remuneration.’
- 3.15 This is consistent with Principle 8 of our revised draft Code, which requires firms to ensure their bonus pool calculations include adjustments for all types of current and potential risks, and take into account the cost and quantity of capital and liquidity required.

Performance measurement/assessment, deferral and vesting

- 3.16 CEBS guidance recommends that firms disclose ‘information relating to the design and structure of remuneration processes, such as the key features and objective of the remuneration policy’.
- 3.17 This is consistent with our revised draft Code which contains a number of proposed measures with regard to performance measurement and assessment, deferral and vesting. Among other things, Principle 12 requires firms to ensure that performance assessment is based on longer-term performance; that a substantial portion of variable remuneration is made up of shares or other capital instruments; that there are minimum standards of deferral and vesting; and that unvested deferred remuneration is reduced in event of employee misbehaviour or a downturn in the firm’s performance.
- 3.18 CEBS guidance further advises that firms should disclose how they will ensure ‘staff in control functions are remunerated independently of the businesses they oversee’. This is consistent with Principle 5 of our revised draft Code, which requires firms to ensure employees engaged in control functions are remunerated independently of the business areas they control (draft SYSC 19.3.14R).

Criteria for different types of remuneration

- 3.19 We propose to implement the CRD3 requirement that firms should disclose:
‘information on the performance criteria on which the entitlement to shares, options or variable components of remuneration is based’.
- 3.20 CEBS guidance recommends that disclosure should include a description of the different forms of variable remuneration offered (cash, equity, etc), as well as the rationale for using these different forms and for allocating them to different categories of staff.

Variable component schemes

- 3.21 We propose to implement the CRD3 requirement for firms to disclose:
‘the main parameters and rationale for any variable component scheme and any other non-cash benefits’.
- 3.22 Although this requirement is closely tied to the ones described above covering the design and structure of remuneration, it is directed more towards firms that operate long-term incentive plans for their staff. We suggest that, to meet this requirement, firms may wish to provide key details of any such plans.

Quantitative disclosure

- 3.23 We propose to implement CRD3’s requirements for firms to disclose the following quantitative information:
- ‘aggregate quantitative information on remuneration, broken down by business area’; and**
- ‘aggregate quantitative information on remuneration, broken down by senior management and members of staff whose actions have a material impact on the risk profile of the credit institution, indicating the following:**
- i) the amounts of remuneration for the financial year, split into fixed and variable remuneration, and the number of beneficiaries;**
 - ii) the amounts and form of variable remuneration, split into cash, shares and share-linked instruments and other types;**
 - iii) the amounts of outstanding deferred remuneration, split into vested and unvested portions;**
 - iv) amounts of deferred remuneration awarded during the financial year, paid out and reduced through performance adjustments;**
 - v) new sign-on and severance payments made during the financial year, and the number of beneficiaries of such payments; and**
 - vi) the amounts of severance payments awarded during the financial year, number of beneficiaries, and highest such award to a single person.**

For credit institutions that are significant in terms of their size, internal organisation and the nature, scope and the complexity of their activities, the quantitative information referred to in this point shall also be made available to the public at the level of directors within the meaning of Article 11.

3.24 We believe these requirements are consistent with the general requirement of our revised Code as set out in draft SYSC 19.2. As previously stated, we believe stakeholders will benefit from greater clarity regarding the firm's remuneration policies, procedures and practices, notably whether and how they promote sound and effective risk management.

3.25 CEBS guidance in this area includes the following:

- Information for each business area 'should include number of staff, total remuneration and total variable remuneration'. The guidance recognises that 'some institutions may only have one or two business areas'. In our view, the reference to business areas can be interpreted as separate and significant business activities such as retail banking, investment banking, stockbroking, asset management and others.
- Significant credit institutions (as described in the last paragraph above) will need to disclose remuneration for directors (within the meaning of Article 11 of the Directive) as a separate category.

Consultation question

Q1: Do you agree with our proposed approach to implement the remuneration disclosure requirements of CRD3?

4 Practical implementation

Introduction

- 4.1 In this chapter, we consider the practical aspects of implementing the Third Capital Requirements Directive (CRD3) requirements on disclosure of remuneration. The first section sets out our proposals in respect of the frequency and form of disclosure. The second section discusses and invites feedback on the question of extending the disclosure requirements to non-EEA firms operating as branches in the UK. In the third section, we put forward proposals on applying the principle of proportionality.

Frequency and form of disclosure

- 4.2 In this section, we set out our expectations of when and how firms will make disclosures on remuneration. As before, we are guided in this by the CRD3 requirements and the latest draft guidance issued by the Committee of European Banking Supervisors (CEBS) where available.

Frequency of disclosure

- 4.3 CRD3 requires firms to make disclosure to the public, ‘including regular, at least annual, updates’. This mirrors the current Pillar 3 rule in BIPRU 11⁴, which requires firms to publish disclosures ‘on an annual basis at a minimum’. CEBS guidance advises that disclosures should be published ‘as soon as practicable’, and that the first reports will be expected ‘in 2011’.
- 4.4 It is our understanding that CEBS’ phraseology (‘as soon as practicable’ and ‘in 2011’) was a considered choice. To meet this, and taking into account that it may be an onerous new requirement for some firms, we propose to set a **deadline of 31 December 2011** for firms to make their first disclosure under these provisions. Firms should take note of CEBS guidance that disclosure should be published as soon as practicable.

4 Prudential sourcebook for Banks, Building Societies and Investment Firms.

Form of disclosure

- 4.5 Requirements on the media and location of Pillar 3 disclosures are generally set out in BIPRU 11.3.10R. CRD3 does not add to these. CEBS guidance advises that disclosure ‘may take the form of a **stand-alone report** or may be included in the institution’s **annual report and accounts**’.
- 4.6 The existing rules under BIPRU 11.3.10 provide that:
- i) firms may determine the appropriate medium, location and means of verification;
 - ii) firms must provide all disclosures in one medium or location where feasible;
 - iii) equivalent disclosures made under other requirements (e.g. accounting) may be deemed to constitute compliance; and
 - iv) if disclosures are not included in financial statements, firms must indicate where they can be found.
- 4.7 We propose to adhere to BIPRU 11 and CEBS guidance, as described above. However, concerning 4.6(iii), firms must show that the remuneration disclosure provided under other requirements is ‘equivalent’ to that required by CRD3.

Consultation question

Q2: Do you agree with our proposed requirements in terms of frequency and form of disclosure as set out in paragraphs 4.3 to 4.7?

Scope of disclosure reporting requirements

- 4.8 CRD3 amends the provisions of the CRD that provide for the Basel Pillar 3 regime. This is implemented in the UK through the provisions of BIPRU 11. All firms currently within the scope of BIPRU 11 (BIPRU firms, as defined in BIPRU 1.1.6R and BIPRU 1.1.7R) will therefore be required to make disclosures on remuneration, although the nature and extent of that disclosure will be subject to the principle of proportionality (see next section).
- 4.9 Pillar 3 disclosure requirements do not apply to overseas firms that operate in the UK through branches. Incoming EEA and Treaty firms will be subject to the home state regulation of their supervisor under the CRD, and are outside the scope of this discussion. Other overseas firms operating through branches are not BIPRU firms within the meaning of BIPRU⁵, and hence fall outside the scope of BIPRU 11.⁶
- 4.10 This approach is justifiable in light of current disclosure requirements that focus on capital and risk. One of the main purposes of Pillar 3 is to require disclosures to be made to the market for the benefit of the market, and the intention is that they will enhance market discipline. In the context of capital, this is most meaningfully assessed in the context of the whole legal entity, not least because branches are not subject to individual capital requirements.

5 BIPRU 1.1.6R, BIPRU 1.1.7R(3).

6 BIPRU 11.1.1R.

- 4.11 In the context of remuneration, however, the question has been raised as to whether the same arguments apply. Unlike capital requirements, it is meaningful to talk of remuneration arrangements in relation to a branch⁷ and requiring the disclosure of information in respect of such arrangements would require a meaningful part of the picture to be disclosed. This in turn could make a real contribution to market discipline. While extending the requirement to branches will involve some cost, it will also support our regulatory efforts to promote effective risk management. In addition, it would also provide a level playing field between firms operating in the UK through branches and BIPRU firms.
- 4.12 We are therefore inviting feedback on whether there would be any meaningful disadvantages in extending the scope of the disclosure requirements to third country BIPRU firms⁸ in relation to their activities carried on from establishments in the UK. If we did so, we would expect to apply a broadly similar proportionate approach to such firms, as we are proposing to apply to BIPRU firms (see next section).
- 4.13 Having had regard to the feedback provided on this discussion question, and after further consideration on our part, we would (if minded to pursue this requirement) issue a Consultation Paper with proposed Handbook rules in early 2011. The rules would require third country BIPRU firms within scope to make the appropriate disclosures (which would include information relating to 2010 remuneration) by the end of 2011; that is, according to the same timetable as for the other entities within scope.

Questions for discussion in paragraphs 4.8 to 4.13

- Q3: Do you think there would be any meaningful disadvantages in extending the scope of our disclosure requirements to third country BIPRU firms in relation to their activities carried on from establishments in the United Kingdom?
- Q4: Do you have any comments on the potential costs and benefits that would be incurred in implementing the above proposal?

Applying the principle of proportionality and Pillar 3 exemptions

- 4.14 With regard to disclosure of remuneration, CRD3 states that ‘**credit institutions shall comply with the requirements...in a manner that is appropriate to their size, internal organisation and the nature, scope and complexity of their activities**’.
- 4.15 CEBS guidance states that ‘Pillar 3 remuneration disclosures may be made on a proportionate basis, based on criteria already applying to existing Pillar 3 disclosures, for example, the institution as a whole may be exempt from disclosure; or certain types of disclosure may be exempted on the grounds that the information is not material, or is proprietary or confidential. Also, the overall remuneration proportionality principle

⁷ It is worth noting that, in relation to the substantive requirements of the draft Remuneration Code, third country BIPRU firms are within scope in respect of their activities carried on from establishments in the United Kingdom.

⁸ Defined at: <http://fsahandbook.info/FSA/html/handbook/Glossary/T> As noted above, incoming EEA and Treaty firms are subject to home state supervision under the CRD regime, and accordingly are outside the scope of this discussion.

will apply to the type and amount of information disclosed. Small or non-complex institutions will only be expected to provide some qualitative information and very basic quantitative information where appropriate.’

- 4.16 This guidance largely reflects the scope and exemptions that generally apply to the Pillar 3 regime, (as set out in CRD3 itself, and as implemented in BIPRU 11). In particular, under BIPRU 11.2, the following institutions are not required to make a solo disclosure:
- a) **UK subsidiaries of EEA firms** – CRD3 requires certain disclosures by ‘significant UK subsidiaries’ to be made on an individual or sub-consolidated basis (e.g. in relation to capital resources), but this requirement has not been extended to the provisions on disclosure of remuneration.
 - b) **Non-EEA firms** that have been granted a waiver on the basis of comparable disclosure at consolidated level in the home state.

UK subsidiaries of UK firms do not need to make individual disclosures, but will contribute material for consolidated disclosures by their groups.

- 4.17 BIPRU 11.2 also exempts certain types of information on grounds of materiality, proprietary nature or confidentiality:
- a) information is material if its omission or misstatement could change or influence the assessment or decision of a user relying on that information for the purpose of making economic decisions;
 - b) information is proprietary if sharing that information with the public would undermine the firm’s competitive position; and
 - c) information is confidential if there are obligations to customers or other counterparty relationships binding the firm to confidentiality.

Proportionality for institutions

- 4.18 Taking account of CEBS guidance, we intend to apply proportionality by setting different disclosure requirements for firms depending on their size, internal organisation and the nature, scope and complexity of their activities.
- 4.19 We propose to divide firms into the following four groups, each group being subject to a different level of disclosure requirements as described below:
- **Tier 1 firms – Full disclosure of all items under CRD3:** Banks and building societies with capital resources in excess of £1bn, and Full Scope BIPRU Investment €730K firms with capital resources in excess of £750m. We expect this category to include around 26 very significant groups. We believe firms of this size and complexity should observe the highest standards of disclosure.
 - **Tier 2 firms – Disclosure of most qualitative items (including design characteristics of remuneration) and selected quantitative items:** Banks and building societies with capital resources between £50m and £1bn, and Full Scope BIPRU Investment €730K firms with capital resources between £100m and £750m. We expect this category to include some 200 firms. We believe firms

of this size and complexity should provide a high degree of disclosure, although some finer details need not be disclosed.

- **Tier 3 firms – Disclosure of most qualitative items (excluding design characteristics of remuneration systems) and selected quantitative items:** Banks and building societies with capital resources of less than £50m, Full Scope BIPRU Investment €730K firms with capital resources less than £100m. We expect this category to include around 300 firms. We believe firms of this size and complexity should also provide a high degree of disclosure, although details such as the design characteristics of remuneration need not be disclosed.
- **Tier 4 firms – Disclosure of basic qualitative and quantitative items only:** All BIPRU Limited Licence and Limited Activity firms. We expect this category to comprise over 2,000 firms. We believe firms with limited licences and permissions need disclose only basic qualitative and quantitative information on remuneration.

Annex 3 shows in more detail how this approach would be applied.

- 4.20 In several cases, a firm will be a member of a group from which consolidated disclosure will be required under BIPRU 11.2. In such circumstances, we would expect the consolidated disclosure to be made at a standard that meets the highest tier that would apply within the group. So, for example, if on a standalone basis the group contains firms in both Tiers 1 and 3, we would expect the consolidated disclosure as a whole to meet Tier 1 standards.

Consultation question

Q5: Do you agree with our proposed application of the principle of proportionality to institutions as set out in paragraphs 4.18 to 4.20?

Staff

- 4.21 CRD3 requires firms to disclose details of remuneration for senior management and members of staff whose professional activities have a material impact on their risk profile. As noted above, this definition is expressed in very similar terms to the definition of the categories of staff to whom the substantive provisions of CRD3 apply, as reflected in our definition of ‘Code Staff’ in CP10/19 (SYSC 19.3.4R of the draft Handbook text).

Types of information – Pillar 3 exemptions

- 4.22 With regard to types of information, BIPRU 11 provides potential exemptions on grounds of materiality, proprietary nature or confidentiality (see paragraph 4.11).
- a) Under Pillar 3 rules on **materiality**, firms may decide what is material based on whether the information would influence a user in ‘making economic decisions’. We propose to issue guidance that it is unlikely that this exemption would apply in circumstances where it would be proportionate for the firm to disclose the information in question (as discussed above), and that their Pillar 3 disclosures should explain why this exemption applies in their case.
 - b) We anticipate that it would be highly unlikely for the exemption for **proprietary information** to apply in the area of remuneration.
 - c) We also think it unlikely that the existing exemption for **confidentiality** would apply given the nature of the disclosures required in relation to remuneration. CRD3 provides that the new requirements on disclosing remuneration information are without prejudice to the Data Protection Directive⁹ which was primarily implemented in the UK by the Data Protection Act 1998. Firms will need to take account of any duties to process personal data lawfully as a result, but we would not anticipate this to be a significant issue in view of the nature of the disclosures required. In particular, we note that under the data protection regime, personal data consists of data from which a living individual is identifiable and that disclosure of such data, while subject to certain safeguards, is not prohibited.

Consultation question

- Q6: Do you agree with our proposals on implementation with regard to staff and types of information, as set out in paragraphs 4.21 and 4.22?

⁹ Directive 95/46/EC of the European Parliament and of the Council of 24 October 1995 on the protection of individuals with regard to the processing of personal data and on the free movement of such data.

5 Next steps

Trade associations

- 5.1 We ask all trade associations representing firms that fall within the scope of CRD3 to inform them about the proposed new disclosure rules. We also encourage the associations to prepare a collective response to the Consultation Paper (CP) on their members' behalf.

Firms

- 5.2 Firms must ascertain whether they are covered by the scope of Capital Requirements Directive (CRD3) as soon as possible. Further information can be found in Chapter 2 of CP09/29.¹⁰
- 5.3 We ask all firms covered by CRD3 to read the proposals in this CP and to give us feedback by 8 December.
- 5.4 Firms may give us feedback individually. However, as noted above, we are encouraging trade associations to produce a collective response on behalf of their members.

Timetable

- 5.5 As set out in Chapter 1, our timetable for implementing the CRD3 requirements on disclosure is as follows:
- 8 December 2010: The consultation period for this CP closes.
 - Mid-December 2010: We publish the PS and final rules. This will include an updated section on 'next steps'.
 - 1 January 2011: Handbook rules come into effect in respect of 2010 remuneration for UK firms and UK subsidiaries of foreign firms.
 - February/March 2011: Depending on feedback to the discussion questions in Chapter 4, we may commence further consultation on extending disclosure requirements to branches.

¹⁰ CP09/29: *Strengthening Capital Standards 3* (December 2009).

Excerpts from CRD3 text and CEBS draft guidance

Guidelines for institutions

5.1. External disclosure

Recital (21) CRD III – Good governance structures, transparency and disclosure are essential for sound remuneration policies. In order to ensure adequate transparency to the market of their remuneration structures and the associated risk, credit institutions and investments firms should disclose detailed information on their remuneration policies practices and, for reasons of confidentiality, aggregated amounts for those members of staff whose professional activities have a material impact on the risk profile of the institution. That information should be made available to all stakeholders (shareholders, employees and the general public). However, this obligation should be without prejudice to Directive 95/46/EC of the European Parliament and of the Council of 24 October 1995 on the protection of individuals with the regard to the processing of personal data and the free movement of such data.

Annex XII, Part 2 Directive 2006/48/EC, new point 15

‘15. The following information, including regular updates no less frequently than annually, shall be disclosed to the public regarding the remuneration policy and practices of the credit institution for those categories of staff whose professional activities have a material impact on their risk profile. Credit institutions shall comply with the requirements set out in this point in a way that is appropriate to their size, internal organisation and the nature, scope and complexity of their activities and without prejudice to Directive 95/46/EC of the European Parliament and of the Council of 24 October 1995 on the protection of individuals with the regard to the processing of personal data and the free movement of such data:

- a) information concerning the decision-making process used for determining the remuneration policy, including if applicable, information about the composition and the mandate of a remuneration committee, the external consultant whose services have been used for the determination of the remuneration policy and the role of the relevant stakeholders;

- b) information on link between pay and performance;
- c) the most important design characteristics of the remuneration system, including, information on the criteria used for performance measurement and risk adjustment, deferral policy and vesting criteria;
- d) information on the performance criteria on which the entitlement to shares, options or variable components of remuneration is based;
- e) the main parameters and rationale for any variable component scheme and any other non-cash benefits;
- f) aggregate quantitative information on remuneration, broken down by business area;
- g) aggregate quantitative information on remuneration, broken down by senior management and members of staff whose actions have a material impact on the risk profile of the credit institution, indicating the following;
 - i) amounts of remuneration for the financial year, split into fixed and variable remuneration, and number of beneficiaries;
 - ii) amounts and form of variable remuneration, split into cash, shares and share-linked instruments and other;
 - iii) amounts of outstanding deferred remuneration, split into vested and unvested portions;
 - iv) the amounts of deferred remuneration awarded during the financial year, paid out and reduced through performance adjustments;
 - v) new sign-on and severance payments made during the financial year, and number of beneficiaries of such payments; and
 - vi) the amounts of severance payments awarded during the financial year, number of beneficiaries, and highest such award to a single person.

In the case of directors of credit institutions that are significant in terms of their size, internal organisation and the nature, scope and the complexity of their activities, the quantitative information referred to in this point shall be made available to the public at the level of directors within the meaning of Article 11.

5.1.1. Specific and general requirements on disclosure

143. Institutions must disclose, to the public, detailed information regarding their remuneration policies and practices for members of staff whose professional activities have a material impact on the institution's risk profile. On a firm-wide basis, institutions should give general information about the basic characteristics of their remuneration policies and practices.

144. The Pillar 3 disclosure may take the form of a stand-alone report or may be included in the institutions' annual report and accounts. The overall Pillar 3 requirements specify where and how an institution must disclose this information. In all cases, the institution must ensure that access to the location of the disclosure is readily available.
145. Pillar 3 remuneration disclosures may be made on a proportionate basis, based on criteria already applying to existing Pillar 3 disclosures, for example, the institution as a whole may be exempt from disclosure; or certain types of disclosure may be exempted on the grounds that the information is not material, or is proprietary or confidential. Also, the overall remuneration proportionality principle will apply to the type and amount of information disclosed. Small or non-complex institutions will only be expected to provide some qualitative information and very basic quantitative information where appropriate. Institutions should disclose how they have applied the proportionality principle, including possible neutralizations, at their institution. Although Pillar 3 requirements are generally disclosed at a consolidated level, jurisdictions should consider if an institution is a significant subsidiary in the jurisdiction in which it operates, whether it should be expected to disclose remuneration information at the subsidiary level as opposed to at the consolidated group level.
146. The disclosure must be published at least on an annual basis and as soon as practicable. Supervisors will expect the first institution's disclosure reports in 2011; institutions can undertake an evolutionary process for the first periods.

5.1.2. Policy and practices

147. The disclosure report must set out the decision-making process used to determine the remuneration policy for the individuals to which it applies. This may include the governance procedure relating to the development of the remuneration policy and should include information about the bodies (including the composition and the mandate), such as the Remco or external consultants, who played a significant role in the development of the remuneration policy. Institutions must outline the role of all relevant stakeholders involved in the determination of the remuneration policy. Additionally, the disclosure should include a description of the regional scope of the institution's remuneration policy, the types of staff considered as material risk takers and the criteria used to determine such staff.
148. The report must include information on how pay and performance are linked. Such information should include a description of the main performance metrics utilized for: the firm, top-level business lines, and for individuals (i.e. scorecards). Institutions should disclose information relating to the design and structure of remuneration processes, such as the key features and objectives of the remuneration policy and how the institution ensures that staff in control functions are remunerated independently of the businesses they oversee. The report must also include a description of the different forms of variable remuneration utilized (i.e. cash, equity, options, other capital instruments, and long-term incentive plans) and should include the rationale for using these different forms and for allocating them to different categories of staff. Additionally, the report should include a discussion of the parameters used to allocate deferred and non-deferred remuneration for different staff categories.

149. Disclosure reports should describe how the institution takes into account current and future risks to which they are exposed when implementing remuneration methodologies and what these risks are. Also, institutions should describe the measures used to take account of these risks and the ways in which these measures affect remuneration. In addition, institutions should disclose the ways in which they seek to adjust remuneration to take account of longer-term performance – as in the institution’s policy on deferral, vesting and performance adjustment.
150. It would be useful to ensure that the disclosure is produced and owned by the management body that has the ultimate sign-off on remuneration decisions. This management body should state in the report whether it considers the performance conditions applied to be appropriate and if it considers the remuneration policies and practices of the institution to be compatible with effective management of risks. The disclosure should also include a description of any actions taken to remedy deficiencies.

5.1.3. Aggregate quantitative information

151. Institutions must provide aggregate quantitative information by business area and on remuneration for members of staff whose actions have a material impact on the risk profile of the institution. The information for each of the major business areas at an institution, i.e., investment banking business area, retail banking business area, etc. should include: number of staff, total remuneration and total variable remuneration. Some institutions may only have one or two business areas.
152. More detailed qualitative information on remuneration must be disclosed for senior managers and other members of staff whose actions have a material impact on the risk profile of the institution including aggregate information on amounts of remuneration, amounts and forms of variable remuneration, and amounts of outstanding deferred remuneration. Other more detailed quantitative information is also required as per the Directive.
153. Quantitative information on remuneration must also be disclosed separately on an aggregate basis at the level of directors (within the meaning of Article 11 of the Directive¹) for institutions that are significant in terms of their size, internal organisation and the nature, scope and complexity of their activities. This will be a separate category of disclosure information to the categories of senior management and other staff members who have a material impact on the risk profile of the institution.

5.2. Internal disclosure

154. The remuneration policy of a credit institution or investment firm should be accessible to all staff members of that institution. Institutions must ensure that the information regarding the remuneration policy disclosed internally reveals at least the details which are disclosed externally. Therefore, according to the size, internal organisation and the nature, the scope and the complexity of the activities of the institution, the information provided to staff members might contain some of the elements listed in Annex XII, Part 2, Point 15. The staff members should know in advance the criteria that will be used to determine their remuneration. The appraisal

1 Article 11 of the Directive refers to those persons who effectively direct the business of the credit institution.

process should be properly documented and should be transparent to the member of staff concerned. Confidential quantitative aspects of the remuneration of staff members shall not be subject to internal disclosure.

Guidelines for supervisors

155. Supervisors should:

- Review public disclosure on remuneration made by institutions, and compare these to any information received on external disclosure via supervisory reporting.
- Require periodic (or ad hoc) supervisory reporting on remuneration disclosure in order to monitor the development of remuneration practices within institutions.
- Ask for staff member assessment documents including balanced scorecards that are used to assess member of staff's performance.
- Interview staff members at an institution to see if they have access to the institution's remuneration policies and to check that they understand how their remuneration is determined.

Excerpts from FSB's Principles and Standards

Principle 9

1. **Firms must disclose clear, comprehensive and timely information about their compensation practices to facilitate constructive engagement by all stakeholders.** Stakeholders need to be able to evaluate the quality of support for the firm's strategy and risk posture. Appropriate disclosure related to risk management and other control systems will enable a firm's counterparties to make informed decisions about their business relations with the firm. Supervisors should have access to all information they need to evaluate the conformance of practice to the Principles.¹

Standard 15

Disclosure

2. An annual report on compensation should be disclosed to the public on a timely basis. In addition to any national requirements, it should include the following information:
 - the decision-making process used to determine the firm-wide compensation policy, including the composition and the mandate of the remuneration committee;
 - the most important design characteristics of the compensation system, including criteria used for performance measurement and risk adjustment, the linkage between pay and performance, deferral policy and vesting criteria, and the parameters used for allocating cash versus other forms of compensation;
 - aggregate quantitative information on compensation, broken down by senior executive officers and by employees whose actions have a material impact on the risk exposure of the firm, indicating:
 - amounts of remuneration for the financial year, split into fixed and variable compensation, and number of beneficiaries;

1 Full text of the Principles available at www.financialstabilityboard.org/publications/r_0904b.pdf, and Standards at FSB Principles for Sound Compensation Practices – Implementation Standards: www.financialstabilityboard.org/publications/r_090925c.pdf

- amounts and form of variable compensation, split into cash, shares and share-linked instruments and other;
- amounts of outstanding deferred compensation, split into vested and unvested;
- the amounts of deferred compensation awarded during the financial year, paid out and reduced through performance adjustments;
- new sign-on and severance payments made during the financial year, and number of beneficiaries of such payments; and
- the amounts of severance payments awarded during the financial year, number of beneficiaries, and highest such award to a single person.

Proposed approach to proportionality for firms

Annex 3: Proposed approach to proportionality for firms

(NB. Tiers 1 to 4 are defined in paragraph 4.19 of the main text)

CRD3 disclosure requirement	Tier 1 firms	Tier 2 firms	Tier 3 firms	Tier 4 firms
(a) Information concerning the decision-making process used for determining the remuneration policy, including if applicable, information about the composition and the mandate of a remuneration committee, the external consultant whose services have been used for the determination of the remuneration policy and the role of the relevant stakeholders	✓	✓	✓	✓
(b) Information on link between pay and performance	✓	✓	✓	✓
(c) The most important design characteristics of the remuneration system, including information on the criteria used for performance measurement and risk adjustment, deferral policy and vesting criteria	✓	✓		
(d) Information on the performance criteria on which the entitlement to shares, options or variable components of remuneration is based	✓			
(e) The main parameters and rationale for any variable component scheme and any other non-cash benefits	✓			
(f) Aggregate quantitative information on remuneration, broken down by business area	✓	✓	✓	✓
(g) Aggregate quantitative information on remuneration, broken down by senior management and members of staff whose actions have a material impact on the risk profile of the credit institution....indicating the following	✓	✓	✓	✓ (see Note 1)
(i) amounts of remuneration for the financial year, split into fixed and variable remuneration, and number of beneficiaries	✓	✓	✓	
(ii) amounts and form of variable remuneration, split into cash, shares and share-linked instruments and other	✓			
(iii) amounts of outstanding deferred remuneration, split into vested and unvested portions	✓			
(iv) the amounts of deferred remuneration awarded during the financial year, paid out and reduced through performance adjustments	✓			
(v) new sign-on and severance payments made during the financial year, and number of beneficiaries of such payments	✓			
(vi) the amounts of severance payments awarded during the financial year, number of beneficiaries, and highest such award to a single person.	✓			
In the case of directors of credit institutions that are significant in terms of their size, internal organisation and the nature, scope and the complexity of their activities, the quantitative information referred to in this point shall be made available to the public at the level of directors within the meaning of Article 11	✓			

Note 1: Tier 4 firms will need to disclose total remuneration broken down between senior management and staff with material risk impact, but they will not be required to provide the details in sections g (i) to (vi).

Cost-benefit analysis

Introduction

1. This annex contains our cost-benefit analysis (CBA) for implementing remuneration disclosure provisions within the Third Capital Requirements Directive (CRD3) in the UK. We have already carried out a CBA covering other aspects of the CRD3 implementation in CP10/19 Annex 1, published in September 2010.
2. When proposing new rules, we are obliged (under sections 155 and 157 of the Financial Services and Markets Act 2000) to publish a CBA, unless we believe the proposals will give rise to no costs or to an increase in costs of minimal significance. The CBA provides an estimate of the costs and an analysis of the benefits that will arise from the proposals. It is a statement of the differences between the baseline (broadly speaking, the current position) and the position that will arise if we implement the proposals.
3. To estimate the cost and benefits of the changes described in this publication, we are building on the CBA that was prepared for CP10/19, published in September 2010. Final rules to this consultation will be published in Q4 2010.
4. In this CBA, we consider the costs and benefits associated with revisions to the proposals that were not part of CP10/19. These revisions are driven by the draft CRD3¹ requirements and only cover disclosure elements contained within CRD3.
5. The rest of this CBA is structured as follows:
 - overview of the population of firms affected;
 - direct costs to us;
 - incremental compliance costs incurred by firms; and
 - benefits of the changes to firms and the wider economy.
6. This CBA is based on the results of a firm survey, discussions with stakeholders and input from our policy and supervisory experts. We are grateful to firms and other third parties that have input to the CBA.

1 The Directive has not yet been published in the Official Journal. See further, CP10/19, paragraph 1.5

Overview of the firms affected

7. Implementing the CRD3 will alter the rules and guidance on remuneration disclosures that apply to just over 2,500 firms including groups. Table 1 below sets out the approximate number of firms affected and what category they fall within.
8. As explained in CP19/10, the current Code applies to the largest banks, building societies and broker dealers. The introduction of CRD3 significantly increases the number of firms covered by the Code. This new population incorporates all banks and building societies, all Capital Adequacy Directive (CAD) investment firms and UK branches of firms whose home state is outside the EEA. UK branches of firms whose home state is within the EEA are not required to apply the UK Code, as their home state will be required to implement the provisions of CRD3.

Table 1: The population of firms subject to CRD3 rules

Category	Approx number of firms scope
Credit institutions	239
Investment managers	1,379
Advisory and arranging intermediaries	393
Other	568
Total²	2,579

Direct costs to us

9. The implementation of the disclosure provisions may require additional resources and a reallocation of priorities for some of our staff. However, our analysis suggests that implementing the disclosure requirements will not yield any additional costs other than the estimates made in CP10/19 (Annex 1) for the implementation of CRD3. The incremental costs for our risk-based monitoring and enforcement of the disclosure proposals will be minimal and will be absorbed into the business as usual costs.

Incremental compliance costs incurred by firms

10. Extending the scope will lead to incremental compliance costs for firms. These costs may be incurred initially, when the new systems are set up, as well as on an ongoing basis. The table below summarises the expected incremental compliance costs to firms.
11. We have based the cost estimates provided in this CBA on a survey, carried out in August 2010, of 144 firms that are either in scope or will be as at 1 January 2011. This survey asked for an indication of the costs associated with the proposed implementation of the remuneration disclosure provisions within CRD3. The firms chosen formed a sample of large and small firms, across a range of businesses covered by the scope of CRD3.
12. We received 64 responses from firms to the survey. Table 2 below lists the categories and number of respondents within each category.

² This includes all banks and building societies, and all CAD investment firms.

Table 2: Respondents by category

Category	Number of firms responding to survey	Approximate number of firms in extended scope
Credit institutions	17	239
Investment managers	19	1,379
Advisory and arranging intermediaries	13	393
Other	15	568
Total	64	2579

13. The following tables report the costs estimated by the firms in the survey. We also provide the range of estimates for each cost item and the overall average and median costs for each group. Due to the different types of firms caught by CRD3, there are variations in the estimates provided by firms.

Incremental compliance costs estimates per peer group

Table 3 – Credit institutions

Costs	One-off	Ongoing (annual)
Changes in systems and controls	£0 – £35,000	£0 – £2,000
Additional data collection and reporting	£0 – £25,000	£0 – £60,000
Additional record keeping	£0 – £5,000	£0 – £5,000
Other clerical costs	£0 – £650	£0
Publishing costs	£0 – £10,000	£0 – £10,000
Average of total costs	£2,650	£1,300
Median	£0	£0
Estimate for 239 firms³	£0 – £650,000	£0 – £320,000

Table 4 – Investment managers

Costs	One-off	Ongoing (annual)
Changes in systems and controls	£0 – £50,000	£0 – £20,000
Additional data collection and reporting	£0 – £100,000	£0 – £40,000
Additional record keeping	£0 – £50,000	£0 – £20,000
Other clerical costs	£0 – £50,000	£0 – £20,000
Publishing costs	£0 – £50,000	£0 – £20,000
Average of total costs	£4,900	£2,250
Median	£150	£100
Estimate for 1379 firms	£200,000 – £6.8m	£150,000 – £3.1m

³ We expect the average to represent an upper bound of the range, given the presence of outliers in the responses. We use the median as a lower bound given that most firms in our survey reported very low cost estimates.

Table 5 – Advisory and arranging intermediaries

Costs	One-off	Ongoing (annual)
Changes in systems and controls	£0 – £5,000	£0 – £2,500
Additional data collection and reporting	£0 – £10,000	£0 – £5,000
Additional record keeping	£0 – £2,500	£0 – £1,500
Other clerical costs	£0 – £2,500	£0 – £1,500
Publishing costs	£0 – £5,000	£0 – £500
Average of total costs	£600	£300
Median	£0	£0
Estimate for 393 firms	£0 – £240,000	£0 – £120,000

Table 6 – Other⁴

Costs	One-off	Ongoing (annual)
Changes in systems and controls	£0 – £50,000	£0 – £10,000
Additional data collection and reporting	£0 – £20,000	£0 – £150,000
Additional record keeping	£0 – £10,000	£0 – £5,000
Other clerical costs	£0 – £5,000	£0 – £30,000
Publishing costs	£0 – £20,000	£0 – £5,000
Average of total costs	£2,900	£4,300
Median	£500	£100
Estimate for 568 firms	£300,000 – £1.65m	£50,000 – £2.5m

14. Based on these responses, we estimate the total one-off compliance cost to the firms affected would be up to £9.4m. We estimate the corresponding ongoing cost to be up to £6m per annum.

Changes in systems and controls

15. The implementation of the disclosure requirements may involve changes in firms' processes, systems and controls. The information collected in our survey of firms confirmed that the initial costs to make appropriate changes and incremental annual compliance costs will differ depending on the size, complexity and activity of the organisation. On the whole, costs estimates given were relatively low even for the most complex firms. As these requirements are as part of Pillar 3 requirements, we envisage most of the costs to be absorbed into the business as usual costs.

Data collection and reporting

16. Firms may have to collect annual remuneration data for us, which may include data for reporting purposes. The data may cover a whole host of areas in terms of remuneration, including an assessment of the impact of the firm's remuneration policies on its risk profile and employee behaviour.

4 Includes Own Account Traders, Lloyd's Managing Agent, Wholesale Market Brokers, Energy Market, Stockbrokers, some Corporate Finance Firms and Wholesale Market Brokers

17. The incremental cost for firms will depend on the extent to which new processes have to be implemented and on the additional level of detail required for the statement. The cost estimates provided by firms vary across the different peer groups, but the average and median cost figures are relatively low. We also expect these costs to depend on the complexity and current procedures of the organisation.

Record keeping

18. Firms will have to archive detailed information on their remuneration policies, practices and, for confidentiality reasons, aggregated amounts for those staff whose professional activities have a material impact on the risk profile of the institution. This information should be readily available for relevant stakeholders including the general public. Estimates for the costs associated with these requirements are reported in the tables above.

Administrative and publishing costs

19. There may be some additional administrative and publishing costs involved, where a firm discloses its remuneration information via an accessible medium. Estimates for the costs associated with these requirements are reported in the tables above. In some cases, though, firms have been unable to allocate a cost.

Benefits of the changes to the Code to firms and the wider economy

20. As we discussed in CP10/19, inappropriate remuneration policies can promote excessive risk-taking and pose a risk to our financial stability and market confidence objectives. Our remuneration code aims at reducing the impact of these market failures.
21. The additional disclosure requirements prescribed by CRD3 and described in this CP could, in theory, also help to mitigate this market failure. At present, only details on board members and very senior executive remuneration packages are typically published. By making information on firms' compensation structures and levels more widely available, the proposals could increase discipline on remuneration policies.
22. First, they could promote public scrutiny. This could increase pressure on shareholders and firms to have remuneration structures that restrain excessive risk-taking. They may also increase market discipline by reducing information asymmetry between shareholders (or investors) and the firm's management. The disclosure of remuneration policies would then enable shareholders and investors to assess an institution's risk and adjust the return they required to invest in that firm. Firms with riskier policies could end up paying a higher cost of capital.
23. In practice, however, these benefits will depend on whether the extra information is actually used and understood by the market and the public. As such, the benefits will depend on the quality of the information provided and its comparability across firms. We would also expect the benefits to be lower for smaller and possibly private companies. Risks to our objectives are less severe at smaller non-credit institutions

while there is less scope for market discipline to play a role in private firms. Our proportionate approach in implementing the Directive reflects that. The benefits may also vary across the business cycle. Market discipline and public pressure may be more effective in times of stress (when investors want to avoid riskier institutions) than in good times.

Specific costs and benefits of extending the scope of disclosure requirements to UK branches of non-EEA firms

24. As discussed in CP10/19 and in this document, inappropriate remuneration policies can promote excessive risk-taking and pose a risk to our financial stability and market confidence objectives. Our remuneration code aims at reducing the impact of these market failures. Remuneration arrangements at a branch are, in essence, no different from those at a subsidiary and can pose the same risks. Disclosure of remuneration practices of branches which are not subject to a CRD3-equivalent disclosure regime could therefore constitute meaningful and comparable information to assess a firm's risk profile. Hence, mandating remuneration disclosure at branches could also yield the benefits described in the paragraphs above (such as increased market and public discipline). Further, it could reduce competitive distortions between UK entities and UK branches of non-EEA firms in attracting and retaining staff.
25. Mandating the disclosure of branch remuneration policies would also involve some costs. The costs of disclosure for a branch are likely to be similar to the disclosure costs of a subsidiary. Assuming that around 100 UK branches would be captured by the requirements, and that these branches would primarily be branches of credit institutions or investment firms, we estimate the one-off costs of extending the scope of the requirements to be between £8,000 and £400,000. We estimate the corresponding ongoing costs to be between £5,000 and £200,000 pa. In addition, mandating the disclosure of branches remuneration practices could negatively impact the competitiveness of London as a financial centre. Foreign firms may choose to establish their branches in other countries where they would not have to disclose their branch's remuneration practices.

Q7: Do you have any observations on the cost-benefit analysis?

List of questions in this Consultation Paper

Consultation questions

- Q1: Do you agree with our proposed approach to implement the disclosure requirements of CRD3?
- Q2: Do you agree with our proposed requirements in terms of frequency and form of disclosure, as set out in paragraphs 4.3 to 4.7?

Discussion questions from paragraphs 4.8 to 4.13

- Q3: Do you think there would be any meaningful disadvantages in extending the scope of our disclosure requirements to third country BIPRU firms in relation to their activities carried on from establishments in the United Kingdom?
- Q4: Do you have any comments on the potential costs and benefits that would be incurred in implementing the above proposal?

Consultation questions

- Q5: Do you agree with our proposed application of the principle of proportionality to institutions as set out in paragraphs 4.18 to 4.20?
- Q6: Do you agree with our proposals on implementation with regard to staff and types of information, as set out in paragraphs 4.21 and 4.22?
- Q7: Do you have any observations on the cost-benefit analysis?

Compatibility statement

1. This annex sets out our view on how the proposals and draft rules in this Consultation Paper (CP) are compatible with our general duties under section 2 of the Financial Services and Markets Act 2000 (FSMA) and our regulatory objectives set out in sections 3 to 6 of FSMA. We also outline how our proposals are consistent with our principles of good regulation.

Comparability with our statutory objectives

2. Our duty is, as far as is reasonably possible, to act in a way that is compatible with our regulatory objectives and which we consider most appropriate for the purpose of meeting those objectives. The following objectives are particularly relevant to our proposals.

Market confidence and financial stability

3. We believe our proposals will contribute to greater market confidence through improved disclosure of remuneration, which is aimed at improving market transparency and market discipline. These proposals are consistent with our initiatives as set out in CP10/19 *Revising the Remuneration Code*, which are aimed at curbing incentives that contribute to excessive risk-taking in the financial services industry.

Consumer protection

4. Our proposals to improve the level of disclosure on remuneration will enhance the alignment of remuneration practices with effective risk management. This in turn should have positive outcomes for consumer protection.

Compatibility with the Principles of Good Regulation

5. Section 2(3) of FSMA requires that, in carrying out our general functions, we must have regard to a number of matters we refer to as ‘principles of good regulation’. Of these, the following are relevant to our proposals.

The need to use our resources in the most efficient and economic way

6. Our approach to implementation has been designed to ensure the efficient use of resources. We have used ‘copy-out’ in implementing changes to align with the requirements of Capital Requirements Directive (CRD3) and will take into account the work of other regulators and international forums, in particular the latest Committee of European Banking Supervisors’ (CEBS) draft guidelines, to which we have contributed. Costs should also be minimised by our intention to integrate the remuneration process into existing supervisory arrangements as soon as possible. Our efficiency will be further enhanced by existing knowledge within the FSA on the application of Basel Pillar 3 rules under Prudential sourcebook for Banks, Building Societies and Investment Firms (BIPRU), through which the disclosure requirements will be implemented. Our cost-benefit analysis, which provides estimates of the costs required, is in Annex 4.

The responsibilities of those who manage the affairs of authorised persons

7. Our proposals would result in greater responsibilities on firms’ senior management to ensure the timely disclosure of specific details of remuneration as prescribed under CRD3. They are consistent with the requirement to hold senior management responsible for risk management and controls within firms. The proposals also continue to put emphasis on firms to ensure that remuneration policies and frameworks have adequate (independent) oversight and any conflicts of interest are managed effectively.

The principle that a burden or restriction which is imposed should be proportionate to the benefits

8. We believe that the costs associated with our proposals will be proportionate to the benefits delivered. In particular, we intend to adopt a proportionate approach in our implementation of the proposed rules where appropriate, as discussed in Chapter 4. Further detail on anticipated incremental costs for firms is provided in our cost-benefit analysis in Annex 4.

The international character of financial services and markets and the desirability of maintaining the competitive position of the UK

9. We have tried, as far as possible, to achieve alignment with internationally agreed standards and to ensure that the right regulatory outcome is achieved in respect of the UK financial services industry. In drafting the proposed rules we have taken account of developments in the EU, in particular the amendments to CRD3 as well as the latest draft guidance from CEBS. Our intention is to adopt a predominantly ‘copy-out’ approach to implementing the disclosure provisions of CRD3 into Handbook rules and we will continue our work in CEBS to achieve effective implementation.

The need to minimise adverse effects on competition and the desirability of facilitating competition between those who are subject to any form of regulation

10. It is difficult to assess the impact of our proposals on firm competition at this point in time. However, we believe that unintended adverse effects on competition will be minimised by ensuring, as far as possible, consistency in the standards being applied (both domestically, in extending the scope of the Code, and within the EU, as a result of CRD3) and adopting a proportionate approach to implementation as appropriate.

The desirability of enhancing the understanding and knowledge of members of the public of financial matters

11. We believe our proposals are consistent with the desirability of enhancing the understanding and knowledge of members of the public of financial matters (including the UK financial system). The implementation of disclosure requirements on remuneration will facilitate public users' ability to access appropriate information on firms' remuneration structures and policies.

Draft Handbook text

Appendix 1

Draft Handbook text

PRUDENTIAL SOURCEBOOK FOR BANKS, BUILDING SOCIETIES AND INVESTMENT FIRMS (REMUNERATION DISCLOSURES) INSTRUMENT 2010

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 138 (General rule-making power);
 - (2) section 139A (General rules about remuneration);
 - (3) section 156 (General supplementary powers); and
 - (4) section 157(1) (Guidance).
- B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force on [1 January 2011].

Amendments to the Handbook

- D. The Prudential sourcebook for Banks, Building Societies and Investment Firms (BIPRU) is amended in accordance with the Annex to this instrument.

Notes

- E. In the Annex to this instrument, the “notes” (indicated by “**Note:**”) are included for the convenience of readers but do not form part of the legislative text.

Citation

- F. This instrument may be cited as the Prudential Sourcebook for Banks, Building Societies and Investment Firms (Remuneration Disclosures) Instrument 2010.

By order of the Board
[16 December 2010]

Annex

Amendments to the Prudential sourcebook for Banks, Building Societies and Investment Firms (BIPRU)

In this Annex, underlining indicates new text and striking through indicates deleted text.

11.5 Technical criteria on disclosure: General requirements

...

Disclosures: remuneration

- 11.5.18 R A firm must disclose the following information, including regular, at least annual, updates, regarding its remuneration policy and practices for those categories of staff whose professional activities have a material impact on its risk profile:
- (1) information concerning the decision-making process used for determining the remuneration policy, including if applicable, information about the composition and the mandate of a remuneration committee, the external consultant whose services have been used for the determination of the remuneration policy and the role of the relevant stakeholders;
 - (2) information on the link between pay and performance;
 - (3) the most important design characteristics of the remuneration system, including information on the criteria used for performance measurement and risk adjustment, deferral policy and vesting criteria;
 - (4) information on the performance criteria on which the entitlement to shares, options or variable components of remuneration is based;
 - (5) the main parameters and rationale for any variable component scheme and any other non-cash benefits;
 - (6) aggregate quantitative information on remuneration, broken down by business area;
 - (7) aggregate quantitative information on remuneration, broken down by senior management and members of staff whose actions have a material impact on the risk profile of the firm, indicating the following:
 - (a) the amounts of remuneration for the financial year, split into fixed and variable remuneration, and the number of beneficiaries;

- (b) the amounts and forms of variable remuneration, split into cash, shares, share-linked instruments and other types;
- (c) the amounts of outstanding deferred remuneration, split into vested and unvested portions;
- (d) the amounts of deferred remuneration awarded during the financial year, paid out and reduced through performance adjustments;
- (e) new sign-on and severance payments made during the financial year, and the number of beneficiaries of those payments;
- (f) the amounts of severance payments awarded during the financial year, number of beneficiaries and highest such award to a single person.

[Note: Paragraph 15 of Annex XII to the *Banking Consolidation Directive*.]

11.5.19 G The FSA would normally consider the requirements to publish disclosures in accordance with BIPRU 11.3.8R and 11.3.9R in respect of BIPRU 11.5 as a whole to meet the requirement in paragraph 15 of Annex XII to the *Banking Consolidation Directive* to publish “regular, at least annual, updates” (as implemented in BIPRU 11.5.18R).

11.5.20 R (1) A firm that is significant in terms of its size, internal organisation and the nature, scope and the complexity of its activities must also disclose the quantitative information referred to in BIPRU 11.5.18R at the level of senior personnel.

(2) Firms must comply with the requirements set out in BIPRU 11.5.18R in a manner that is appropriate to their size, internal organisation and the nature, scope and complexity of their activities and without prejudice to the UK or other national transposition of Directive 95/46/EC of the European Parliament and of the Council of 24 October 1995 on the protection of individuals with regard to the processing of personal data and on the free movement of such data.

[Note: Paragraph 15 of Annex XII to the *Banking Consolidation Directive*.]

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