Policy Statement

10/20

Financial Services Authority

Revising the Remuneration Code

Feedback on CP10/19 and final rules

December 2010

FSA
Financial Services Authority

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This Policy Statement reports on the main issues arising from Consultation Paper 10/19 *Revising the Remuneration Code* and publishes final rules.

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Copies of this Policy Statement are available to download from our website – www.fsa.gov.uk. Alternatively, paper copies can be obtained by calling the FSA order line: 0845 608 2372.

List of acronyms used in this Policy Statement

The Code	The FSA's Remuneration Code
AIFMD	Alternative Investment Fund Managers Directive
AIFM	Alternative Investment Fund Managers
ARROW	Advanced Risk-Responsive Operating FrameWork
BIPRU	Prudential sourcebook for Banks, Building Societies and Investment Firms
CAD	Capital Adequacy Directive
CBA	Cost Benefit Analysis
CEBS	Committee of European Banking Supervisors
CEO	Chief Executive Officer
CF	Control Function
CP	Consultation Paper
CRD3	The latest amendments to the Capital Requirements Directive, Directive 2010/76/EU
EBA	European Banking Authority
EEA	European Economic Area
EHRC	Equality and Human Rights Commission
EIA	Equality Impact Assessment
EU	European Union
FSB	Financial Stability Board
FSMA	The Financial Services and Markets Act 2000
CGS	Credit Guarantee Scheme
HR	Human Resources
ICAAP	Individual Capital Adequacy Assessment Process

LLP	Limited Liability Partnership
LTIP	Long Term Incentive Plan
MiFID	The Markets in Financial Instruments Directive
NED	Non-Executive Director
PS	Policy Statement
RemCo	Remuneration Committee
RPS	Remuneration Policy Statement
SIF	Significant Influence Function
SYSC	Senior Management Arrangements, Systems and Controls (sourcebook)
TP	Transitional Provision
UCITS	Undertakings for Collective Investment in Transferable Securities

1 Overview

Purpose

1.1 In Consultation Paper 10/19 (CP10/19) we set out proposals to amend our Remuneration Code (the Code) as currently set out in SYSC 19 of the FSA Handbook. We proposed and formally consulted on incorporating changes to the Code into the Handbook and applying the Code to an extended group of banks, building societies and CAD[1] investment firms. We also reported on the implementation of the Code to large banks, building societies and broker dealers in 2010, and on progress in achieving international alignment of remuneration standards.

1.2 This Policy Statement (PS) reports on the responses we received to CP10/19 and the decisions we have reached about how we will revise and apply the Code.

Background

1.3 In CP10/19 we proposed a revised framework for regulating financial services firms' remuneration structures and an extension of the scope of the Code, primarily to implement changes required as a result of the remuneration provisions in the most recent set of amendments to the Capital Requirements Directive (CRD3).

1.4 The proposed revisions to the Code, as set out in CP10/19, also took account of other developments, including the provisions relating to remuneration within the Financial Services Act 2010, Sir David Walker's review of corporate governance, and lessons learned from our implementation of the Code so far.

1.5 The new framework that we proposed contained rules, evidential provisions and guidance relating to 12 Principles, which continue to cover the three main areas of regulatory scope: governance; performance measurement; and remuneration structures. It also introduced some new rules: for example on discretionary severance pay; linking remuneration to a firm's capital base; and discretionary pension payments.

1.6 The CP also stated our intention to adopt a proportionate approach to implementation, reflecting the size of the firm and the nature, scope and complexity

1 Capital Adequacy Directive 2006/49/EC.

of its activities. We proposed a framework for applying proportionality, as well as our intended approach to supervision, setting out our intentions to take a risk-based and proportionate approach. We invited comments on the proposals.

1.7 We made it clear in the CP that our policy would take account of EU guidelines on CRD3 that were at that stage being prepared by a Committee of European Banking Supervisors (CEBS) working group. These guidelines were published on 10 December[2], and are discussed below.

1.8 On 10 November 2010 we published CP10/27, which consulted on our proposals for rules on the disclosure of remuneration policies and practices. Following the consultation, we are publishing the PS and final rules on disclosure in PS10/21, to accompany this document.

Outcome of our consultation on CP10/19

1.9 During the consultation period, we attended meetings in London with trade associations and firms, held bilateral discussions with regulators from other countries and continued to participate in the work of the CEBS working group preparing the guidelines on the CRD3 provisions.

1.10 We received 148 responses to CP10/19 from a range of interested parties including trade associations, professional services firms, law firms and a variety of financial institutions. A list of respondents, excluding those who wished to remain anonymous, is provided in Annex 1.

1.11 Most respondents recognised that the revised Code, like our current Code, addresses an important and valid supervisory issue for the FSA. There was support for – and very little adverse comment on – the Principles dealing with governance, the role of control functions in devising and implementing remuneration policies, and 'ex ante' risk adjustment. The overwhelming sense was that firms understood the reasons for the proposed revised Code, and were seeking additional guidance on how the Code should be implemented.

1.12 There were, however, mixed responses on the proposed changes to the Code's rules on remuneration structures (Principle 12), which set out prescriptive rules on bonus structures, including the requirements for deferral, performance adjustment, allocation into shares and guaranteed bonuses. In part, these comments indicated opposition to measures contained in CRD3 itself or the CEBS remuneration guidelines. See Chapter 2 for more details.

Summary of our policy response

1.13 Having considered the comments received in the consultation process and against the backdrop of needing to ensure consistency with the CEBS guidelines, we have revised the Code as set out in Appendix 1. The changes take account of the

2 www.cebs.org/cebs/media/Publications/Standards%20and%20Guidelines/2010/Remuneration/Guidelines.pdf

responses to the CP summarised above and the final CEBS guidelines. Details of our policy response are set out in Chapter 2. The changes are, for the most part, technical in nature. Key points include:

- In line with the CEBS guidelines, the requirement that, for Code Staff, at least 50% of any variable remuneration should be paid in shares or other specified instruments will now be applied equally to both the deferred and undeferred portions of variable remuneration.
- In line with the CEBS guidelines, we have strengthened the guidance stating that the provisions on guaranteed bonuses should be applied on a firm-wide basis (and not just to Code Staff).

1.14 We clarify, in Chapter 3, the way in which we intend to apply proportionality to the range of firms subject to the Code. Key points here include:

- A high-level structure creating four tiers of firms with differing minimum expectations of compliance for each group.
    - Proportionality tiers one and two contain credit institutions and broker dealers that engage in significant proprietary trading/investment banking activities.
    - Proportionality tier three consists of primarily small banks and building societies, and firms that may occasionally take over-night/short-term risk with their balance sheet.
    - Proportionality tier four contains firms that generate income from agency business without putting their balance sheets at risk.
- A proportionate approach will also be applied across the range of firms in each tier, and the aim is to avoid sharp differences between applying the Code to firms at the lower end of one tier and the higher end of the next.
- Firms in Proportionality tiers three and four will not be expected to apply rules that the CEBS guidelines recommend can be disapplied. The most significant of those relate to: the requirement to have a UK-based Remuneration Committee; deferral; and the proportion of variable remuneration to be paid in shares. For other rules, we will apply an approach that is likely to result in less onerous requirements compared to Proportionality tiers one and two, particularly for risk adjustment. We will still be able to require higher standards in certain areas, such as governance, from the larger firms in the lower proportionality tiers.

1.15 A key change in the revised Code is that the provisions for Code Staff are tougher than last year. The overall effect of our policies, including an expectation in the Code that firms should apply deferral on a firm-wide basis, is likely to mean that in aggregate more staff in the banks and broker dealers will be subject to deferral in 2010 than before.

Key messages about this policy statement

Objective of the Code

1.16 The fundamental objectives of our remuneration policy remain unchanged. They are to sustain market confidence and promote financial stability through reducing the incentives for inappropriate risk-taking by firms, and thereby to protect consumers.

1.17 The need to ensure that remuneration policies and practices are consistent with and promote effective risk management therefore remains fundamental. However, from our experience to date in day-to-day supervision, the policies and practices of a number of firms continue to exhibit weaknesses, which are inconsistent with effective risk management.

The international context

1.18 As noted and discussed in CP10/19, wider international alignment of remuneration practices remains weak. CRD3 aims to align remuneration principles across the EU, but hardens the distinction in approach that appears to be emerging between the EU and other major jurisdictions regarding the implementation of the Financial Stability Board (FSB) Principles on Remuneration. A number of major G20 countries have implemented the Financial Stability Board (FSB) Principles and Standards on the basis of guidance rather than as enforceable rules. This difference is causing difficulties for EU banks competing to recruit and retain staff in non-EU markets.

1.19 We have worked closely with our EU colleagues to prepare for the implementation of CRD3, and will keep in close contact with them – both via CEBS and bilaterally – to ensure continuing close alignment of supervisory practices in future. We will continue to monitor developments with other EU supervisory authorities to assess the impact of these different approaches. We will be prepared to consider options for mitigating the adverse competitive implications for firms, within the limitations imposed by CRD3.

1.20 During the first half of 2011, the FSB will be undertaking a further review of the implementation of its Principles and Standards by significant financial institutions. This will consider the national policy measures undertaken, including our supervisory and regulatory framework. An FSA-nominated representative will chair the group that has been asked to prepare the criteria for this assessment.

Timing issues

1.21 As agreement on the final text of CRD3 was only reached in early July 2010 for implementation on 1 January 2011, we – along with other EU supervisory authorities – have faced a tight timeframe for consulting on the proposed amendments to the Code and preparing this PS. We had originally planned to issue this PS in November, but decided to wait until we could take the final CEBS guidelines into account, to cause less disruption for firms.

1.22 In October we informed the firms currently in scope and the relevant trade associations of our change of plan. We made it clear that firms already within the scope of the Code would still be required to comply in full with the revised Code from 1 January 2011.

We noted that the rules in our PS would be on broadly similar lines to those proposed in CP10/19, with the exception of a small number of detailed provisions to further align with the CEBS remuneration guidelines. We encouraged firms to continue to work on that basis for the 2010 remuneration round.

1.23 For the large number of firms (over 2,500) coming into the scope of the Code for the first time on 1 January 2011, we proposed transitional arrangements in CP10/19 that recognised the challenges for them in implementing the provisions on remuneration structures by the implementation date. We proposed to require firms to comply as soon as reasonably possible and in any event by the end of a six-month transitional period. We have retained these transitional arrangements in the final rules.

Who should read this PS?

1.24 This paper should be read in particular by all FSA-authorised banks, building societies and CAD investment firms. It will also be of interest to trade bodies and consumer groups.

Structure of this policy statement

1.25 This PS is structured as follows:

- Chapter 2 sets out the feedback to our proposed changes to the Code and our responses, including any amendments we are making.
- Chapter 3 sets out our approach to implementation, including how we plan to apply the Code proportionately to individuals, firms and groups.
- Chapter 4 sets out our expectations for what firms need to do to implement the Code and how it will fit within our existing supervisory framework.
- Annex 1 lists the respondents to CP10/19, excluding those who wished to remain anonymous.
- Annex 2 lists the Principles of the Code.
- Annex 3 contains a glossary of terms.
- Appendix 1 contains the final handbook text. This will be known as SYSC 19A.
- Appendix 2 provides general guidance on our approach to applying the Code proportionately. It also sets out the proportionality approach for disclosure.

Cost-benefit analysis

1.26 Annex 1 of CP10/19 included a cost-benefit analysis (CBA). In the areas where we have not changed our policy position since the consultation, that CBA still applies. For the provisions that have been amended, we provide an update of the costs and benefits below.

1.27 In line with CEBS guidelines, we have changed the allocation of the shares/share-linked component between the deferred and undeferred component of the bonus. The requirement that 50% of any variable remuneration should be paid in shares or other specified instruments should now be applied equally to both the deferred and undeferred portions of variable remuneration. This amendment may generate incremental compliance costs for firms (as it makes the requirements operate in a more complicated way). It could also adversely affect UK competitiveness, as firms subject to this requirement may find it more difficult to compete for talent on a global basis.

1.28 Extending the scope of the Code on guaranteed bonuses to all staff may generate limited additional compliance costs and could make it more difficult for the firms subject to the rules to compete outside the EU for talent at all levels of seniority.

1.29 The amendments above will bring small benefits by further increasing the alignment of remuneration practices with risk. They will contribute to the realisation of the benefits described in CP10/19.

1.30 Finally, our transitional provisions should reduce compliance costs for firms coming into the Code's scope, as they allow more time to implement the requirements. These provisions may slightly delay the realisation of some of the benefits described in CP10/19.

Compatibility statement

1.31 CP10/19 included a compatibility statement that explained why we considered our proposals to be compatible with our general duties under section 2 of FSMA and with our regulatory objectives, set out in sections 3 to 6 of FSMA. In light of the removal of our public awareness objective in October 2010, we have updated the statement to include: the need to have regard to the desirability of enhancing the understanding and knowledge of members of the public of financial matters.

1.32 We believe that 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). Implementing these remuneration requirements and extending the scope of the Code to a wider population of firms – including UK branches of non-EEA firms – and the EU-wide application of the CRD3 proposals will provide transparency in how staff within these firms are remunerated for the work they do. In addition, in amending the Code we have tried, as far as possible, to minimise adverse effects on the competitiveness of the UK as a financial centre. We believe that the remainder of the compatibility statement published in CP10/19 is still valid.

Next steps for 2011

1.33 The revised Code will come into force on 1 January 2011. The key steps for implementing the new regulatory framework during 2011 will be as follows:

- 1 January 2011: the revised Code on remuneration practices comes into force for firms within its scope.
- Late-January 2011: presentations by the FSA on the revised Code, open to all firms in scope.
- Later in 2011: FSA to issue:
  - A form for data and other information to be supplied, by all firms.
  - Templates/questionnaires for completing Remuneration Policy Statements (RPSs) for firms in proportionality tier one. Separate questionnaires/templates will be used for firms in proportionality tiers two to four.
- 1 July 2011: latest date by which the firms newly within scope must be fully compliant with the rules on remuneration structures.

2 Policy responses to CP10/19

2.1 This chapter summarises the feedback we received to the questions posed in CP10/19. We outline the views of respondents on the proposed amendments to the Remuneration Code (the Code), including on: applying the Code; revisions to the Principles of the Code; and questions relating to proportionality and transitional arrangements. We also set out our responses to these views and how we have decided to proceed.

Application to individuals

2.2 In CP10/19 we set out the CRD3 definition of the group of employees to whom all the Principles of our Code will apply (Code Staff). We asked:

> Q1: Do you agree with our proposed approach to the definition of Code Staff?

2.3 Some firms responded that it might not be appropriate for all significant influence function (SIF) individuals to be captured as risk takers. Examples given included certain control functions (CFs), such as SIFs who are located abroad, CF4s (partners) and other owner/managers.

2.4 Questions were also asked about the extent to which managers of parent companies outside the scope of the Code might be considered within the scope of the Code Staff rules if their group included a firm within scope. (This could relate, for example, to the managers of an insurance company that has an asset management subsidiary within its group.)

2.5 Many firms said that, although the table under SYSC 19.3.6G(4) (as published in CP10/19) included a useful list of business lines, it might not be applicable or relevant to all types of institutions. One respondent argued that not all Heads of Department who report directly to an Executive Director have an impact on the firm's risk profile. Another respondent requested assurance that any further guidance on those caught by the Code would not lead to an inconsistent application within the European Economic Area (EEA).

2.6 There were requests for further clarification, including about what constitutes a 'material impact on the risk profile of an organisation' and whether investment management firms need to identify Code Staff at their firms at all. Some respondents said there were real difficulties in applying the remuneration rules to executives who are also owners (e.g. individual proprietors, directors who are also shareholders, partners or Limited Liability Partnerships (LLP) members).

2.7 Some firms expressed concern about applying the Code to secondees from overseas, who are employed by an entity that is not subject to the Code. A trade association suggested there should be a minimum period of six months in situation for secondees to be treated as Code Staff.

Our response: We have interpreted the CRD3 principles as follows:

We would normally expect all SIFs (CFs 1-29) to be included in a firm's Code Staff list. We note that although CF2s (Non-Executive Directors) are unlikely to receive variable remuneration, they should still be included. CF4s need to be included, but our approach to proportionality means that these individuals, along with individual proprietors and other owner/managers, do not necessarily have to apply our rules on remuneration structures (although this depends on the characteristics of the firm of which they are partners, rather than on their status as partners).

In light of comments received about the applicability of the table in SYSC 19.3.6G(4) to all institutions, we acknowledge that some of the suggested roles in the non-exhaustive list may be most relevant to investment banks and not necessarily applicable to firms such as small building societies. This has been clarified in the final Handbook text.

Many risk-takers and parent SIFs (who are based overseas) are in a position to have a material impact on the risk profile of the UK entities. We will have close regard for cases of possible avoidance, i.e. where an individual may have been relocated to avoid the impact of the Code. However, we may consider cases for exemption where the individual has global responsibilities, and where a group's UK entities form only a part of those responsibilities.

For those managers of a group who are outside the direct scope of the Code, where the group contains a company within the scope, two tests need to be applied. The first is the extent to which the risk profile of the company within scope can have an impact on the group as a whole, and the second is the significance of the entity within scope within the responsibilities of the group-level managers. See paragraph 2.8 below on applying the Code to groups, which considers how the Code applies to group companies that are not directly within the scope of the Code on a stand-alone basis, but which contain such firms.

All firms within the scope of the Code must collate their Code Staff list annually and update it as appropriate. We will discuss the Code Staff list with proportionality tier one firms on an annual basis after they have submitted their Remuneration Policy Statement (RPS).

Firms in proportionality tiers two, three and four may be asked to provide us with their Code Staff list as part of a supervisory interaction – for example, an ARROW assessment or a supervisory or thematic review.

Our approach to proportionality, including categorising firms into four proportionality tiers, is described in Chapter 3 and Appendix 2.

Secondees

We appreciate that there may be instances when someone undertakes a secondment and is not a risk taker – for example, they are purely work-shadowing or training and are not having a material impact on the firm's risk profile. In this case, we would not consider the individual to be Code Staff for that part of the year.

If the role of the secondee involves material risk-taking, firms should refer to our guidance on part-year Code Staff (in Chapter 3 and Appendix 2) to determine how the Code applies to such individuals.

Further guidance on identifying relevant staff can also be found in the CEBS guidelines.

2.8 We asked:

> Q2: Do you agree with our approach to applying the Code to firms, individuals and groups, as outlined above?

Applying the Code to firms

2.9 The Code applies to those firms caught by the CRD. These are: Credit institutions (as defined under Article 4(1) (a) of Directive 2006/48/EC, and Investment firms (as defined under Article 3(1) (b) of Directive 2006/49/EC[3]). We have also applied the Code to third-country BIPRU firms, but only in relation to their activities from establishments in the UK.

2.10 Exempt CAD[4] firms are not included within the scope of the Code.

2.11 Some respondents expressed concern that we were not implementing our rules in the same way as other member states (for example, that because of our interpretation of MiFID[5], other Member States were not applying the CRD3 remuneration provisions to asset management firms).

Applying the Code to groups

2.12 This is a complex issue, which can be considered under four main headings:

2.12.1 Applying the Code to a UK-headquartered group's operations outside the UK.

2.12.2 Applying the Code to the operations of groups headquartered elsewhere.

2.12.3 Applying the Code to different types of businesses within a group with different risk characteristics and profiles.

2.12.4 Applying the Code to unregulated entities within a group.

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3 This in turn builds on the definition of investment firms in MiFID (Article 4(1) of Directive 2004/39/EC), but with further exclusions.

4 Capital Adequacy Directive (2006/49/EC)

5 Markets in Financial Instruments Directive

Applying the Code to a UK-headquartered group's operations outside the UK (global scope)

2.13 The majority of respondents (firms and trade associations alike) said that the proposed application of the Code would have an adverse effect on the international competitiveness of UK banks in markets such as North America and Asia, damaging a firm's ability to retain and attract staff. Some respondents said that it could be a contributory factor in a decision to move the headquarters of a group out of the UK and to relocate overseas.

2.14 There was also uncertainty about applying the Code where there may be differences between the home and host country's regulatory regimes.

Applying the Code to the operations of groups headquartered elsewhere

2.15 We received no significant comments on this issue.

Applying the Code to different types of business within a group

2.16 A number of firms sought clarification about how the Code applies to consolidated groups.

Unregulated entities

2.17 Firms queried how the Code would apply to unregulated entities within a group.

Our response:

Applying the Code to a UK-headquartered group's operations outside the UK (global scope)

The Code applies to firms directly within the scope of the Code, as set out in paragraph 2.9 above. It thereby applies to overseas branches of such firms.

In addition to applying to firms directly within the scope of the Code, firms are required to comply with the Code at the level of any UK consolidation group on a consolidated basis.[6] It therefore applies to overseas group members that form part of the UK consolidation group.[7] See also the discussion of unregulated entities below.

We believe that the continuation of our policy on global scope will be to some extent balanced by the new CRD3 requirements on Code Staff, which will for most firms lead to a reduced and more senior group of employees being subject to the Code's rules than under the existing Code.

We understand that the same approach on global scope will be taken by all other EU member states, and our policy will be sensitive to how other EU member states adopt these provisions.

The CEBS guidelines state that account should be taken of local regulations, such as fiscal or employment legislation, which we will do.

6 In the case of an EEA sub-group, at the level of the sub-group, on a sub-consolidated basis.
7 Or EEA sub-group, as the case may be.

Applying the Code to the UK operations of groups headquartered elsewhere

The Code will not apply to branches of EEA firms, since they will be subject to the requirements of CRD3 implemented by their home state supervisors. Other overseas presences in the UK, whether subsidiaries with overseas parent companies or branches, will be subject to the Code.

These entities will also be subject to the Code's proportionality provisions, set out in Chapter 3.

Different types of business within a group

Our approach to proportionality, including categorising firms into four proportionality tiers, is described in Chapter 3. In determining the application of the Code to a group, we will apply the requirements for the highest tier to any entity within the group. However, if a group can present a reasonable case for applying lower tier requirements to a specific entity, we may be minded to agree.

Unregulated entities

Our response to Q1 discussed how we would approach the question of whether the senior managers/risk takers of unregulated entities might be regarded as Code Staff. This section considers the question of applying the Code to group entities that are not within the direct scope of the Code.

Unregulated entities can be outside the scope of our regulation altogether (i.e. a non-financial company) or outside the scope of CRD3 (for example, a general insurance company).

In addition to applying the Code to the consolidation group discussed above, under our rules we will take into account the activities of other group members (inside and outside the consolidation group) when determining whether the systems and controls of a UK firm directly subject to the Code, including its remuneration policies, are adequate. A key question will be the significance of the unregulated entities to the UK entity – for example, what might be the impact on the UK entity of inappropriate remuneration policies in the unregulated entities that might lead to excessive risk taking. In a situation where we think their inappropriate remuneration policies could threaten the regulated entity, we might require additional risk mitigation, including possible additional capital requirements, at the regulated entity.

Equality and diversity

2.18 In the current Code, we state that 'In considering the risks arising from its remuneration policies, a firm will also need to take into account its statutory duties in relation to equal pay and non-discrimination'.[8]

2.19 We included this as a consultation question in CP10/19 as part of our duty under the Equality Act 2010 to have regard to the impact of our policies on equality and diversity.

8 SYSC 19.2.2G(3)

2.20 We asked:

> Q3: Do you have any comments on how the proposals contained in this CP affect equality and diversity issues?

2.21 We did not receive many responses to Q3. The vast majority of respondents expressed support for measures to promote equality and diversity, and felt that our proposals would not have a negative or positive impact in this area. Some respondents questioned whether this was an issue within our scope, especially taking account of the ongoing enquiry into discrimination in the financial services sector by the Equality and Human Rights Commission (EHRC).

2.22 One respondent commented that deferral, forfeiture and clawback were likely to increase rather than diminish the likelihood of 'Equal Pay' claims if (during the deferral period) clawback or forfeiture arose when an employee was absent from work due to, for example, maternity or adoption leave or long-term sickness.

2.23 Another respondent doubted there was any need for SYSC 19.2.2G(2) (as published in CP10/19), given that employment legislation already requires firms to take account of statutory requirements on discrimination and equal pay. The respondent added that employees are already entitled to highlight such treatment before the Employment Tribunal and the EHRC. It was suggested that SYSC 19.2.2G(2) could in fact provide an additional avenue of redress, which would involve us in disputes for which there was already an appropriate and legally binding arbiter.

Our response: We have conducted an Equality Impact Assessment (EIA) as part of our review, which is available on request.

As part of this EIA, we are considering the following steps:

- monitoring whether the new provisions of the Code, introduced as a result of CRD3, have an undue impact on particular groups;
- asking questions relating to firms' compliance with their equality obligations as part of our discussions with firms; and
- requesting relevant data from firms on this subject, most likely through thematic work.

We intend to retain the guidance (in SYSC 19A.2.2G(2) of the final Handbook text) referring to firms' statutory duties regarding equal pay and non-discrimination in relation to the Code's general requirement. It is not the case, however, that this would provide a right of complaint to the FSA in individual cases.

Remuneration Principles 1-11

2.24 Question 4 covered the majority of the Principles within the revised Code. Many of the Principles are the same or similar to those in the current Code, (although they are now rules rather than evidential provisions). CRD3 also introduced a number of new Principles to the Code – for example, discretionary severance pay, linking remuneration to a firm's capital base and discretionary pension payments. Please refer to the list of Code Principles in Annex 2.

2.25 We asked:

> Q4: Do you agree with our proposals for changes to the Remuneration Principles 1-11?

2.26 Principles 1-3 – Most respondents supported these Principles, while saying that they felt their own procedures already met these requirements adequately, or that our proposals did not fit the specific characteristics of their sector.

2.27 Principle 4 – There were more concerns regarding the governance Principle. Respondents questioned the proposal for the Remuneration Committee to be made up entirely of Non-Executive Directors (NEDs), particularly as some subsidiaries of overseas firms, and some privately owned firms, have few or no NEDs. Respondents also sought clarification about how proportionality would be applied in relation to this Principle.

2.28 Principle 5 – A number of respondents disagreed with the proposal that Risk and Compliance Staff should be involved in individual compensation decisions. They felt that this was the responsibility of Senior Management with input from Human Resources (HR). Some also felt that by providing for Risk and Compliance Staff to contribute to business decisions of the Business Units they oversee, the Code would compromise their independence.

2.29 Principle 6 – There were relatively few specific responses on this Principle, with no common themes.

2.30 Principle 7 – There were only three responses on this Principle. One respondent commented that the guidance relating to directors who have joined the organisation after the event was useful. Another pointed out that the rules should not restrict the firm's ability to maintain long-term competitiveness.

2.31 Principle 8 – Many respondents commented that Principle 8 should be applied in a proportionate manner and not as a 'one size fits all' requirement. It was generally felt that it did not give enough flexibility between different types of firm and business model.

2.32 On the proposed guidance for long-term incentive plans (LTIPs), several respondents commented that it was unusual for LTIPs to vest over a period of longer than three years and that the majority of firms would have to make changes to current remuneration structures.

2.33 Principle 9 – Most respondents agreed with the principle of aligning pension policies with the firm's business strategy, objectives, values and long-term interests. Many sought clarity on the definition of discretionary pension benefits, in particular seeking confirmation that this was only intended to cover discretionary pension payments that emanated from a bonus payment (for example, if an employee wanted to waive some of their bonus into a pension scheme).

2.34 On the proposed retention period for discretionary pensions, some respondents suggested that the five-year holding obligation be waived in exceptional cases of early retirement for disability, or where the enhanced pension benefit covered a death or

disability risk. One firm commented that it was extremely important to distinguish arrangements that should be caught under this requirement from genuine waivers into pensions and similar approaches to appropriate retirement saving.

2.35 Principle 10 – Most respondents sought clarity on how we would expect firms to ensure compliance with this rule. Some firms suggested that it would be difficult to implement a robust system of monitoring compliance in practice. One respondent suggested that one way of complying with this rule would be for a firm to introduce a policy prohibiting the use of such hedging strategies or insurance contracts, and taking disciplinary action where appropriate if a breach of such policy were identified. One credit institution suggested that a simple annual declaration from all Code Staff should be required by the rules of variable reward schemes.

2.36 Principle 11 – Most respondents supported this principle. One trade association requested further guidance. Their rationale was that many firms use a range of payment structures and employment vehicles that might be deemed in breach of this Principle, but that were not intended to avoid the Code and did not result in increased risk for the firm. In so far as the use of these vehicles was established market practice and the firms concerned were non-systemic, the respondent believed that we should exercise caution when evaluating these vehicles and provide clear guidance to firms to avoid unnecessary expense for smaller market participants.

Our response: We have not made any changes to the draft rules for these Principles, as there was broad agreement among respondents and the Principles are aligned with the CEBS guidelines.

Remuneration Committees (Principle 4) – In response to the membership of Remuneration Committees (RemCos), the handbook text now states that the chairman and members of the RemCo must not perform any executive function of the firm.

We have given guidance in Appendix 2 on proportionality and RemCos (both generally, and in respect of our expectations for foreign firms).

Our requirements make it clear that firms need to include measures to avoid conflicts of interest in their remuneration policies. An example of a conflict that might arise is where incentives are put in place to encourage the promotion of one product over another, against the best interests of the firm's clients. Our approach complements work that is already underway to scrutinise reward structures for in-house sales staff, which involves assessing whether sales incentives increase the risk of mis-selling and whether any such risks are adequately controlled.

Government intervention (Principle 7) – These rules will only apply to firms that receive a capital injection or a specific government guarantee (including an asset guarantee). We do not expect this Principle to cover firms in receipt of the Credit Guarantee Scheme (CGS).

We intend the restrictions to apply from the date at which a firm's Board formally asks for government capital or a government guarantee, or from the date of other specific bespoke intervention.

In principle, if any of the senior personnel in office at the time of the intervention remain on the Board, it is intended that the restrictions apply until the firm has exited from intervention. However, in practice, there may be circumstances for us to exclude those directors from these rules where the firm returns to profit.

Pensions (Principle 9) – We do not expect firms to breach the scheme rules/laws of other jurisdictions.

CRD3 describes discretionary pension benefits as enhanced pension benefits, granted on a discretionary basis by a firm to an employee as part of their variable remuneration package, which do not include accrued benefits granted to them under the terms of the company pension scheme.

An example of a discretionary pension benefit could be: an employer-financed retirement benefit scheme, where the benefits or contributions are defined at the discretion of the firm by reference to the individual employee's performance.

It should be noted that there may be other examples of discretionary pension benefits and if firms have any further queries, they should contact their supervisor.

Avoidance (Principle 11) – The CEBS guidelines state that firms should ensure variable remuneration is not paid through vehicles or methods that aim to avoid the requirements of CRD3.

As set out in CP10/19, we do not expect firms to offer non-recourse loans to staff or to set up other structures through which to pay remuneration in an attempt to avoid the rules of the Code.

Principle 12 – Remuneration structures

2.37 This was unsurprisingly the most controversial Principle and prompted the most debate, particularly from the firms within the extended scope who objected to the remuneration provisions within CRD3 and the draft CEBS guidelines.

2.38 Principle 12 is a development of the current Code's Principle 8 on remuneration structures although it applies to all applicable Code Staff in proportionality tier one firms.[9] Some of its provisions may be disapplied in relation to proportionality tier three and four firms.

2.39 We have grouped the responses to this question into the following broad categories, in line with how they are presented in the handbook text:

- guaranteed bonuses (including retention awards);
- leverage (ratio of fixed to variable remuneration);
- severance payments;
- issuance in shares;
- deferral; and
- performance adjustment.

9 Excluding those who fall under the de minimis concession.

2.40 We asked:

> Q5: Do you agree with our general approach to remuneration structures as set out in Principle 12?

2.41 **Guaranteed bonuses** – Many firms did not provide specific comments on guaranteed bonuses. Of those that did, several considered our proposals on guaranteed bonuses to be appropriate.

2.42 **Retention awards** – Several respondents said that limiting or not permitting retention awards for current employees would place existing employers at a disadvantage when seeking to retain key talent, in particular in situations where they wish to counter an offer of employment elsewhere. Some respondents said that the loss of such staff could place the UK at a competitive disadvantage. Some argued that retention awards should be permitted in certain circumstances. A few specific technical queries were also noted.

2.43 One trade association commented that the proposed rules on limiting guarantees would produce a 'poacher's paradise' as it would incentivise firms to focus on external hiring rather than developing and rewarding their own talent.

2.44 **Leverage** – Most respondents were supportive of the Code's proposals on leverage or had no concerns in this area. Firms were generally opposed to the setting of a mandatory ratio of 'fixed to variable' remuneration. Limited Liability Partnerships (LLPs) sought greater clarification around how a 'fixed to variable' remuneration ratio would be calculated where part-ownership was involved.

2.45 **Severance payments** – Very few respondents provided specific comments on severance payments. Several agreed that our proposals on severance payments were appropriate. Nonetheless, a few issues were raised in this area. A couple of respondents did not agree that deferring outstanding bonuses or long-term incentive plans was good practice in all cases of severance (e.g. redundancy).

2.46 **Issuance in shares** – Some mutuals and other unlisted firms raised concerns about the requirement to pay at least 50% of variable pay in the form of shares, share-linked instruments or other equivalent non-cash instruments, as such instruments did not exist in their case. Some asset management firms highlighted the fact that variable remuneration was an important tool in managing and reducing risk for asset managers as it helped them ensure that they could match base expenses against income. There was strong agreement that there should be a proportionate approach for relatively low risk asset- management firms that did not undertake proprietary trading and where fees received were not subject to claw back. Additionally, many respondents requested greater clarity about when deferral was applicable and to what part of the remuneration package it applied.

2.47 Private equity and venture capital firms felt it would be disproportionate to apply the proposed rules on deferral and share-based payments. They argued that carried interest and co-investment arrangements are not strictly remuneration. However, they are investment arrangements that feature inherent long-term deferral and risk-adjustment characteristics, as well as distribution-based only on realised cash profits, not unrealised accounting profits.

2.48 **Deferral –** Most respondents agreed in principle with our deferral proposals. But some were concerned that the deferral rules were too prescriptive regarding structure and levels of award, arguing that this would put UK firms at a potential competitive disadvantage as other jurisdictions have taken a lighter approach.

2.49 **Performance adjustment –** Many firms were supportive of performance adjustments in principle. However, a number of respondents believed that the proposals to claw back unvested bonuses in instances of poor firm performance were unjustified and introduced excessive downside risk for employees. The majority of asset managers believed that performance adjustment was unnecessary in their case since fund manager remuneration was already directly linked to the performance of their portfolio.

2.50 Several large credit institutions and CAD investment firms stated that the three instances when a firm should reduce unvested deferred variable remuneration (as set out in SYSC 19.3.49E of the draft Handbook text published in CP10/19) could create super-equivalence to CRD3 depending on the interpretation of other countries, potentially putting UK firms at a competitive disadvantage.

Our response: Our approach to proportionality, including applying the provisions on remuneration structures, is described in Chapter 3 and Appendix 2.

Guaranteed bonuses – In alignment with the CEBS guidelines, the guidance stating that we expect firms to apply the rules relating to guaranteed bonuses on a firm-wide basis has been strengthened.

Retention awards – We recognise the comments made about the limiting factor of one-year awards to new hires and the argument that, under our proposals in CP10/19, firms would not be able to match such awards offered to their staff by competitors. SYSC 19A.3.43G states that retention awards may be granted in exceptional circumstances, such as a corporate restructuring and where a strong case can be made for retention of particular key staff members on prudential grounds. Proposals to give retention awards should form part of any notice of the restructuring proposals required in accordance with Principle 11 and the general notification requirements in SUP 15.3.

Leverage – We will align with the CEBS guidelines on leverage. Firms should set out in their remuneration policy a maximum ratio(s) on the variable component in relation to the fixed component. This could vary between and within firms, depending on the role(s) of staff concerned.

Severance payments – We have not made any changes to the draft Handbook text. In response to the comment received, the Code does not intend to prohibit severance payments. The aim is to ensure that they do not reward failure.

Allocating the shares/share-linked component between deferred and undeferred components of the bonus – In CP10/19 we proposed that the requirement that at least 50% of variable remuneration consists of an appropriate balance of shares or other instruments should apply to variable remuneration as a whole, allowing firms to decide whether shares should form part of the non-deferred element, the deferred element, or a mixture of both. The CEBS guidelines have, however, specified that the 50% requirement should be applied equally to the deferred and the undeferred elements. We have provided guidance to this effect in the Handbook text.

Listed firms in proportionality tiers one and two will be expected to meet this requirement. Unlisted firms in these proportionality tiers will be expected to provide alternative instruments, and they will be able to rely on the transitional guidance giving them until 1 July 2011 (at the latest) to prepare appropriate instruments ahead of the 2011/12 remuneration round. We will continue to discuss possible alternatives with the relevant firms and trade associations in the early months of 2011 and if necessary, provide further guidance on the use of these instruments in the remuneration context.

The proportionality principle means that firms in proportionality tiers three and four will not normally be required to apply this rule to their Code Staff.

Firms which do not have shares, or those who would not be in a position to issue shares, can apply the relevant transitional provision set out in the handbook text.

Retention period – CRD3 states that variable remuneration issued in shares or other instruments should also be subject to an appropriate retention policy designed to align incentives with the longer-term interests of the firm. The CEBS guidelines do not specify a minimum retention period. However, CRD3 provides that the minimum retention period should be sufficient to align incentives with the longer term interests of the institution.

Firms and employees should make their own arrangements to deal with the tax liability that will arise when shares that are still subject to a retention policy vest.

Deferral – we clarify that, as stated in SYSC 19.3.46R(5) (of the draft Handbook text published in CP10/19), the 60% requirement relates to Code Staff with variable remuneration greater than £500,000. We have therefore not changed the draft Handbook text in this regard in our final rule.

In response to the queries on the 60% deferral requirement for directors of significant firms, we would expect 'significant firms' to include those in proportionality tier one, subject to the de minimis concession. We would not expect the reference to 'directors' to include non-executive directors, and have clarified this in the final Handbook text.

We will give particular emphasis to the guidance in SYSC 19A.2.3G(3) that firms should apply the principles relating to deferral and performance adjustment on a firm-wide basis. Deferral policies can take account of the 'De minimis' concession. They should generally rise with the leverage ratio, and with the total amount of variable remuneration being awarded.

Performance adjustment – We have not made any changes to the draft Handbook text.

Approach to proportionality

2.51 The questions on proportionality generated a high number of responses, particularly from asset management firms and their trade associations. We will outline our approach separately in Chapter 3 and Appendix 2.

2.52 We asked:

> Q6: Do you agree with our proposals, as set out in Annex 5, for applying proportionality at the rules level?

2.53 Several firms agreed with the proposed approach – however, a large number requested that we provide further guidance or Handbook text that specifically recognised the difference in business models, risks and remuneration practices

between banks and the majority of investment firms; and provided a clear path or gate system to help firms understand which rules they would be required to apply.

2.54 Several trade associations requested the disapplication of all rules that were super-equivalent to CRD3 for investment firms and suggested that we waited for the CEBS Guidelines to be published before issuing rules or guidance on proportionality. Furthermore, some firms requested the opportunity for further consultation on proportionality before the final rules are made.

2.55 A number of the large banks' responses highlighted the competitive implications of allowing their competitors to apply the Code in a more proportionate manner. Conversely, some investment firms stated that making them apply the full Code would disadvantage them in relation to their non-CRD3 or international peers.

Our response: We recognise the importance of this issue for the large and diverse range of firms within the scope of the revised Code, and have carefully considered firms' suggestions and concerns about proportionality. We have also taken into account the CEBS guidelines. These recognise the importance of proportionality and have given clear guidance that some rules may be 'neutralised' for some firms. These include some of the more prescriptive elements of our Principle 12 remuneration structure rules (i.e. deferral and allocation into shares) and the specific requirement to have a RemCo (Principle 4).

We have devised a high-level, four-tier framework seeking to help firms understand our expectations.

Proportionality tiers one and two are intended to include larger banks and building societies and broker dealers that engage in significant proprietary trading/investment banking activities. Proportionality tier three will consist primarily of small banks and building societies, and firms that may occasionally take over-night/short-term risk with their balance sheet. Proportionality tier four will contain firms that generate income from agency business without putting their balance sheets at risk.

General guidance is given on this approach in Appendix 2. The proportionality tiers are intended to help firms apply the Code in a proportionate manner that is consistent with the CEBS Guidelines. As such, the proportionality tiers provide an indication of which of the Code's principles certain firms may be generally be allowed to disapply.

Q7: Which metrics and thresholds do you believe are appropriate to determine how different firms can apply the specific rules of proportionality? (Please refer to Annex 5)

2.56 The most popular suggestions are listed below:

- **Systemic importance** – Many respondents suggested that the Code should primarily be used to address remuneration practices at firms with systemic importance (as was intended by CRD3) and therefore non-systemic firms, like asset managers, should be allowed more scope to apply the Code proportionately.
- **Business model** – Several respondents requested that proportionality should be applied in a way that distinguished between the risks inherent in the business

models of banks and principal traders – who take risk on to their balance sheets – and agency brokers who focus primarily on flow business.

- **Legal status –** The difficulties for partnerships (including LLPs), private companies and mutuals in issuing shares were frequently cited as a reason for allowing firms with these legal structures to disapply the Principle 12 rule on share-based awards. Respondents also highlighted the adverse tax implications for partners if deferral schemes were required.
- **BIPRU categorisation –** Several respondents suggested that BIPRU limited licence and limited activity firms should be allowed greater scope to apply the Code proportionately than full scope BIPRU firms.
- **FSA permissions –** A number of respondents suggested that firms with permission to (i) deal in investments as principal; (ii) take customers deposits; and/or (iii) hold client money should require a fuller application of the Code.
- **Firm size –** Several respondents suggested metrics like capital resources; net assets; liabilities; funds under management; and employee numbers may be appropriate to determine thresholds for applying certain rules. Conversely, a number of respondents explained why they felt it inappropriate to use prescriptive and/or arbitrary thresholds and recommended a more tailored approach determined by firms' supervisors.

2.57 Some respondents suggested that a matrix containing several metrics was more appropriate for assessing firms' nature, scale, scope, internal organisation and complexity than relying on one or two key metrics. It was also suggested that the concept of proportionality should be applicable within group structures. The following metrics were also suggested: capital adequacy; FSA enforcement history; geographic coverage; operation of remuneration structures like co-investment (particularly if combined with a high water mark) and carried interest; diversification; the length of risk exposure; and independence.

Our response: When devising the metrics and thresholds for the proportionality tiers, we took into account the need to focus systemic importance and the risk posed by different business model types. The key metrics and thresholds we have reflected and/or applied are:

- Business model type – i.e. investment banks and credit institutions compared to investment firms.
- BIPRU Firm status – i.e. whether the firm is a bank, building society, full-scope BIPRU investment firm or limited licence or limited activity investment firm.
- For banks, building societies and BIPRU €730k firms that are full scope BIPRU investment firms, specific quantitative thresholds based on the capital resources (or in the case of third country BIPRU firms, total assets).

Risk adjustment

2.58 This is included in the current Code and this has been a key area of focus for the firms currently within scope of the Code.

2.59 We asked:

> Q8: Do you agree with our proposed approach to risk adjustment?

2.60 We received a good level of response from banks, asset managers and trade associations.

2.61 **Flexibility** – There was overwhelming support for our proposal to maintain a flexible approach to risk adjustment and to refrain from being too prescriptive. Many respondents pointed out that there was no single recognised methodology or 'best practice' in this area, and they felt that a firm should be allowed to tailor its risk adjustment framework to its particular needs, taking account of the scale and complexity of its business. Respondents also pointed out that the firm's culture should be taken into account, as it could go some way to addressing excessive risk taking. Several respondents emphasised the need to avoid a 'one size fits all' approach, pointing out that the concept of risk adjustment would be different for asset managers and partnerships (more details in the comments below).

2.62 **Practical implementation** – Several respondents commented that, in practice, it would be difficult to define exactly how risk adjustment should be implemented. The respondents recognised that risk adjustment could be a highly subjective process involving considerable assumptions regarding the nature of risk in each firm. The quantitative aspect in particular could be difficult to address. One respondent pointed out that the process of determining the bonus pool 'is rarely entirely formulaic or based on a single metric' but involves 'a more holistic view of company performance.' Another respondent pointed out that as there was no defined approach, there would be considerable scope for inconsistency.

2.63 **Application of the rules to non-banks** – A number of respondents questioned how this principle would apply to asset managers and firms that are structured as partnerships. Regarding fund managers, one respondent noted that the fund manager/fund relationship is an agency relationship, and the risk that portfolio managers can take is set by the fund's mandate and not the fund manager. The respondent argued that therefore it would not be proportional to apply this aspect of the Code to asset-management firms. Regarding partnerships, one respondent remarked that it was not clear how profits could be adjusted for risk before they were credited to partners. As the partners were also the owners, transferring risk to Code Staff employees would in fact transfer risk away from the partners.

Our response: Our expectations, as set out in SYSC 19.3.22 to 19.3.28 of the draft Handbook text (as published in CP10/19), are not significantly changed from the expectations in the final Handbook text.

They set out the requirement for firms to ensure that any measurement of performance used to calculate a pool, or pools, of variable remuneration should include adjustments for all types of current and potential risks and take into account the cost and quantity of the capital employed and the liquidity required.

Part of the purpose of this is to meet the explicit requirements of CRD3 that firms should take account of the cost of capital in the calculation of their compensation pools, and ensure that adequate risk-adjusted returns are explicitly allocated to their shareholders before distribution of variable compensation.

We will apply a proportionate approach to risk adjustment requirements in CRD3, with our highest expectations concentrated on firms within proportionality.

Transitional arrangements

2.64 We are required to implement CRD3 by 1 January 2011, and CRD3 does not contain transitional provisions. It contains provisions that require it to be applied, in certain circumstances, to contracts concluded before 1 January 2011 and in relation to services provided in 2010 (for the detail, see SYSC 19A.1.3R to 19A.1.5R). We have, while having regard to proportionality, decided to retain the transitional guidance given in the draft Handbook text published in CP10/19

2.65 We asked:

> Q9: Do you agree with our proposed transitional arrangements for implementation of the amended Code?

2.66 Relatively few respondents answered this question. Of those that did, the overwhelming majority thought that the transitional arrangements did not allow sufficient time for firms to implement the Code, particularly given the timetable for the publication of the final rules and CEBS guidance. Some respondents suggested that regulators should adopt a consistent approach and that the UK should not adopt a rules-based approach ahead of other regulators potentially putting the UK at a competitive disadvantage.

2.67 Some respondents suggested that transitional arrangements should be extended for a period of 12-18 months. Others suggested that implementation should be aligned with the implementation of Solvency II and AIFMD, which would allow time to amend existing schemes. Others suggested that implementation should coincide with a firm's financial year-end.

2.68 Some respondents also raised concerns about the impact of the rules on employment contracts, where CP10/19 indicates that firms should renegotiate contracts that will not comply. Respondents thought this would be difficult to do and could create potential for legal challenge.

Our response: For firms that are not subject to the current Code which came into effect on 1 January 2010, we are keeping the transitional guidance proposed in CP10/19 relating to remuneration structures. Such firms will need to comply with requirements on remuneration structures (Principle 12) as soon as reasonably possible and in any event by 1 July 2011 – providing time for firms that reasonably need it to prepare for the new requirements ahead of the 2011/12 remuneration round.

We also intend to keep the transitional guidance relating to the requirement to pay 50% of variable remuneration into shares or other non-cash instruments. This will give relevant firms time to consider alternative instruments, and we will engage with both the firms and the relevant trade associations during this time.

3 Further explanation of our policy

3.1 This Chapter provides additional detail on how we will apply the revised Code to individuals, firms and groups. It also gives more explanation on other policy issues and further detail on our approach to proportionality.

Applying the Code to individuals – Code Staff

3.2 We received a number of queries regarding the minimum time period required to qualify as a Code Staff. 19.3.6G(1)(e) in CP10/19 stated that someone who is Code Staff for any part of the year should be considered Code Staff at the year-end. The following paragraphs now provide clarification in this area.

3.3 The general position is that a person who has been Code Staff for any part of the year will be treated as Code Staff, and should, in particular, be entered in the firm's record of Code Staff. However, for those persons who have only been Code Staff for part of the year, we consider that having regard to proportionality, some provisions relating to remuneration structures should either be disapplied or applied to only a proportion of variable remuneration. The approach depends on the length of time that the individual was a Code Staff in relation to the performance year in question.

3.4 For example, if an employee has been a Code Staff for no more than three months, they would not be expected to apply the rules on deferral, issuance in shares and performance adjustment in relation to variable remuneration for that year (unless a special sign-on or retention award had been paid, in which case the employee is to be treated in the same way as someone who had been Code Staff for more than three months). Whether or not the restrictions on guaranteed variable remuneration apply depends on whether or not the part-year Code Staff are treated as 'de minimis' (as modified to apply to the case of part-year Code Staff).

3.5 If an employee has been Code Staff for more than three months of the performance year, then a two-stage process applies. The first stage is to work out whether the employee is treated as de minimis (as modified to apply to the case of part-year Code Staff). Where an employee is not de minimis, the restrictions on guaranteed variable remuneration apply. The rules on deferral, issuance in shares and performance also apply to such an employee, but only for a proportion of the employee's variable

remuneration for that year.[10] The detailed guidance on this approach is set out in the general guidance in Appendix 2.

3.6 As a general requirement, firms should identify all persons who were Code Staff for any part of the year, stating how long they were Code Staff.

3.7 If an employee is no longer employed by the firm at the end of the performance year, it is unlikely that they will receive variable remuneration for that year (and accordingly there will be nothing to apply the rules on deferral and issuance in shares to). However, firms should expect us to review whether such individuals received, for example, inappropriate discretionary severance pay on leaving the firm or interim bonus payments before their departure, to ensure that such awards comply with the Code.

Parent SIFs

3.8 For a UK-headquartered group, all SIFs, regardless of where they are based, should normally be included in a firm's list of Code Staff.

3.9 For risk takers and SIFs that are employed by a branch or subsidiary based in the UK, but where the individual is located overseas, whether they should be included as Code Staff will depend on the extent to which they are in a position to have a material impact on the risk profile of the UK entities. We will have close regard for cases of possible avoidance, i.e. where an individual may have been relocated to avoid the impact of the Code. However, we may consider cases for exemption where the individual has global responsibilities, and where the UK entities form only a part of those responsibilities.

Applying the Code proportionately

3.10 A central element of the implementation of CRD3 is extending the scope of the Code. From 1 January 2011, the population of firms subject to the Code will incorporate all banks and building societies and CAD investment firms. The Code is also applied to third-country BIPRU firms, but only in relation to activities conducted from establishments in the UK.

3.11 Regulatory authorities can apply a proportionate approach to implementing the CRD3 remuneration provisions to this diverse population of firms. The CEBS guidelines recognise that the aim of the proportionality principle is to match remuneration policies and practices with the individual risk profile, risk appetite and the strategy of the institution, so that the objective of the CRD3 principles are more effectively achieved. This proportionality principle is set out in SYSC 19A.3.3R(2):

> 'When establishing and applying the total remuneration policies for Remuneration Code Staff, a firm must comply with this section in a way

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10 Or the whole variable remuneration, in the case of a new joiner where the variable remuneration awarded only applies to the part of the year during which the new Code staff worked at the firm.

and to the extent that is appropriate to its size, internal organisation and the nature, the scope and the complexity of its activities.'

3.12 The effect of the proportionality principle is that not all firms have to give substance to the remuneration requirements in the same way and to the same extent. Proportionality operates both ways: some firms will need to apply more sophisticated policies or practices in fulfilling the requirements; other firms can meet the requirements in a simpler or less burdensome way. The CEBS guidelines give clear guidance that some rules may be 'neutralised' for some firms – see paragraph 3.23 – and that proportionality can also operate among different categories of staff – see paragraph 3.37 on 'de minimis'.

3.13 As discussed in Chapter 2, following our consultation, we have carefully considered firms' suggestions and concerns about proportionality. In response we have devised a high-level, four tier proportionality framework that firms should use as a starting point for understanding our expectations. When devising the metrics and thresholds for the tiers, we took into account the need to focus on systemic importance and the risk posed by different business model types.

3.14 Proportionality tiers one and two are intended to include larger banks and building societies; and broker dealers that engage in significant proprietary trading/investment banking activities. Proportionality tier three will consist primarily of small banks and building societies, and firms that may occasionally take over-night/short-term risk with their balance sheet. Proportionality tier four will contain firms that generate income from agency business without putting their balance sheets at risk.

3.15 While this differentiated approach is rationalised by CRD3's recognition of proportionality, we need to ensure we treat similar firms in a similar fashion. This is relevant, for example, to competition between stand-alone asset managers and those employed by banks. Therefore, we do not intend to apply this framework rigidly to all firms. There will be a degree of flexibility in how we apply the boundaries between the tiers to allow us to have regard to firms' specific risk characteristics.

3.16 This four tier framework and its operation is explained in detail in the 'General Guidance on Proportionality: The Remuneration Code (SYSC 19A) & Pillar 3 Disclosures on Remuneration (BIPRU 11)' as contained in Appendix 2. This information is general guidance (given under section 157 of FSMA). We recognise that this policy position will evolve as the CRD3 remuneration provisions are applied across the EEA and as other European Directives (i.e. AIFMD and Solvency II) come into force. As such, we intend to review the metrics and thresholds chosen to ensure their continuing relevance and to enable greater alignment within the EEA.

3.17 The proportionality tiers are intended to help firms adhere to the Code in a manner that is in line with the CEBS guidelines and that provides an element of consistency in application between firms. As such, this framework provides a means of giving: an indication of which of the Code's rules certain firms may be allowed to neutralise; clarity on our expectations for disclosure of remuneration (see PS10/21); and, to some extent, the tiers will delineate the intensity of our supervisory approach (in conjunction with our ARROW Framework).

Applying the proportionality tiers

3.18 To determine the standards a firm will be expected to adhere to, it should first establish into which tier it will fall. Firms that are not part of a group, or that are the only entity caught by the Code within a group, will fall within the tier that corresponds with that firm's individual circumstances. Firms that are part of a group containing one or more other firms that are also caught by the Code will fall into the highest proportionality tier[11] of those entities (based on those firms' solo positioning), however see paragraph 3.22.2 for further details.

3.19 The following criteria are used as the basis of the tiering framework at the individual firm/solo level.

3.19.1 **Proportionality tier one firms** – Banks and building societies with capital resources[12] exceeding £1bn; BIPRU €730k firms that are full-scope BIPRU investment firms with capital resources exceeding £750m; and all third country BIPRU firms with total assets (for the branch) exceeding £25bn.

3.19.2 **Proportionality tier two firms** – Banks and building societies with capital resources between £50m and £1bn; BIPRU €730k firms that are full-scope BIPRU investment firms with capital resources between £100m and £750m; and all third country BIPRU firms with total assets (for the branch) in excess of £2bn.

3.19.3 **Proportionality tier three firms** – Any bank, building society and full scope BIPRU investment firm that does not fall within proportionality tiers one or two; and all third country BIPRU firms that do not fall into proportionality tiers one, two or four.

3.19.4 **Proportionality tier four firms** – All limited licence and limited activity firms (including third BIPRU firms with equivalent permissions).

3.20 Please see the 'General Guidance on Proportionality (Appendix 2) for examples of how firms within groups may determine their placement within the tiers.

3.21 The main metric that differentiates between tiers one to three is based on capital resource thresholds. However, this approach cannot easily be applied to third country BIPRU firms which operate in the UK through branches. Branches do not have capital resources (unlike the whole firm, whose capital resources are unlikely to provide a true reflection of the scale of the activities conducted in the UK branch). Therefore, we are using a total assets metric (based on the total assets of the branch not the firm) to provide an indication of which tier these firms should fall into.

3.22 As stated previously, the tiers only provide, in general guidance, a starting point for firms to understand our general expectations for what constitutes adherence to the Code. Where appropriate, we are able to give individual guidance to firms. Therefore it is important to note the following:

11 Where proportionality tier one is the highest; and proportionality tier four is the lowest.

12 Where ever the term 'capital resources' is used within the criteria for the different proportionality tiers, it refers to the amount held on the firm's last accounting reference date, and bears the definition given in the Handbook Glossary.

3.22.1 There will be a degree of flexibility in how we apply the boundaries between the tiers to allow us to have regard to firms' specific risk characteristics.

3.22.2 If a firm believes that the solo firm, the group or an entity within the group should fall into a lower tier than the one determined by the general guidance on proportionality tiers, the onus is on the firm to provide a suitable rationale to its supervisors. We will then determine whether to issue individual guidance to vary the firm's tier.[13]

3.22.3 Similarly, if we determine that a firm should fall into a higher tier, individual guidance may be issued to this effect. For example, if a tier three bank is known to be aggressively expanding, we may give individual guidance that the firm should apply the Code at the tier two level of proportionality, to ensure the firm puts a greater focus on aligning remuneration with effective risk management.

Our expectations for compliance for each tier

3.23 The CEBS guidelines give clear guidance that some rules may be 'neutralised' for some firms. The guidelines also state that proportionality can operate among different categories of staff. The following tables summarise how we expect this guidance to relate to different tiers.

TIER ONE	
Tier one definition	Banks and building societies with capital resources[14] exceeding £1bn; BIPRU €730k firms that are full scope BIPRU investment firms with capital resources exceeding £750m; all third country BIPRU firms with total assets (for the branch) exceeding £25bn.
Applying the Code to firms	**All of the Code's rules** are to be applied by all tier one firms, **except** in the case listed below: • **Principle 4 – Governance – SYSC 19A.3.12R – Remuneration Committee (RemCo)** It may not always be necessary for a firm with an overseas parent to establish a RemCo solely for the UK entity. We will, however, want to ensure that the UK governing body sufficiently oversees the remuneration policies of the UK entities and has the capability to act in an independent manner.
Applying the Code to individuals	Firms can apply the 'de minimis' concession[15] for specific Code Staff whose remuneration is below certain thresholds relating to total remuneration and leverage.
Supervision	Remuneration policies and practices within in tier one firms will be subject to annual review – see Chapter 4 for further details.

13 The FSA's policy on individual guidance is set out in SUP 9, and firms should in particular note the policy on what the FSA considers to be a reasonable request for guidance.

14 Where ever the term 'capital resources' is used within the criteria for the different proportionality tiers, it refers to the amount held on the firm's last accounting reference date, and bears the definition given in the Handbook Glossary.

15 SYSC 19A.3.34 G (1) – The FSA would not generally consider it necessary for a firm to apply the rules on: guaranteed variable remuneration; retained shares or other instruments; deferral; and performance adjustment; where in relation to an individual, total remuneration is no more than £500,000 and variable remuneration is no more than 33% of total remuneration.

TIER TWO	
Tier two definition	Banks and building societies with capital resources between £50m and £1bn; BIPRU €730k firms that are full scope BIPRU investment firms with capital resources between £100m and £750m; and all third country BIPRU firms with total assets (for the branch) between £2bn and £25bn.
Applying the Code to firms	**All of the Code's rules** are to be applied by all tier two firms, **except** in the cases listed below: • **Principle 4 – Governance – SYSC 19A.3.12R – Remuneration Committee** It may not always be necessary for a firm with an overseas parent to establish a RemCo solely for the UK entity. We will, however, want to ensure that the UK governing body sufficiently oversees the remuneration policies of the UK entities and has the capability to act in an independent manner. • **Principle 12 – Remuneration structures – SYSC 19.3.47R – Retained shares and other instruments** Firms such as building societies and unlisted firms may be able to demonstrate that it is inappropriate for them to use alternative instruments to shares. Individual guidance should generally be sought.
Applying the Code to individuals	Tier two firms can apply the 'de minimis' concession for all Code Staff with qualifying remuneration structures.
Supervision	All tier two firms will be required to submit an annual data return. Remuneration policies and practices will be reviewed in line with ARROW risk assessment schedules or via thematic reviews – see Chapter 4 for further details.

TIER THREE	
Tier three definition	Any bank, building society and full scope BIPRU investment firm that does not fall within proportionality tiers one or two; and all third country BIPRU firms that are not in proportionality tiers one, two or four.
Applying the Code to firms	We generally consider that the following Code rules may be **disapplied** by all firms in tier three: • **Principle 4 – Governance – SYSC 19A.3.12R – Remuneration Committee** However we consider it to be desirable, particularly for larger firms, to have a RemCo. • **Principle 12 – Remuneration structures:** ◦ **SYSC 19A.3.47R – Retained shares and other instruments** ◦ **SYSC 19A.3.49R – Deferral** However we encourage firms to consider using these deferral techniques on a firm-wide basis to ensure the alignment of their remuneration practices with effective risk management. ◦ **SYSC 19A.3.51R and SYSC 19A.3.52E – Performance adjustment** We would normally consider it appropriate for the firm to disapply the above rules, while having regard to proportionality.
Applying the Code to individuals	The 'de minimis' concession applies to tier three firms (although in view of proportionality, it may be relevant only in relation to the restrictions on guaranteed variable remuneration).
Supervision	All tier three firms will be required to submit an annual data return. Remuneration policies and practices will be reviewed in line with ARROW risk-assessment schedules or via thematic reviews – see Chapter 4 for further details.

<table>
<tr><th colspan="2">TIER FOUR</th></tr>
<tr><td>Tier four definition</td><td>All limited licence and limited activity firms (including third country BIPRU firms with such permissions).</td></tr>
<tr><td>Applying the Code to firms</td><td>We generally consider that the following Code rules may be <u>disapplied</u> by all firms in tier four:
• Principle 4 – Governance – SYSC 19A.3.12R – Remuneration Committee
However we consider it to be desirable, particularly for larger firms, to have a RemCo.
• Principle 12 – Remuneration structures:
◦ SYSC 19A.3.44R - Leverage
We would normally consider it appropriate for limited licence and limited activity firms to disapply this rule, as anticipated in the CEBS guidelines.
◦ SYSC 19A.3.47R - Retained shares and other instruments
◦ SYSC 19A.3.49R – Deferral
However we encourage firms to consider using these deferral techniques on a firm-wide basis to ensure the alignment of their remuneration practices with effective risk management.
◦ SYSC 19A.3.51R and SYSC 19A.3.52E – Performance adjustment

We would normally consider it appropriate for the firm to disapply the above rules, while having regard to proportionality.

Tier four firms will also be able to take into account the specific features of their types of activities when adhering the following requirements:
• Principle 8 – Profit-based measurement and risk adjustment
• Principle 12 – Remuneration structures – SYSC 19A.3.38R – Multi-year framework</td></tr>
<tr><td>Applying the Code to individuals</td><td>The ‘de minimis’ concession applies to tier four firms (although in view of proportionality, may be relevant only in relation to the restrictions on guaranteed variable remuneration).</td></tr>
<tr><td>Supervision</td><td>All tier four firms will be required to submit an annual data return – see Chapter 4 for further details.</td></tr>
</table>

3.24 Where numerical criteria have been set within specific rules – for example, SYSC 19A.3.49R requires deferral of a minimum of 40% or 60% of variable remuneration for Code Staff – there is <u>no scope</u> to use the proportionality principle to lower the specified levels.

Firms to consider proportionality in their individual circumstances

3.25 It is primarily the responsibility of the firm to assess its own characteristics and to develop and implement remuneration policies and practices which appropriately align with the risks faced and provide adequate and effective incentives to its staff. Therefore, we are not expecting all firms to adhere to the remuneration requirements in the same way and to the same extent, i.e. there is no ‘one-size fits all’ approach. For this reason, the proportionality tiers only provide a starting point, rather than comprehensive guidance on how individual firms can adhere to the Code.

3.26 There are some principles within the Code that require firms to review the wording and associated implementation of remuneration policies to ensure they in line with effective risk management – for example, Principles 1, 2 and 3. It is our view that

most firms should already be able to identify ways in which their current policies meet these requirements and we believe that addressing any identified shortfalls should not prove to be particularly onerous.

3.27 We recognise that some principles will be more relevant to certain firms – for example, Principle 7 will only be relevant to firms that have received exceptional government intervention.

3.28 For other principles, regardless of the four tier framework, our expectations of what constitutes compliance will take into account firms' size, internal organisation and the nature, scale and complexity of their activities. Therefore, within tiers there will be some firms that will be expected to apply more sophisticated policies or practices to fulfil the requirements, while others can meet the requirements in a simpler or less burdensome way.

3.29 This is explained further in the example provided in Part D of the 'General Guidance on Proportionality: The Remuneration Code (SYSC 19A) & Pillar 3 Disclosures on Remuneration (BIPRU 11)' which highlights our expectations for complex investment banks to apply more sophisticated risk adjustment techniques (Principle 8) when compared to a mortgage and savings bank or a building society.

3.30 Another example is SYSC 19A.3.14R, which requires that firms: 'ensure that employees engaged in control functions (1) are independent from the business units they oversee; (2) have appropriate authority; and (3) are remunerated: (a) adequately to attract qualified and experienced staff; and (b) in accordance with the achievement of the objectives linked to their functions, independent of the performance of the business areas they control'. Our expectations of what constitutes compliance with this rule will be different for large, complex firms compared to smaller, less sophisticated firms.

3.31 In general, we do not expect tier four firms to find compliance with the Code to be particularly onerous. However, there may be some areas of the Code, for example Principle 3 (i.e. conflicts of interest) where we will conduct further work to consider what is appropriate for different sectors, particularly asset management.

Further guidance

3.32 We intend to work with various trade associations in 2011 to consider whether further guidance would help firms in different sectors understand our expectations for compliance for each of the Code's principles.

Applying the Code to non-EEA branches

3.33 Third country BIPRU firms which conduct activities from UK establishments (third country branches) fall within the scope of the Code. As explained in the previous section, our general approach to proportionality will use firms' capital resources as the main basis for dividing them into proportionality tiers. Given that branches do not have their own capital, another basis for that division is needed in the case of third

country branches. Having considered several options, we plan to use a branch's total assets as the measure. For the first year, branches will be asked to identify which tier they fall into by calculating their total assets, where appropriate using the method already followed for the completion of FSA044. We will consider a revised approach during 2011, given that FSA044 is being discontinued at the end of 2010.

3.34 All branches that are limited licence firms or limited activity firms will fall within tier four on a solo basis. For other branches, those with total assets exceeding £25bn will fall into tier one, those with total assets less than £25bn and exceeding £2bn in tier two, and those with assets of £2bn or less in tier three. For branches that are part of wider groups, the process for applying the proportionality framework to groups is explained in paragraph 3.18.

Other policy issues

Definition of remuneration

3.35 The CEBS guidelines consider remuneration to include fixed or variable remuneration, in the form of monetary payments or benefits (including carried interest).

3.36 We would expect variable remuneration to include commission – however, we would not expect this to apply to large numbers of Code Staff.

Remuneration structures

De minimis

3.37 This provision applies to the application of the rules on Remuneration structures.

3.38 For the avoidance of doubt, the guidance (now moved to Principle 12) requires that **both** conditions have to be met for 'de minimis' to apply. Further guidance is given on how 'de minimis' applies to part-year Code Staff, as noted above, in Appendix 2.

Issuance in shares

3.39 We recognise that a number of firms within the scope of the Code will not be in a position to issue shares, either because they are not listed or there is no market price available.

3.40 In these cases, alternative instruments which reflect the firm's value and have the same intended effect as share-based instruments may be used.

3.41 As stated in Chapter 2, we will continue to discuss possible alternatives to share-linked instruments with the relevant firms and trade associations in the early months of 2011 and, if necessary, provide further guidance on the use of these instruments in the remuneration context.

Alternative capital instruments

3.42 We recognise that awarding deferred variable remuneration in the form of shares (or instruments that are directly linked to share prices), does not always provide an effective link between the structure of a remuneration award and risk adjustment. Firstly, deferred shares can, in certain circumstances, provide an incentive to increase risk taking to boost the share price. Secondly, an award in deferred shares provides only an imperfect link between an individual's risk behaviour and the long term performance of the firm as a whole, especially for middle-ranking staff within larger institutions.

3.43 CRD3 asks CEBS to specify alternative capital instruments that adequately reflect the credit quality of credit institutions for use in deferred variable remuneration. Guidelines regarding hybrid capital instrument published by CEBS in 2009 are relevant to this work, but further work is needed to provide clear guidance on how such instruments could be used in the remuneration context. We will encourage the CEBS working group on remuneration should undertake further work on this subject.

3.44 We will also monitor regulatory and market developments regarding alternative instruments. If needed, we will also provide further guidance on the use of these instruments in the remuneration context.

Voiding provisions

3.45 In CP10/19, we proposed to apply voiding provisions only to a limited number of rules (prohibiting certain forms of remuneration, namely the restrictions relating to guaranteed variable remuneration, deferral and replacing payments recovered or property transferred under void agreements). We are maintaining our approach in this respect. However, we do intend to limit the range of firms to which the voiding provisions apply. For 2011 we are including a transitional provision, such that voiding under the new Code will only apply to firms which were within the scope of the current 2010 Code. During 2011 we intend to bring forward a new limiting provision on voiding, such that voiding will only apply to firms broadly equivalent to proportionality tier one.

3.46 We have given guidance on the proportionate application of certain rules to part-year Code Staff (in Appendix 2). On voiding, the basic de minimis provision applies (in SYSC 19A.3.54R(3)). Although the additional guidance on part-year Code Staff may mean that the de minimis rule will operate more generously in the context of voiding and part-year Code Staff, we think a clear limit in relation to voiding is preferable.

CEBS guidelines on remuneration policies and practices

3.47 The final CEBS guidelines on remuneration policies and practices were published on 10 December 2010. We have made a number of changes to the Code to reflect the guidance provided by CEBS. We strongly recommend that firms read the guidelines and take it into account.

4 Implementing the Code

Introduction

This chapter provides more information about how we expect firms to adhere to the revised Code. We set out the timing and transitional issues and what action we will expect firms to have undertaken by 1 January 2011 for each of the Principles. Finally, we outline the supervisory approach we shall be taking for firms in the scope of the Code.

What we will expect by the implementation date

4.1 We recognise that the timeframes for implementing CRD3 have been and remain extremely short, in view of the fact that the text of the Directive was only agreed in early July 2010 and necessitated local consultation before implementation.

Firms subject to the current Code

4.2 We have already explained to the firms that are already subject to the current Code, that we expect full compliance with the revised Code from the implementation date. A substantial majority of the revised Code's rules are the same or very similar to the rules and provisions in the current Code, and we have already held discussions with most of these firms during the fourth quarter of 2010.

4.3 We have put in place transitional guidance to allow firms within the scope of the present Code up to six months, where necessary, to comply with the requirement to pay at least 50% of variable remuneration in shares or other instruments.

Firms coming into scope

4.4 For firms that are coming into scope for the first time, we have also put in place transitional guidance, which will allow additional time where necessary to prepare for implementing the rules relating to remuneration structures (Principle 12).

4.5 Our approach to proportionality, set out in Chapter 3 and Appendix 2, will result in different expectations for compliance depending on a firm's position in the proportionality structure.

4.6 Our approach to the rules and guidance within the Principles of the revised Code will be as follows:

- Principles 1 to 6, 9,10 and 11 – We will expect all firms to be broadly compliant with these rules from 1 January 2011. Any shortfalls should be identified and a time specific plan prepared to rectify them should be in place by the end of January.
- Principle 7 – This will apply only to firms in receipt of government assistance, as set out in Chapter 2.
- Principle 8 – We will expect firms in proportionality tier one to be ready to apply risk-adjustment techniques to bonus pools with effect from 1 January. Other firms will need to be able to demonstrate, in line with our approach to proportionality, that they have considered the impact of future risks and uncertainties on their bonus pools, and ensure that these are taken into account when determining future bonus pools. This will be reviewed as part of our ongoing supervisory programmes.
- Principle 12 – Firms coming into scope for the first time need to have made the changes to remuneration structures necessary to comply with these rules by 1 July 2011 at the latest, in accordance with the transitional guidance set out in SYSC TP3 of the Handbook.

Supervisory approach

4.7 We set out some ideas for our supervisory approach in paragraphs 4.12 to 4.16 of CP10/19. The approach that we have decided to follow differs slightly but not fundamentally from that set out in the CP.

4.8 As set out in CP10/19, our starting point for all firms in scope will be a requirement to submit an annual data return that sets out aggregate data on their remuneration policies and practices, and also a certification that the firm's remuneration policies are compliant with the Code. We will use the data to review whether the firm's policies and practices warrant further investigation, either as part of a supervisory programme or by including the firm in a thematic review. We will also use the data to enable us to submit aggregate data which we will be required in due course to supply to the European Banking Authority (EBA), the successor body to the Committee of European Banking Supervisors (CEBS).

4.9 It is likely that we will ask firms to supply this data return during the second half of 2011. The data will be based on 2010/11 remuneration awards, where relevant.

4.10 At the same time, all firms will be expected to prepare a Remuneration Policy Statement (RPS), which records the firm's self-assessment of compliance with the Code. The RPS should be reviewed and approved by the firm's Remuneration Committee, or equivalent body with responsibility for remuneration policies. It should be revised annually to take account of any changes in policies, practices or procedures, and the changes should be approved by the Remuneration Committee or the equivalent body.

4.11 A proportionate approach will be taken, both to the content of the RPS and to our review of it. Proportionality tier one firms will be asked to complete a more detailed RPS, and to submit it to us at an appropriate time ahead of their year-end. Firms in proportionality tiers two, three and four will be asked to prepare a less detailed RPS, on the basis of a questionnaire/template. We will expect the Remuneration Committee or the equivalent body to have reviewed and approved it. Firms should keep the document up-to-date, and we may request a copy at any time. It is likely to be requested, for example, as part of the documentation ahead of an ARROW assessment, or as part of a thematic review. Firms may also need to use it to complete an ICAAP.

Further consultation and dialogue with firms and other regulators

4.12 We are arranging presentations on the revised Code in mid-January. Further details on these presentations will be provided in due course.

4.13 As mentioned in Chapter 3, we will be willing to engage in further discussions with trade associations representing firms in proportionality tiers three and four about applying proportionality. If the industry wishes, we will cooperate with the associations to produce industry guidance.

4.14 We will also engage with the relevant trade associations in discussions on appropriate alternatives to shares, to meet the requirements of SYSC 19A.3.47R. This issue is relevant for firms that do not have shares, or whose shares are unlisted, taking account of the proportionality provisions, and of the relevant transitional provisions.

4.15 We will continue to engage closely with our EU colleagues, both bilaterally and via CEBS/EBA, to ensure a consistent application of the Directive to the extent possible. CEBS has planned to carry out an implementation study towards the end of 2011 to assess convergent application of the CRD3 and CEBS guidelines provisions on remuneration across the EU.

4.16 Beyond the EU, we will continue to liaise closely with other G20 regulatory authorities. As noted in Chapter 1, an FSB working group will be reviewing the implementation of the FSB standards, by regulatory authorities and by major firms, during the first half of 2011.

List of respondents to CP10/19

Aberforth Partners

Addleshaw Goddard LLP

Adelante Asset Management Limited

Aegon Asset Management Uk

Affiliated Managers Group

Albion Ventures LLP

Alternative Investment Management Association

Artemis Investment Management LLP

Association of British Insurers

Association of Finacial Markets in Europe

Association of Financial Mutuals

Association of Foreign Banks

Association of Independent Financial Advisers

Association of Private Client Investment Managers and Stockbrokers

Aviva plc

Axa Investment Managers

Bache Commodities Limited

Baille Gifford

Bank of New York Mellon

Barclays plc

BDO LLP

Berwin Leighton Paisner

BlackRock Group Limited

BlueCrest Capital Management (UK) LLP

Brewin Dolphin Limited

British Bankers' Association

British Private Equity & Venture Capital Association

Building Societies Association

C. Hoare and Co.

Canaccord Genuity Limited

Canada Life Limited

Capita group

Capital International

CFA Society of the UK

Chartered Institute for Securities & Investment

Chi-X Europe

Chris Burgoyne

City HR Association

Clifford Chance

Co-operative Financial Services

Cofunds Limited

Colchester Global Investors Limited

Collins Stewart

Complyport Limited

Coriolis Capital

Cube Capital UK Limited

Dechert LLP

Eden Financial Limited

Elliot Advisers (UK) Limited

Ernst & Young

Eversheds

Evo Investment Advisors (Europe) LLP

F&C Management Limited

Fenician

Fidelity International Holding Limited

FM Consult

Futures & Options Association

GetCo

GFI Group EME-AP

Guy Butler Limited

Habrok Capital Management LLP

Hargreave Hale

Hargreaves Lansdowne

Hermes Equity Ownership Services

Houlihan Lokey

HSBC plc

ICAP

ICI (Investment Company Institute)

ICMA Asset Management & Investors Council (AMIC)

IG Group

Ignis Asset Management Limited

ILAG (Investment & Life Assurance Group)

Indicus Advisors LLP

Invesco Perpetual

Investment Advisers Association

Investment Management Association

Investment Quotient

J Rothschild Capital Management Limited

Killik & Co

Kinetic Partners

Kirkland and Ellis LLP

Lansdowne Partners Limited

Leeds Building Society

Liverpool Victoria

Lloyds Banking Group

Local Authority Pension Fund Forum

M&G Investments

Managed Funds Association

Marex Financial

Marshall Wace LLP

MM & K Ltd

Mondrian Investment Partners Limited

Morant Wright management ltd

Nationwide Building Society

Nevsky Capital LLP

New City Initiative

Nomura Code Securities Limited

Northern Trust

Northwest Investment Management Limited

Northwood Capital LLP

Numis Securities

Occam Asset Management

Old Mutual plc

Oriel Securities

Pantheon Venures LLP

Phoenix Group

RAB Capital plc

Rees Pollock

Rensburg Sheppards

Royal Bank of Canada

Royal Bank of Scotland plc

Russell Investment

Sainsbury's Bank

Schroder Investment Management Limited

Share Plan Lawyers Group

Shell Trading

Skipton Building Society

Spectron Energy Services Limited and Spectron Commodities Limited

Standard Chartered plc

Standard Life Investments

Standard Life plc

T Rowe Price International

Talisman Asset Management

Thames River Capital LLP

Thames River Multi-Capital LLP

The Bank of Tokyo-Mitsubishi

The City of London Law Society (CLLS) Regulatory Law Committee

The Law Society

The Society of Pension Consultants

Threadneedle Asset Management

Towers Watson

Tradition

Trafalgar Capital Management (UK) LLP

Troy Asset Management

TT International

Tullett Prebon

United Trust Bank

Universities Superannuation Scheme Limited

Vanguard Investments

Vantage Capital Markets LLP

West Bromwich Building Society

Wholesale Market Brokers' Association

Yorkshire Building Society

We also received three responses where the respondents requested total confidentiality. Please note we do not intend on making public any of the responses we have received without prior approval of the author.

Annex 2

List of Remuneration Code Principles

Code Principle	**Handbook references (SYSC)**
1: Risk management and risk tolerance	19A.3.7R
2: Supporting business strategy, objectives, values and long-term interests of the firm	19A.3.8R
3: Avoiding conflicts of interest	19A.3.9R
4: Governance	19A.3.10R – 19A.3.13G
5: Control functions	19A.3.14R – 19A.3.17G
6: Remuneration and capital	19A.3.18R – 19A.3.19G
7: Exceptional government intervention	19A.3.20R – 19A.3.21G
8: Profit-based measurement and risk adjustment	19A.3.22R – 19A.3.28G
9: Pension policy	19A.3.29R
10: Personal investment strategies	19A.3.30R – 19A.3.31G
11: Avoidance of the Remuneration Code	19A.3.32R
12: Remuneration structures	19A.3.33G – 19A.3.53G
13: Effect of breach of the Remuneration Principles (voiding and recovery)	19A.3.54R – 19A.3.55G, SYSC 19A Annex 1

Glossary of terms

The Code	The FSA's Remuneration Code. The current Code was published as part of Policy Statement 09/15 in August 2009. We are now finalising amendments to that Code.
Code Staff	All staff who have a material impact on the firm's risk profile, including a person who performs a significant influence function for a firm, a senior manager (as defined below) and risk takers.
Clawback	A performance adjustment technique that allows firms to demand payback of all or part of an individual's bonus that has already vested with the individual, to take account of developments after vesting. (See also 'ex-post risk adjustment' and 'malus'.)
Deferral	Delayed payment of variable remuneration. CRD3 and the Code call for a substantial portion of bonus to be deferred and to be paid in separate portions over a number of years, rather than up-front in one lump sum.
De minimis	A concession that allows Code Staff, whose remuneration is below certain thresholds, to be excluded from rules on deferral, performance adjustment, proportion of remuneration paid in shares and guaranteed bonuses.
Ex-ante risk adjustment (risk adjustment)	When calculating annual bonus pools before pay-out, firms are expected to make adjustments to take account of the risks and costs incurred in generating income. This is known as ex-ante risk adjustment.
Ex-post risk adjustment (performance adjustment)	After bonuses have been announced and paid, firms are expected to make further adjustments to take account of subsequent risks and developments. Such adjustment will be made to the deferred unvested portion of the bonus. This is known as ex-post risk adjustment. Malus and clawback are two techniques of ex-post risk adjustment.
G20	A group of finance ministers and central bank governors from 20 economies: 19 countries plus the European Union. They are seen as the main economic council of wealthy nations.
Malus	A performance adjustment technique that allows firms to adjust the as-yet unvested portion of an individual's bonus to take account of developments after communication of the bonus. (See also 'ex-post risk adjustment' and 'clawback'.)

Senior manager	An individual employed by the firm to whom the governing body (or a member of the governing body) of the firm has given responsibility for management and supervision, and who reports directly to the governing body, a member of the governing body, the chief executive, or the head of a significant business group.
Solvency II	A fundamental review of the capital adequacy regime for the European insurance industry. It aims to establish a revised set of EU-wide capital requirements and risk management standards that will replace the current Solvency requirements.
Third country	A country that is not a member of the European Economic Area.
Vesting	The point at which an individual's remuneration (whether in cash, shares or other instruments) becomes that individual's legal property. Deferred portions of the bonus are not yet the legal property of the individual, and therefore have not vested.

Handbook text

SENIOR MANAGEMENT ARRANGEMENTS, SYSTEMS AND CONTROLS (REMUNERATION CODE) (NO 2) 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 149 (Evidential provisions);
(4) section 156 (General supplementary powers); and
(5) 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 modules of the FSA Handbook of rules and guidance listed in column (1) below are amended in accordance with the Annexes to this instrument listed in column (2).

(1)	(2)
Glossary of definitions	Annex A
Senior Management Arrangements, Systems and Controls sourcebook (SYSC)	Annex B
General Prudential sourcebook (GENPRU)	Annex C
Supervision manual (SUP)	Annex D

Notes

E. In the Annexes 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 Senior Management Arrangements, Systems and Controls (Remuneration Code) (No 2) Instrument 2010.

By order of the Board
16 December 2010

Annex A

Amendments to the Glossary of definitions

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

Insert the following new definitions in the appropriate alphabetical position. The text is not underlined.

discretionary pension benefit	(in *SYSC* 19A) enhanced pension benefits granted on a discretionary basis by a *firm* to an *employee* as part of that *employee's* variable *remuneration* package, but excluding accrued benefits granted to an *employee* under the terms of his company pension scheme. [**Note:** article 4(49) of the *Banking Consolidation Directive*]
FSB Compensation Standards	(in accordance with the definition of "the Implementation Standards" in section 139A(12) of the *Act*) the Implementation Standards for Principles for Sound Compensation Practices issued by the Financial Stability Board on 25 September 2009.
Remuneration Code staff	(for a *BIPRU firm* and a *third country BIPRU firm*) has the meaning given in *SYSC* 19A.3.4R.
remuneration principles proportionality rule	(in *SYSC* 19A) has the meaning given in *SYSC* 19A.3.3R.

Amend the following definitions as shown.

parent undertaking	(1) (in accordance with section 420 of the *Act* (Parent and subsidiary undertaking) and section 1162 of the Companies Act 2006 (Parent and subsidiary undertakings)): … (c) (for the purposes of … *SYSC* 12 (Group risk systems and controls requirement) and *SYSC* 19A (Remuneration Code) and in relation to whether an *undertaking* is a parent *undertaking*) an *undertaking* which has the following relationship to another *undertaking* ("S"): …
remuneration	any form of remuneration, including salaries, *discretionary pension benefits* and benefits of any kind. [**Note:** paragraph 23 of Annex V to the *Banking Consolidation Directive*]
Remuneration Code	*SYSC* ~~19~~ 19A (Remuneration Code).

Remuneration Code general requirement	*SYSC* ~~19.2.1R~~ 19A.2.1R.
~~*remuneration committee*~~	~~a committee or other body responsible for a *firm's remuneration policy*.~~
~~*remuneration policy*~~	~~the policy, procedures and practices established, implemented and maintained in accordance with the *Remuneration Code general requirement*.~~
~~*third country BIPRU 730k firm*~~	~~an *overseas firm* that:~~ ~~(a) is not an *EEA firm*;~~ ~~(b) has its head office outside the *EEA*; and~~ ~~(c) would be a *BIPRU 730k firm* if it had been a *UK domestic firm*, had carried on all its business in the *United Kingdom* and had obtained whatever authorisations for doing so as are required under the *Act*.~~

Annex B

Amendments to the Senior Management Arrangements, Systems and Controls sourcebook (SYSC)

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

1 Annex 1 Detailed application of SYSC

…

Part 3	Tables summarising the application of the common platform requirements to different types of firm	
3.1	G	The *common platform requirements* apply in the following two ways (subject to the provisions in Part 2 of this Annex).
3.2	G	For a *common platform firm*, they apply in accordance with Column A in the table below.
3.3	G	For all other *firms* apart from *insurers*, *managing agents* and the *Society*, they apply in accordance with Column B in the table below. For these *firms*, where a *rule* is shown modified in Column B as 'Guidance', it should be read as *guidance* (as if "should" appeared in that rule instead of "must") and should be applied in a proportionate manner, taking into account the nature, scale and complexity of the firm's business.

Provision SYSC 4	COLUMN A Application to a common platform firm	COLUMN B Application to all other firms apart from insurers, managing agents and the Society
SYSC 4.1.1R	Rule but *SYSC* 4.1.1R(2) applies only to a *BIPRU firm*	Rule but *SYSC* 4.1.1R(2) applies only to a *third country BIPRU firm*

…

1.1A.1 G The application of this sourcebook is summarised at a high level in the following table. …

Type of firm	Applicable chapters
…	
Every other *firm*	Chapters 4 to 12, 18, ~~19~~ 19A

…

1.4 Application of SYSC 11 to SYSC ~~19~~ 19A

...

1.4.1 G The application of each of chapters *SYSC* 11 to *SYSC* ~~19~~ 19A is set out in those chapters.

…

1.4.2 R A contravention of a rule in *SYSC* 11 to *SYSC* ~~19~~ 19A does not give rise to a right of action by a *private person* …

…

4.1.1 R (1) A *firm* must have robust governance arrangements, which include a clear organisational structure with well defined, transparent and consistent lines of responsibility, effective processes to identify, manage, monitor and report the risks it is or might be exposed to, and internal control mechanisms, including sound administrative and accounting procedures and effective control and safeguard arrangements for information processing systems.

(2) A *BIPRU firm* and a *third country BIPRU firm* must comply with the *Remuneration Code*.

[**Note**: article 22(1) of the *Banking Consolidation Directive*, article 13(5) second paragraph of *MiFID*]

4.1.2 R For a *common platform firm*, the arrangements, processes and mechanisms referred to in *SYSC* 4.1.1R must be comprehensive and proportionate to the nature, scale and complexity of the *common platform firm's* activities and must take into account the specific technical criteria described in *SYSC* 4.1.7R, *SYSC* 5.1.7R ~~and~~, *SYSC* 7 and (for a *BIPRU firm* and a *third country BIPRU firm*) *SYSC* 19A.

…

~~Remuneration policies~~

4.1.12 G ~~Certain *banks*, *building societies* and *BIPRU 730k firms* will need to comply with the *Remuneration Code* requirement to establish, implement and maintain an effective *remuneration policy* that is consistent with effective risk management. See *SYSC* 19.1 for details of the application of the *Remuneration Code*.~~ [deleted]

…

6.1.4-A G In setting the method of determining the *remuneration* of *relevant persons* involved in the compliance function, ~~certain *banks*, *building societies* and~~ *BIPRU* ~~*730k*~~ *firms* will also need to comply with the *Remuneration Code*.

~~See *SYSC* 19.1 for details of the application of the *Remuneration Code*.~~

…

7.1.7B G In setting the method of determining the *remuneration* of *employees* involved in the risk management function, ~~certain *banks*, *building societies* and~~ *BIPRU* ~~*730k*~~ *firms* will also need to comply with the *Remuneration Code*. ~~See *SYSC* 19.1 for details of the application of the *Remuneration Code*.~~

…

12.1.13 R If this *rule* applies under *SYSC* 12.1.14R to a *firm*, the *firm* must:

(1) comply with *SYSC* 12.1.8R(2) in relation to any *UK consolidation group* or *non-EEA sub-group* of which it is a member, as well as in relation to its *group*; and

(2) ensure that the risk management processes and internal control mechanisms at the level of any *UK consolidation group* or *non-EEA sub-group* of which it is a member comply with the obligations set out in the following provisions on a consolidated (or sub-consolidated) basis:

…

(da) the *Remuneration Code*;

…

The following new text is inserted after SYSC Chapter 19. SYSC Chapter 19 is deleted in its entirety. The deleted text is not shown struck through and the new text is not underlined.

19A Remuneration Code

19A.1 General application and purpose

Who? What? Where?

19A.1.1 R (1) The *Remuneration Code* applies to a *BIPRU firm* and a *third country BIPRU firm*.

(2) In relation to a *third country BIPRU firm*, the *Remuneration Code* applies only in relation to activities carried on from an establishment in the *United Kingdom*.

(3) Otherwise, the *Remuneration Code* applies to a *firm* within (1) in the same way as *SYSC* 4.1.1R (General Requirements).

19A.1.2 G Part 2 of *SYSC* 1 Annex 1 provides for the application of *SYSC* 4.1.1R (General Requirements). In particular, and subject to the provisions on group risk systems and controls requirements in *SYSC* 12, this means that:

(1) in relation to what the *Remuneration Code* applies to, it:

(a) applies in relation to *regulated activities*, activities that constitute *dealing in investment as principal* (disregarding the exclusion in article 15 of the *Regulated Activities Order* (Absence of holding out etc)), *ancillary activities* and (in relation to *MiFID business*) *ancillary services*;

(b) applies with respect to the carrying on of *unregulated activities* in a *prudential context*; and

(c) takes into account activities of other *group* members; and

(2) in relation to where the *Remuneration Code* applies, it applies in relation to:

(a) a *firm's UK* activities;

(b) a *firm's passported activities* carried on from a *branch* in another *EEA State*; and

(c) a *UK domestic firm's* activities wherever they are carried on, in a *prudential context*.

When?

19A.1.3 R A *firm* must apply the *remuneration* requirements in *SYSC* 19A.3 in relation to:

(1) *remuneration* awarded, whether pursuant to a contract or otherwise, on or after 1 January 2011;

(2) *remuneration* due on the basis of contracts concluded before 1 January 2011 which is awarded or paid on or after 1 January 2011; and

(3) *remuneration* awarded, but not yet paid, before 1 January 2011, for services provided in 2010.

[**Note:** article 3(2) of the Third Capital Requirements Directive (Directive 2010/76/EU)]

19A.1.4 G Subject to the requirements of *SYSC* 19A.1.5R, in the *FSA's* view *SYSC* 19A.1.3R does not require a *firm* to breach requirements of applicable contract or employment law.

[**Note:** recital 14 of the Third Capital Requirements Directive (Directive

2010/76/EU)]

19A.1.5 R (1) This *rule* applies to a *firm* that is unable to comply with the *Remuneration Code* because of an obligation it owes to a *Remuneration Code staff member* under a provision of an agreement made on or before 29 July 2010 (the "provision").

(2) A *firm* must take reasonable steps to amend or terminate the provision referred to in (1) in a way that enables it to comply with the *Remuneration Code* at the earliest opportunity.

(3) Until the provision referred to in (1) ceases to prevent the *firm* from complying with the *Remuneration Code*, the *firm* must adopt specific and effective arrangements, processes and mechanisms to manage the risks raised by the provision.

Purpose

19A.1.6 G (1) The aim of the *Remuneration Code* is to ensure that *firms* have risk-focused *remuneration* policies, which are consistent with and promote effective risk management and do not expose them to excessive risk. It expands upon the general organisational requirements in *SYSC* 4.

(2) The *Remuneration Code* implements the main provisions of the Third Capital Requirements Directive (Directive 2010/76/EU) which relate to *remuneration*. The Committee of European Banking Supervisors published 'Guidelines on Remuneration Policies and Practices' on 10 December 2010. Provisions of the Third Capital Requirements Directive relating to Pillar 3 disclosures of information relating to remuneration have been implemented through amendments to *BIPRU* 11 (specifically the *rules* and *guidance* in *BIPRU* 11.5.18R to *BIPRU* 11.5.21G).

(3) The *Remuneration Code* also fulfils the *FSA's* duty under section 139A of the *Act* (General rules about remuneration) to have *rules* requiring certain *firms* to have and act in accordance with a *remuneration* policy which is consistent with the effective management of risks and with the *FSB Compensation Standards*.

Notifications to the FSA

19A.1.7 G (1) The *Remuneration Code* does not contain specific notification requirements. However, general circumstances in which the *FSA* expects to be notified by *firms* of matters relating to their compliance with requirements under the *regulatory system* are set out in *SUP* 15.3 (General notification requirements).

(2) In particular, in relation to *remuneration* matters such circumstances should take into account *unregulated activities* as well as *regulated activities* and the activities of other members of a *group* and would

include each of the following:

(a) significant breaches of the *Remuneration Code*, including any breach of a *rule* to which the detailed provisions on voiding and recovery in *SYSC* 19A Annex 1 apply;

(b) any proposed *remuneration* policies, procedures or practices which could:

(i) have a significant adverse impact on the *firm's* reputation; or

(ii) affect the *firm's* ability to continue to provide adequate services to its *customers* and which could result in serious detriment to a *customer* of the *firm*; or

(iii) result in serious financial consequences to the *financial system* or to other *firms*;

(c) any proposed changes to *remuneration* policies, practices or procedures which could have a significant impact on the *firm's* risk profile or resources;

(d) fraud, errors and other irregularities described in *SUP* 15.3.17R which may suggest weaknesses in, or be motivated by, the *firm's remuneration* policies, procedures or practices.

(3) Such notifications should be made immediately the *firm* becomes aware, or has information which reasonably suggests such circumstances have occurred, may have occurred or may occur in the foreseeable future.

Individual guidance

19A.1.8 G The *FSA's* policy on individual *guidance* is set out in *SUP* 9. *Firms* should in particular note the policy on what the *FSA* considers to be a reasonable request for *guidance* (see *SUP* 9.2.5G). For example, where a *firm* is seeking *guidance* on a proposed *remuneration* structure the *FSA* will expect the *firm* to provide a detailed analysis of how the structure complies with the *Remuneration Code*, including the general requirement for *remuneration* policies, procedures and practices to be consistent with and promote sound and effective risk management.

19A.2 General requirement

Remuneration policies must promote effective risk management

19A.2.1 R A *firm* must establish, implement and maintain *remuneration* policies, procedures and practices that are consistent with and promote sound and

effective risk management.

[**Note:** Article 22(1) of the *Banking Consolidation Directive*]

19A.2.2 G (1) If a *firm's remuneration policy* is not aligned with effective risk management it is likely that *employees* will have incentives to act in ways that might undermine effective risk management.

(2) The *Remuneration Code* covers all aspects of *remuneration* that could have a bearing on effective risk management including salaries, bonuses, long-term incentive plans, options, hiring bonuses, severance packages and pension arrangements. In applying the *Remuneration Code*, a *firm* should have regard to applicable good practice on *remuneration* and corporate governance, such as guidelines on executive contracts and severance produced by the Association of British Insurers (ABI) and the National Association of Pension Funds (NAPF). In considering the risks arising from its *remuneration* policies, a *firm* will also need to take into account its statutory duties in relation to equal pay and non-discrimination.

(3) As with other aspects of a *firm's* systems and controls, in accordance with *SYSC* 4.1.2R *remuneration* policies, procedures and practices must be comprehensive and proportionate to the nature, scale and complexity of the *common platform firm's* activities. What a *firm* must do in order to comply with the *Remuneration Code* will therefore vary. For example, while the *Remuneration Code* refers to a *firm's remuneration* committee and risk management function, it may be appropriate for the *governing body* of a smaller *firm* to act as the *remuneration* committee, and for the *firm* not to have a separate risk management function.

(4) The principles in the *Remuneration Code* are used by the *FSA* to assess the quality of a *firm's remuneration* policies and whether they encourage excessive risk-taking by a *firm's employees*.

(5) The *FSA* may also ask *remuneration* committees to provide the *FSA* with evidence of how well the *firm's remuneration* policies meet the *Remuneration Code's* principles, together with plans for improvement where there is a shortfall. The *FSA* also expects relevant *firms* to use the principles in assessing their exposure to risks arising from their *remuneration* policies as part of the *internal capital adequacy assessment process* (*ICAAP*).

(6) The *Remuneration Code* is principally concerned with the risks created by the way *remuneration* arrangements are structured, not with the absolute amount of *remuneration*, which is generally a matter for *firms' remuneration* committees.

19A.2.3 G (1) The specific *remuneration* requirements in this chapter may apply only in relation to certain categories of *employee*. But the *FSA* would expect *firms*, in complying with the *Remuneration Code*

general requirement, to apply certain principles on a *firm*-wide basis.

(2) In particular, the *FSA* considers that *firms* should apply the principle relating to guaranteed variable *remuneration* on a *firm*-wide basis (Remuneration Principle 12(c); *SYSC* 19A.3.40R to *SYSC* 19A.3.43G).

(3) The *FSA* would also expect *firms* to apply at least the principles relating to risk management and risk tolerance (Remuneration Principle 1); supporting business strategy, objectives, values and long-term interests of the firm (Remuneration Principle 2); conflicts of interest (Remuneration Principle 3); governance (Remuneration Principle 4); risk adjustment (Remuneration Principle 8); pension policy (Remuneration Principle 9); personal investment strategies (Remuneration Principle 10); payments related to early termination (Remuneration Principle 12(e)) and deferral (Remuneration Principle 12(g)) on a *firm*-wide basis.

Record-keeping

19A.2.4 G In line with the record-keeping requirements in *SYSC* 9, a *firm* should ensure that its *remuneration* policies, practices and procedures are clear and documented. Such policies, practices and procedures would include performance appraisal processes and decisions.

Interpretation of references to remuneration

19A.2.5 R (1) In this chapter references to *remuneration* include *remuneration* paid, provided or awarded by any *person* to the extent that it is paid, provided or awarded in connection with *employment* by a *firm*.

(2) Paragraph (1) is without prejudice to the meaning of *remuneration* elsewhere in the *Handbook*.

19A.2.6 G *Remuneration* includes, for example, payments made by a seconding organisation which is not subject to the *Remuneration Code* to a secondee in respect of their *employment* by a *firm* which is subject to the *Remuneration Code*.

19A.3 Remuneration principles for banks, building societies and investment firms

Application: groups

19A.3.1 R (1) A *firm* must apply the requirements of this section at *group*, *parent undertaking* and *subsidiary undertaking* levels, including those *subsidiaries* established in a country or territory which is not an *EEA State*.

(2) Paragraph (1) does not limit *SYSC* 12.1.13R(2)(da) (which relates to the application of the *Remuneration Code* within *UK consolidation*

groups and *non-EEA sub-groups*).

[**Note:** Paragraph 23 (final, unnumbered point) of Annex V to the *Banking Consolidation Directive*]

19A.3.2 G SYSC 12.1.13R(2)(da) requires the *firm* to ensure that the risk management processes and internal control mechanisms at the level of any *UK consolidation group* or *non-EEA sub-group* of which a *firm* is a member comply with the obligations set out in this section on a consolidated (or sub-consolidated) basis. In the *FSA's* view, the requirement to apply this section at *group*, *parent undertaking* and *subsidiary undertaking* levels (as provided for in *SYSC* 19A.3.1R(1)) is in line with the requirements in article 73(3) of the *Banking Consolidation Directive* concerning the application of systems and controls requirements to *groups* (as implemented in *SYSC* 12.1.13R).

Application: categories of staff and proportionality

19A.3.3 R (1) This section applies in relation to *Remuneration Code staff*, except as set out in (3).

(2) When establishing and applying the total *remuneration* policies for *Remuneration Code staff*, a *firm* must comply with this section 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 (the *remuneration principles proportionality rule*).

(3) Paragraphs (1) and (2) do not apply to the requirement for significant *firms* to have a *remuneration* committee (*SYSC* 19A.3.12R).

[**Note:** Paragraph 23 of Annex V to the *Banking Consolidation Directive*]

[**Note:** In addition to the *guidance* in this section which relates to the *remuneration principles proportionality rule*, the *FSA* has given *guidance* on the division of *firms* into categories for the purpose of providing a framework for the operation of the *remuneration principles proportionality rule*. This *guidance* was published in Policy Statement 10/20 'Revising the Remuneration Code' and is available at http://www.fsa.gov.uk/Pages/Library/Policy/Policy/index.shtml.]

19A.3.4 R *Remuneration Code staff* comprises categories of staff including senior management, risk takers, staff engaged in control functions and any *employee* receiving total remuneration that takes them into the same *remuneration* bracket as senior management and risk takers, whose professional activities have a material impact on the *firm's* risk profile.

[**Note**: paragraph 23 of Annex V to the *Banking Consolidation Directive*]

19A.3.5 R A *firm* must:

(1) maintain a record of its *Remuneration Code staff* in accordance with the general record-keeping requirements (*SYSC* 9); and

(2) take reasonable steps to ensure that its *Remuneration Code staff* understand the implications of their status as such, including the potential for *remuneration* which does not comply with certain requirements of the *Remuneration Code* to be rendered void and recoverable by the *firm*.

19A.3.6 G (1) In the *FSA's* view:

(a) a *firm's* staff includes its *employees*;

(b) a *person* who performs a *significant influence function* for, or is a *senior manager* of, a *firm* would normally be expected to be part of the *firm's Remuneration Code staff*;

(c) the table in (2) provides a non-exhaustive list of examples of key positions that should, subject to (d), be within a *firm's* definition of staff who are 'risk takers';

(d) *firms* should consider how the examples in the table in (2) apply in relation to their own organisational structure (as the description of suggested business lines in the first row may be most appropriate to a *firm* which *deals on its own account* to a significant extent);

(e) *firms* may find it useful to set their own metrics to identify their 'risk takers' based, for example, on trading limits; and

(f) a *firm* should treat a *person* as being *Remuneration Code staff* in relation to *remuneration* in respect of a given performance year if they were *Remuneration Code staff* for any part of that year.

[**Note:** The *FSA* has given *guidance* on the application of particular rules on *remuneration* structures in relation to individuals who are *Remuneration Code staff* for only part of a given performance year. This *guidance* was published in Policy Statement 10/20 'Revising the Remuneration Code' and is available at http://www.fsa.gov.uk/Pages/Library/Policy/Policy/index.shtml.]

(2)

High-level category	**Suggested business lines**
Heads of significant business lines (including regional heads) and any individuals or groups within their control who have a material impact on the *firm's* risk profile	Fixed income Foreign exchange Commodities Securitisation

	Sales areas Investment banking (including mergers and acquisitions advisory) Commercial banking Equities Structured finance Lending quality Trading areas Research
Heads of support and control functions and other individuals within their control who have a material impact on the *firm's* risk profile	Credit / market / operational risk Legal Treasury controls Human resources Compliance Internal audit

Remuneration Principle 1: Risk management and risk tolerance

19A.3.7 R A *firm* must ensure that its *remuneration* policy is consistent with and promotes sound and effective risk management and does not encourage risk-taking that exceeds the level of tolerated risk of the *firm*.

[**Note:** Paragraph 23(a) of Annex V to the *Banking Consolidation Directive*]

Remuneration Principle 2: Supporting business strategy, objectives, values and long-term interests of the firm

19A.3.8 R A *firm* must ensure that its *remuneration* policy is in line with the business strategy, objectives, values and long-term interests of the *firm*.

[**Note:** Paragraph 23(b) of Annex V to the *Banking Consolidation Directive*]

Remuneration Principle 3: Avoiding conflicts of interest

19A.3.9 R A *firm* must ensure that its *remuneration* policy includes measures to avoid conflicts of interest.

[**Note:** Paragraph 23(b) of Annex V to the *Banking Consolidation Directive*]

Remuneration Principle 4: Governance

19A.3.10 R A *firm* must ensure that its *governing body* in its *supervisory function* adopts and periodically reviews the general principles of the *remuneration* policy and is responsible for its implementation.

[**Note:** Paragraph 23(c) of Annex V to the *Banking Consolidation Directive* and Standard 1 of the *FSB Compensation Standards*]

19A.3.11 R A *firm* must ensure that the implementation of the *remuneration* policy is, at least annually, subject to central and independent internal review for compliance with policies and procedures for *remuneration* adopted by the *governing body* in its *supervisory function*.

[**Note:** Paragraph 23(d) of Annex V to the *Banking Consolidation Directive* and Standard 1 of the *FSB Compensation Standards*]

19A.3.12 R (1) A *firm* that is significant in terms of its size, internal organisation and the nature, the scope and the complexity of its activities must establish a *remuneration* committee.

(2) The *remuneration* committee must be constituted in a way that enables it to exercise competent and independent judgment on *remuneration* policies and practices and the incentives created for managing risk, capital and liquidity.

(3) The chairman and the members of the *remuneration* committee must be members of the *governing body* who do not perform any executive function in the *firm*.

(4) The *remuneration* committee must be responsible for the preparation of decisions regarding *remuneration*, including those which have implications for the risk and risk management of the *firm* and which are to be taken by the *governing body* in its *supervisory function*.

(5) When preparing such decisions, the *remuneration* committee must take into account the long-term interests of shareholders, investors and other stakeholders in the *firm*.

[**Note:** Paragraph 24 of Annex V of the *Banking Consolidation Directive* and Standard 1 of the *FSB Compensation Standards*]

[**Note:** The *guidance* referred to in the Note to *SYSC* 19A.3.3R also gives *guidance* on proportionality in relation to *remuneration* committees.]

19A.3.13 G (1) A *firm* should be able to demonstrate that its decisions are consistent with an assessment of its financial condition and future prospects. In particular, practices by which *remuneration* is paid for potential future revenues whose timing and likelihood remain uncertain should be evaluated carefully and the *governing body* or *remuneration* committee (or both) should work closely with the *firm's* risk function

in evaluating the incentives created by its *remuneration* system.

(2) The *governing body* and any *remuneration* committee are responsible for ensuring that the *firm's remuneration* policy complies with the *Remuneration Code* and where relevant should take into account relevant guidance, such as that issued by the Basel Committee on Banking Supervision, the International Association of Insurance Supervisors (IAIS) and the International Organization of Securities Commissions (IOSCO).

(3) The periodic review of the implementation of the *remuneration* policy should assess compliance with the *Remuneration Code*.

(4) Guidance on what the *supervisory function* might involve is set out in *SYSC* 4.3.3G.

Remuneration Principle 5: Control functions

19A.3.14 R A *firm* must ensure that *employees* engaged in control functions:

(1) are independent from the business units they oversee;

(2) have appropriate authority; and

(3) are *remunerated*:

(a) adequately to attract qualified and experienced staff; and

(b) in accordance with the achievement of the objectives linked to their functions, independent of the performance of the business areas they control.

[**Note:** Paragraph 23(e) of Annex V to the *Banking Consolidation Directive* and Standard 2 of the *FSB Compensation Standards*]

19A.3.15 E (1) A *firm's* risk management and compliance functions should have appropriate input into setting the *remuneration* policy for other business areas. The procedures for setting *remuneration* should allow risk and compliance functions to have significant input into the setting of individual *remuneration* awards where those functions have concerns about the behaviour of the individuals concerned or the riskiness of the business undertaken.

(2) Contravention of (1) may be relied on as tending to establish contravention of the *rule* on *employees* engaged in control functions having appropriate authority (*SYSC* 19A.3.14R(2)).

19A.3.16 R A *firm* must ensure that the *remuneration* of the senior officers in risk management and compliance functions is directly overseen by the *remuneration* committee referred to in *SYSC* 19A.3.12R, or, if such a committee has not been established, by the *governing body* in its *supervisory*

function.

[**Note:** Paragraph 23(f) of Annex V to the *Banking Consolidation Directive*]

19A.3.17 G (1) This Remuneration Principle is designed to manage the conflicts of interest which might arise if other business areas had undue influence over the *remuneration* of *employees* within control functions. Conflicts of interest can easily arise when *employees* are involved in the determination of *remuneration* for their own business area. Where these could arise they need to be managed by having in place independent roles for control functions (including, notably, risk management and compliance) and human resources. It is good practice to seek input from a *firm's* human resources function when setting *remuneration* for other business areas.

(2) The need to avoid undue influence is particularly important where *employees* from the control functions are embedded in other business areas. This Remuneration Principle does not prevent the views of other business areas being sought as an appropriate part of the assessment process.

(3) The *FSA* would generally expect the ratio of the potential variable component of *remuneration* to the fixed component of *remuneration* to be significantly lower for *employees* in risk management and compliance functions than for *employees* in other business areas whose potential bonus is a significant proportion of their *remuneration*. *Firms* should nevertheless ensure that the total *remuneration* package offered to those *employees* is sufficient to attract and retain staff with the skills, knowledge and expertise to discharge those functions. The requirement that the method of determining the *remuneration* of *relevant persons* involved in the compliance function must not compromise their objectivity or be likely to do so also applies (see *SYSC* 6.1.4R(4)).

Remuneration Principle 6: Remuneration and capital

19A.3.18 R A *firm* must ensure that total variable *remuneration* does not limit the *firm's* ability to strengthen its capital base.

[**Note:** Paragraph 23(i) of Annex V to the *Banking Consolidation Directive* and Standard 3 of the *FSB Compensation Standards*]

19A.3.19 G This Remuneration Principle underlines the link between a *firm's* variable *remuneration* costs and the need to manage its capital base, including forward-looking capital planning measures. Where a *firm* needs to strengthen its capital base, its variable *remuneration* arrangements should be sufficiently flexible to allow it to direct the necessary resources towards capital building.

Remuneration Principle 7: Exceptional government intervention

19A.3.20 R A *firm* that benefits from exceptional government intervention must ensure that:

(1) variable *remuneration* is strictly limited as a percentage of net revenues when it is inconsistent with the maintenance of a sound capital base and timely exit from government support;

(2) it restructures *remuneration* in a manner aligned with sound risk management and long-term growth, including when appropriate establishing limits to the *remuneration* of *senior personnel*; and

(3) no variable *remuneration* is paid to its *senior personnel* unless this is justified.

[**Note:** Paragraph 23(k) of Annex V to the *Banking Consolidation Directive* and Standard 10 of the *FSB Compensation Standards*]

19A.3.21 G The *FSA* would normally expect it to be appropriate for the ban on paying variable *remuneration* to *senior personnel* of a *firm* that benefits from exceptional government intervention to apply only in relation to *senior personnel* who were in office at the time that the intervention was required.

Remuneration Principle 8: Profit-based measurement and risk adjustment

19A.3.22 R (1) A *firm* must ensure that any measurement of performance used to calculate variable *remuneration* components or pools of variable *remuneration* components:

(a) includes adjustments for all types of current and future risks and takes into account the cost and quantity of the capital and the liquidity required; and

(b) takes into account the need for consistency with the timing and likelihood of the firm receiving potential future revenues incorporated into current earnings.

(2) A *firm* must ensure that the allocation of variable *remuneration* components within the *firm* also takes into account all types of current and future risks.

[**Note:** Paragraph 23(n) of Annex V to the *Banking Consolidation Directive* and Standard 4 of the *FSB Compensation Standards*]

19A.3.23 G (1) This Remuneration Principle stresses the importance of risk adjustment in measuring performance, and the importance within that process of applying judgment and common sense. A *firm* should ask the risk management function to validate and assess risk-adjustment techniques, and to attend a meeting of the *governing body* or *remuneration* committee for this purpose.

(2) A number of risk-adjustment techniques and measures are available, and a *firm* should choose those most appropriate to its circumstances. Common measures include those based on economic profit or economic capital. Whichever technique is chosen, the full range of future risks should be covered. The *FSA* expects a *firm* to be able to provide it with details of all adjustments that the *firm* has made under a formulaic approach.

(3) The *FSA* expects that a *firm* will apply qualitative judgments and common sense in the final decision about the performance-related components of variable *remuneration* pools.

(4) A *firm's governing body* (or *remuneration* committee where appropriate) should take the lead in determining the measures to be used. It should offer the appropriate checks and balances to prevent inappropriate manipulation of the measures used. It should consult closely and frequently with the *firm's* risk management functions, in particular those relating to operational, market, credit and liquidity risk.

19A.3.24 G (1) Long-term incentive plans should be treated as pools of variable *remuneration*. Many common measures of performance for long-term incentive plans, such as earnings per *share* (EPS), are not adjusted for longer-term risk factors. Total shareholder return (TSR), another common measure, includes in its measurement dividend distributions, which can also be based on unadjusted earnings data. If incentive plans mature within a two to four year period and are based on EPS or TSR, strategies can be devised to boost EPS or TSR during the life of the plan, to the detriment of the true longer-term health of a *firm*. For example, increasing leverage is a technique which can be used to boost EPS and TSR. *Firms* should take account of these factors when developing risk-adjustment methods.

(2) *Firms* that have long-term incentive plans should structure them with vesting subject to appropriate performance conditions, and at least half of the award vesting after not less than five years and the remainder after not less than three years.

(3) Long-term incentive plan awards may be included in the calculation of the deferred portion of variable *remuneration* only if upside incentives are adequately balanced by downside adjustments. The valuation of the award should be based on its value when the award is granted, and determined using an appropriate technique.

19A.3.25 R Assessments of financial performance used to calculate variable *remuneration* components or pools of variable *remuneration* components must be based principally on profits.

19A.3.26 G (1) Performance measures based primarily on revenues or turnover are unlikely to pay sufficient regard to the quality of business undertaken

or services provided. Profits are a better measure provided they are adjusted for risk, including future risks not adequately captured by accounting profits.

(2) Management accounts should provide profit data at such levels within the *firm's* structure as to enable a *firm* to see as accurate a picture of contributions of relevant staff to a *firm's* performance as is reasonably practicable. If revenue or turnover is used as a component in performance assessment, processes should be in place to ensure that the quality of business undertaken or services provided and their appropriateness for *clients* are taken into account.

19A.3.27 R A *firm* must ensure that its total variable *remuneration* is generally considerably contracted where subdued or negative financial performance of the *firm* occurs, taking into account both current *remuneration* and reductions in payouts of amounts previously earned.

[**Note:** Paragraph 23(q) of Annex V to the *Banking Consolidation Directive* and Standard 5 of the *FSB Compensation Standards*]

19A.3.28 G Where a *firm* makes a loss the *FSA* would generally expect no variable *remuneration* to be awarded. Variable *remuneration* may nevertheless be justified, for example, to incentivise *employees* involved in new business ventures which could be loss-making in their early stages.

Remuneration Principle 9: Pension policy

19A.3.29 R A *firm* must ensure that:

(1) its pension policy is in line with its business strategy, objectives, values and long-term interests;

(2) when an *employee* leaves the *firm* before retirement, any *discretionary pension benefits* are held by the *firm* for a period of five years in the form of instruments referred to in *SYSC* 19A.3.47R(1); and

(3) in the case of an *employee* reaching retirement, *discretionary pension benefits* are paid to the *employee* in the form of instruments referred to in *SYSC* 19A.3.47R(1) and subject to a five-year retention period.

[**Note:** Paragraph 23(r) of Annex V to the *Banking Consolidation Directive*]

Remuneration Principle 10: Personal investment strategies

19A.3.30 R (1) A *firm* must ensure that its *employees* undertake not to use personal hedging strategies or *remuneration*- or liability-related *contracts of insurance* to undermine the risk alignment effects embedded in their *remuneration* arrangements.

(2) A *firm* must maintain effective arrangements designed to ensure that

employees comply with their undertaking.

[**Note:** Paragraph 23(s) of Annex V to the *Banking Consolidation Directive* and Standard 14 of the *FSB Compensation Standards*]

19A.3.31 G In the *FSA's* view, circumstances in which a *person* will be using a personal hedging strategy include entering into an arrangement with a third party under which the third party will make payments, directly or indirectly, to that *person* that are linked to or commensurate with the amounts by which the *person's remuneration* is subject to reductions.

Remuneration Principle 11: Avoidance of the Remuneration Code

19A.3.32 R A *firm* must ensure that variable *remuneration* is not paid through vehicles or methods that facilitate the avoidance of the *Remuneration Code*.

[**Note:** Paragraph 23(t) of Annex V to the *Banking Consolidation Directive*]

Remuneration Principle 12: Remuneration structures – introduction

19A.3.33 G Remuneration Principle 12 consists of a series of *rules*, *evidential provisions* and *guidance* relating to *remuneration* structures.

19A.3.34 G (1) Taking account of the *remuneration principles proportionality rule*, the *FSA* does not generally consider it necessary for a *firm* to apply the *rules* referred to in (2) where, in relation to an individual ("X"), both the following conditions are satisfied:

(a) Condition 1 is that X's variable *remuneration* is no more than 33% of total *remuneration*; and

(b) Condition 2 is that X's total *remuneration* is no more than £500,000.

(2) The *rules* referred to in (1) 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).

[**Note:** The *FSA* has also given *guidance* on the application of certain *rules* on *remuneration* structures in relation to individuals who are *Remuneration Code staff* for only part of a given performance year. This guidance was published in Policy Statement 10/20 'Revising the Remuneration Code' and is available at http://www.fsa.gov.uk/Pages/Library/Policy/Policy/index.shtml.]

Remuneration Principle 12(a): Remuneration structures – general requirement

19A.3.35 R A *firm* must ensure that the structure of an *employee's remuneration* is consistent with and promotes effective risk management.

Remuneration Principle 12(b): Remuneration structures – assessment of performance

19A.3.36 R A *firm* must ensure that where *remuneration* is performance-related:

(1) the total amount of *remuneration* is based on a combination of the assessment of the performance of:

(a) the individual;

(b) the business unit concerned; and

(c) the overall results of the *firm*; and

(2) when assessing individual performance, financial as well as non-financial criteria are taken into account.

[**Note:** Paragraph 23(g) of Annex V to the *Banking Consolidation Directive* and Standard 6 of the *FSB Compensation Standards*]

19A.3.37 G Non-financial performance metrics should form a significant part of the performance assessment process and should include adherence to effective risk management and compliance with the *regulatory system* and with relevant overseas regulatory requirements. Poor performance as assessed by non-financial metrics such as poor risk management or other behaviours contrary to *firm* values can pose significant risks for a *firm* and should, as appropriate, override metrics of financial performance. The performance assessment process and the importance of non-financial assessment factors in the process should be clearly explained to relevant *employees* and implemented. A 'balanced scorecard' can be a good technique.

19A.3.38 R A *firm* must ensure that the assessment of performance is set in a multi-year framework in order to ensure that the assessment process is based on longer-term performance and that the actual payment of performance-based components of *remuneration* is spread over a period which takes account of the underlying business cycle of the *firm* and its business risks.

[**Note:** Paragraph 23(h) of Annex V to the *Banking Consolidation Directive*]

19A.3.39 G The requirement for assessment of performance to be in a multi-year framework reflects the fact that profits from a *firm's* activities can be volatile and subject to cycles. The financial performance of *firms* and individual *employees* can be exaggerated as a result. Performance assessment on a moving average of results can be a good way of meeting this requirement. However, other techniques such as good quality risk adjustment and deferral of a sufficiently large proportion of *remuneration* may also be useful.

Remuneration Principle 12(c): Remuneration structures – guaranteed variable remuneration

19A.3.40 R A *firm* must not award, pay or provide guaranteed variable *remuneration* unless it:

(1) is exceptional;

(2) occurs in the context of hiring new *Remuneration Code staff*; and

(3) is limited to the first year of service.

[**Note:** Paragraph 23(j) of Annex V to the *Banking Consolidation Directive* and Standard 11 of the *FSB Compensation Standards*]

19A.3.41 E (1) A *firm* should not award, pay or provide guaranteed variable *remuneration* in the context of hiring new *Remuneration Code staff* ('X') unless:

(a) it has taken reasonable steps to ensure that the *remuneration* is not more generous in either its amount or terms (including any deferral or retention periods) than the variable *remuneration* awarded or offered by X's previous employer; and

(b) it is subject to appropriate performance adjustment requirements.

(2) Contravention of (1) may be relied on as tending to establish contravention of the *rule* on guaranteed variable *remuneration* (*SYSC* 19A.3.40R).

19A.3.42 G Guaranteed variable *remuneration* should be subject to the same deferral criteria as other forms of variable *remuneration* awarded by the *firm*.

19A.3.43 G In the *FSA's* view, variable *remuneration* can be awarded to *Remuneration Code staff* in the form of retention awards where it is compatible with the *Remuneration Code general requirement* to do so. The *FSA* considers this is likely to be the case only where a *firm* is undergoing a major restructuring and a good case can be made for retention of particular key staff members on prudential grounds. Proposals to give retention awards should form part of any notice of the restructuring proposals required in accordance with *Principle* 11 and the general notification requirements in *SUP* 15.3.

Remuneration Principle 12(d): Remuneration structures – ratios between fixed and variable components of total remuneration

19A.3.44 R A *firm* must set appropriate ratios between the fixed and variable components of total *remuneration* and ensure that:

(1) fixed and variable components of total *remuneration* are

appropriately balanced; and

(2) the fixed component represents a sufficiently high proportion of the total *remuneration* to allow the operation of a fully flexible policy on variable *remuneration* components, including the possibility to pay no variable *remuneration* component.

[**Note:** Paragraph 23(l) of Annex V to the *Banking Consolidation Directive*]

Remuneration Principle 12(e): Remuneration structures – payments related to early termination

19A.3.45 R A *firm* must ensure that payments related to the early termination of a contract reflect performance achieved over time and are designed in a way that does not reward failure.

[**Note:** Paragraph 23(m) of Annex V to the *Banking Consolidation Directive* and Standard 12 of the *FSB Compensation Standards*]

19A.3.46 G *Firms* should review existing contractual payments related to termination of employment with a view to ensuring that these are payable only where there is a clear basis for concluding that they are consistent with the *Remuneration Code general requirement*.

[**Note:** Standard 12 of the *FSB Compensation Standards*]

Remuneration Principle 12(f): Remuneration structures – retained shares or other instruments

19A.3.47 R (1) A *firm* must ensure that a substantial portion, which is at least 50%, of any variable *remuneration* consists of an appropriate balance of:

(a) *shares* or equivalent ownership interests, subject to the legal structure of the *firm* concerned, or *share*-linked instruments or equivalent non-cash instruments in the case of a non-listed *firm*; and

(b) where appropriate, *capital instruments* which are eligible for inclusion at stage B1 of the calculation in the *capital resources table*, where applicable that adequately reflects the credit quality of the *firm* as a going concern.

(2) The instruments in (1) must be subject to an appropriate retention policy designed to align incentives with the longer-term interests of the *firm*.

(3) This *rule* applies to both the portion of the variable *remuneration* component deferred in accordance with *SYSC* 19A.3.49R and the portion not deferred.

[**Note:** Paragraph 23(o) of Annex V to the *Banking Consolidation Directive*

and Standard 8 of the *FSB Compensation Standards*]

19A.3.48 G (1) The Committee of European Banking Supervisors has given guidance on the interpretation of the Directive provision transposed by *SYSC* 19A.3.47R(3). Its Guidelines provide that this requirement means that the 50% minimum threshold for instruments must be applied equally to the non-deferred and the deferred components; in other words, *firms* must apply the same chosen ratio between instruments and cash for their total variable *remuneration* to both the upfront and deferred components. (Guidelines on Remuneration Policies and Practices, 10 December 2010, paragraph 133.)

(2) This simplified example illustrates the operation of (1). The variable remuneration of a material risk taker (X) is 100, and by *SYSC* 19A.3.49R(3) X is required to defer 60%. X's upfront component is 40 and X's deferred component is 60. At least 20 of X's upfront component, and at least 30 of X's deferred component, must be in instruments referred to in *SYSC* 19A.3.47R(1).

Remuneration Principle 12(g): Remuneration structures – deferral

19A.3.49 R (1) A *firm* must not award, pay or provide a variable *remuneration* component unless a substantial portion of it, which is at least 40%, is deferred over a period which is not less than three to five years.

(2) *Remuneration* under (1) must vest no faster than on a pro-rata basis.

(3) In the case of a variable *remuneration* component:

(a) of a particularly high amount, or

(b) payable to a *director* of a *firm* that is significant in terms of its size, internal organisation and the nature, scope and complexity of its activities;

at least 60% of the amount must be deferred.

(4) Paragraph (3)(b) does not apply to a *non-executive director*.

(5) The length of the deferral period must be established in accordance with the business cycle, the nature of the business, its risks and the activities of the *employee* in question.

[**Note:** Paragraph 23(p) of Annex V to the *Banking Consolidation Directive* and Standards 6 and 7 of the *FSB Compensation Standards*]

(6) £500,000 is a particularly high amount for the purpose of (3)(a).

(7) Paragraph (6) is without prejudice to the possibility of lower sums being considered a particularly high amount.

19A.3.50 G (1) Deferred *remuneration* paid in *shares* or *share*-linked instruments

should be made under a scheme which meets appropriate criteria, including risk adjustment of the performance measure used to determine the initial allocation of shares. Deferred *remuneration* paid in cash should also be subject to performance criteria.

(2) The *FSA* would generally expect a *firm* to have a *firm*-wide policy (and *group*-wide policy, where appropriate) on deferral. The proportion deferred should generally rise with the ratio of variable *remuneration* to fixed *remuneration* and with the amount of variable *remuneration*. While any variable *remuneration* component of £500,000 or more paid to *Remuneration Code staff* must be subject to 60% deferral, *firms* should also consider whether lesser amounts should be considered to be 'particularly high' taking account, for example, of whether there are significant differences within *Remuneration Code staff* in the levels of variable *remuneration* paid.

Remuneration Principle 12(h): Remuneration structures – performance adjustment, etc.

19A.3.51 R A *firm* must ensure that any variable *remuneration*, including a deferred portion, is paid or vests only if it is sustainable according to the financial situation of the *firm* as a whole, and justified according to the performance of the *firm*, the business unit and the individual concerned.

[**Note:** Paragraph 23(q) of Annex V to the *Banking Consolidation Directive* and Standards 6 and 9 of the *FSB Compensation Standards*]

19A.3.52 E (1) A *firm* should reduce unvested deferred variable *remuneration* when, as a minimum:

(a) there is reasonable evidence of *employee* misbehaviour or material error; or

(b) the *firm* or the relevant business unit suffers a material downturn in its financial performance; or

(c) the *firm* or the relevant business unit suffers a material failure of risk management.

(2) For performance adjustment purposes, awards of deferred variable *remuneration* made in *shares* or other non-cash instruments should provide the ability for the *firm* to reduce the number of *shares* or other non-cash instruments.

(3) Contravention of (1) or (2) may be relied on as tending to establish contravention of the *rule* on performance adjustment (*SYSC* 19A.3.51R).

19A.3.53 G (1) Variable *remuneration* may be justified, for example, to incentivise *employees* involved in new business ventures which could be loss-making in their early stages.

(2) The *governing body* (or, where appropriate, the *remuneration* committee) should approve performance adjustment policies, including the triggers under which adjustment would take place. The *FSA* may ask *firms* to provide a copy of their policies and expects *firms* to make adequate records of material decisions to operate the adjustments.

Effect of breaches of the Remuneration Principles

19A.3.54 R (1) The detailed provisions on voiding and recovery in *SYSC* 19A Annex 1 apply in relation to the prohibitions on *Remuneration Code staff* being *remunerated* in the ways specified in:

(a) *SYSC* 19A.3.40R (guaranteed variable *remuneration*);

(b) *SYSC* 19A.3.49R (non-deferred variable *remuneration*); and

(c) *SYSC* 19A Annex 1.7R (replacing payments recovered or property transferred).

(2) This *rule* does not apply in relation to the prohibition on *Remuneration Code staff* being *remunerated* in the way specified in *SYSC* 19A.3.40R (guaranteed variable *remuneration*) if both the conditions in paragraphs (2) and (3) of that *rule* are met.

(3) This *rule* does not apply in relation to *Remuneration Code staff* (X) in respect of whom both the following conditions are satisfied:

(a) Condition 1 is that X's variable *remuneration* is no more than 33% of total *remuneration*; and

(b) Condition 2 is that X's total *remuneration* is no more than £500,000.

(4) In relation to (3):

(a) references to *remuneration* are to *remuneration* awarded or paid in respect of the relevant performance year;

(b) the amount of any *remuneration* is:

(i) if it is money, its amount when awarded;

(ii) otherwise, whichever of the following is greatest: its value to the recipient when awarded; its market value when awarded; and the cost of providing it;

(c) where *remuneration* is, when awarded, subject to any condition, restriction or other similar provision which causes the amount of the *remuneration* to be less than it otherwise would be, that condition, restriction or provision is to be

ignored in arriving at its value; and

(d) it is to be assumed that the member of *Remuneration Code staff* will remain so for the duration of the relevant performance year.

19A.3.55 G (1) Section 139A(9) of the *Act* enables the *FSA* to make *rules* that render void any provision of an agreement that contravenes specified prohibitions in the *Remuneration Code*, and that provide for the recovery of any payment made, or other property transferred, in pursuance of such a provision. *SYSC* 19A.3.54R (together with *SYSC* 19A Annex 1) is such a *rule* and renders void provisions of an agreement that contravene the specified prohibitions on guaranteed variable *remuneration*, non-deferred variable *remuneration* and replacing payments recovered or property transferred. This is an exception to the general position set out in section 151(2) of the *Act* that a contravention of a *rule* does not make any transaction void or unenforceable.

(2) *SYSC* TP 3.6R provides that *SYSC* 19A.3.54R and *SYSC* 19A Annex 1 apply, until 1 January 2012, only in relation to a *firm* that was subject to the version of the *Remuneration Code* that applied before 1 January 2011.

19A Annex 1 Detailed provisions on voiding and recovery

Rendering contravening provisions of agreements void

1 R Any provision of an agreement that contravenes a prohibition on *persons* being *remunerated* in a way specified in a *rule* to which this annex applies (a "contravening provision") is void.

2 R A contravening provision that, at the time a *rule* to which this annex applies was made, is contained in an agreement made before that time is not rendered void by 1R unless it is subsequently amended so as to contravene such a *rule*.

3 G The effect of 2R, in accordance with section 139A(11) of the *Act*, is to prevent contravening provisions being rendered void retrospectively. Contravening provisions may however be rendered void if they are contained in an agreement made after the *rule* containing the prohibition is made by the *FSA* but before the *rule* comes into effect.

4 R For the purposes of this chapter it is immaterial whether the law which (apart from this annex) governs a contravening provision is the law of the *United Kingdom*, or of a part of the *United Kingdom*.

Recovery of payments made or property transferred pursuant to a void contravening provision

5 R In relation to any payment made or other property transferred in pursuance of a contravening provision, a *firm* must take reasonable steps to:

(1) recover any such payment made or other property transferred by the *firm*; and

(2) ensure that any other *person* ("P") recovers any such payment made or other property transferred by that *person*.

6 G The *rule* in 5R(2) would, for example, apply in the context of a secondment. Where a *group* member seconds an individual to a *firm* and continues to be responsible for the individual's *remuneration* in respect of services provided to the *firm*, the *firm* would need to take reasonable steps to ensure that the *group* member recovers from the secondee any *remuneration* paid in pursuance of a contravening provision.

Replacing payments recovered or property transferred

7 R (1) A *firm* must not award, pay or provide variable *remuneration* to a *person* whose *remuneration* has caused the *firm* to breach a contravening provision (the "contravening *remuneration*") unless the *firm* has obtained a legal opinion stating that the award, payment or provision of the *remuneration* complies with the *Remuneration Code*.

(2) This *rule* applies only to variable *remuneration* relating to a performance year to which the contravening *remuneration* related.

(3) The legal opinion in (1) must be properly reasoned and be provided by an appropriately qualified independent individual.

Notification to the FSA

8 G The *FSA* considers any breach of a *rule* to which this annex applies to be a significant breach which should be notified to the *FSA* in accordance with *SUP* 15.3.11R (Breaches of rules and other requirements in or under the Act). Such a notification should include information on the steps which a *firm* or other *person* has taken or intends to take to recover payments or property in accordance with 5R.

Amend the following as shown:

TP 3 Remuneration code

1 R ~~TP 3 applies to a *firm* that is unable to comply with the *Remuneration Code general requirement* because of an obligation it owes to an *employee* (the "obligation") under an agreement entered into on or before 18 March 2009~~

~~(the "agreement").~~ [deleted]

2 R ~~A *firm's* compliance with the obligation shall not cause it to be in breach of the *Remuneration Code general requirement* provided that the *firm* complies with 3R.~~ [deleted]

3 R ~~(1) Where a *firm* is entitled to amend the agreement in a way that enables it to comply with the *Remuneration Code general requirement* it must do so at the earliest opportunity and no later than 31 March 2010.~~

~~(2) Otherwise, a *firm* must:~~

~~(a) take reasonable steps to amend the obligation or terminate the agreement at the earliest opportunity;~~

~~(b) amend the obligation or terminate the agreement no later than 31 December 2010; and~~

~~(c) adopt specific and effective arrangements, processes and mechanisms to manage the risks raised by the obligation.~~ [deleted]

4 G ~~By 1 January 2010, a *firm* should have at least initiated a review of the extent to which the measurement of performance for any existing long term incentive plans takes account of future risks. The *FSA* may discuss the timing of that review and any remedial action with the *firm*.~~ [deleted]

5 G (1) The *FSA* recognises that *firms* may require additional time to comply in full with the requirements of the *Remuneration Code* where they were not subject to the version of the *Remuneration Code* that applied before 1 January 2011. The *FSA* considers that a *firm* may be able to rely on the proportionality provisions in *SYSC* 4.1.2R and the *remuneration principles proportionality rule* to justify not complying with the requirements of the *Remuneration Code* relating to *remuneration* structures by 1 January 2011 provided it takes reasonable steps to comply as soon as reasonably possible and in any event by 1 July 2011.

(2) On a similar basis and on the same timescales set out in (1), a *firm* which was subject to the previous version of the *Remuneration Code* may be able to justify not complying with the requirement to pay 50% of variable *remuneration* in *shares* or other non-cash instruments (*SYSC* 19A.3.47R).

6 R Until 1 January 2012, *SYSC* 19A.3.54R and *SYSC* 19A Annex 1 (on voiding and recovery) apply only in relation to a *firm* that was subject to the version of the *Remuneration Code* that applied before 1 January 2011.

Sch 4 Powers exercised

The following powers and related provisions in the *Act* have been exercised by the *FSA* to make *rules* in *SYSC*:
Section 138 (General rule-making power)
Section 139A (General rules about remuneration)
…

Sch 5 Rights of action for damages

…

Sch 5.4	G	…					
		SYSC 11 to *SYSC* ~~19~~ 19A					

Annex C

Amendments to the General Prudential sourcebook (GENPRU)

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

1.2.31 R …

(4) Business risk means any risk to a *firm* arising from changes in its business, including the risk that the *firm* may not be able to carry out its business plan and its desired strategy. It also includes risks arising from a *firm's remuneration policy* (see also the *Remuneration Code* which applies to ~~certain *banks*, *building societies* and *BIPRU 730k*~~ *BIPRU firms* and the detailed application of which is set out in *SYSC* 19A.1).

…

Annex D

Amendments to the Supervision manual (SUP)

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

13A Annex 1 Application of the Handbook to Incoming EEA Firms

…		
(1) Module of Handbook	(2) Potential application to an incoming EEA firm with respect to activities carried on from an establishment of the firm (or its appointed representative) in the United Kingdom	(3) Potential application to an incoming EEA firm with respect to activities carried on other than from an establishment of the firm (or its appointed representative) in the United Kingdom
…	…	…
SYSC	… *SYSC* 18 applies. *SYSC* 19A does not apply ~~to an *incoming EEA firm* when acting as such~~.	… *SYSC* 19A does not apply.
…	…	…

Appendix 2

Applying the Remuneration Code Proportionately

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16 December 2010

PART A: INTRODUCTION & INTERPRETATION

Introduction

Status of guidance statement

1. This statement is general *guidance* given by the *FSA* under section 157(1) of the *Act*. It relates both to—

   (1) the *Remuneration Code* of *SYSC* 19A of the *Handbook*, and

   (2) the requirement to make Pillar 3 disclosures in relation to *remuneration* (in accordance with *BIPRU* 11 of the *Handbook*).

2. Paragraphs 14 and 15 make provision about the interpretation of this *guidance* statement. Expressions in italics either bear the meaning in the *Handbook Glossary*, or in the table in paragraph 15.

3. This *guidance* statement has effect from 1 January 2011.

Remuneration principles proportionality rule

4. The *remuneration principles proportionality rule* is set out in *SYSC* 19A.3.3R(2).

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

6. General *guidance* is given in relation to specific aspects of the *remuneration principles proportionality rule* in *SYSC* itself.[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 *firm*.

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.

9. This *guidance* statement represents our initial *guidance* in a field where new requirements relating to *remuneration* are being implemented within the *EEA*. The *FSA* recognises this will be an evolving process, and intends to keep the *guidance* set out in this *guidance* statement under review.

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[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) and the transitional *guidance* given in *SYSC* TP3.5G and *SYSC* TP3.6G.

Guidance on proportionality in relation to remuneration committees and Pillar 3 remuneration disclosures

10. The *remuneration principles proportionality rule* does not apply to the requirement to establish a *remuneration* committee or to make disclosures in relation to *remuneration* under *BIPRU* 11 (as part of Pillar 3). But these requirements are governed by similar proportionality *rules*, on which *guidance* is given in Parts F and G of this *guidance* statement.

Individual guidance

11. The *FSA* may give individual *guidance* to a *firm*, either on its own initiative or on the application of the *firm*. The *FSA's* policy on individual *guidance* is set out in *SUP* 9. In consequence, the *FSA* may give individual *guidance* to a *firm* in relation to the *remuneration principles proportionality rule*. Such *guidance* may relate to the application of the *rule* by the *firm* generally, or in specific areas.

Arrangement of guidance statement

12. This general *guidance* statement is divided into seven Parts:

    (1) This Part, Part A: Introduction & interpretation.

    (2) Part B: Proportionality tiers.

    (3) Part C: Process for dividing firms into proportionality tiers.

    (4) Part D: Guidance to firms in particular proportionality tiers.

    (5) Part E: Guidance about part-year Remuneration Code staff.

    (6) Part F: Remuneration committees.

    (7) Part G: Pillar 3 remuneration disclosures (BIPRU 11).

13. It is supplemented by two Appendices:

    (1) Appendix 1: Supplemental guidance on dividing firms into proportionality tiers.

    (2) Appendix 2: Pillar 3 disclosure requirements by proportionality tier.

Interpretation

14. This *guidance* statement is to be interpreted as if it was an Annex to *SYSC* 19A (other than Part G and Appendix 2, which are to be interpreted as if they were an Annex to *BIPRU* 11). In consequence, *GEN* 2 (interpreting the Handbook) applies to the interpretation of this *guidance* statement.

15. 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—

Table 1: Glossary of terms defined in this guidance statement

Defined expression	**Definition**
CEBS Guidelines	'Guidelines on Remuneration Policies and Practices' of 10 December 2010 of

	the Committee of European Banking Supervisors.
group	has the meaning given in the *Glossary* under paragraph (3).
proportionality tier	has the meaning given in paragraph 17, and references to *proportionality tier one*, etc. are to be construed accordingly.
Remuneration Code firm	a *BIPRU firm* or *third country BIPRU firm* to whom the Remuneration Code applies (in accordance with *SYSC* 19A.1.1R).
solo Remuneration Code firm	a *Remuneration Code firm* which is not part of a *group* containing one or more other *Remuneration Code firms*.

Part B: Proportionality tiers

16. *SYSC* 19A.1.1R provides that the *Remuneration Code* applies to a *BIPRU firm* and a *third country BIPRU firm* (in the case of a *third country BIPRU firm,* in relation to the activities carried on from an establishment in the *United Kingdom*). In this *guidance* statement, such *firms* are referred to as *Remuneration Code firms.*

17. This *guidance* statement provides for the division of *Remuneration Code firms* into four categories—

    (1) *proportionality tier one*,

    (2) *proportionality tier two*,

    (3) *proportionality tier three*, and

    (4) *proportionality tier four*.

18. The process by which firms are divided into *proportionality tiers* is provided in Part C (as supplemented by Appendix 1), and may also depend on individual *guidance*.

19. The *proportionality tiers* provide a framework for the operation of the *remuneration principles proportionality rule*. *Guidance* is given to *firms* in different *proportionality tiers* in Part D.

20. The *proportionality tiers* are also used as the basis for *guidance* on separate proportionality *rules* which apply in relation to *remuneration* committees (Part F) and Pillar 3 remuneration disclosures (Part G and Appendix 2).

PART C: PROCESS FOR DIVIDING FIRMS INTO PROPORTIONALITY TIERS

Overview

21. This Part provides the process by which a *Remuneration Code firm* should ascertain the *proportionality tier* into which it falls. Appendix 1 provides supplementary *guidance* (including examples).

22. A *Remuneration Code firm*, in order to ascertain its *proportionality tier*, 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 tier* will depend on its individual characteristics (as determined in accordance with paragraphs 24 to 26).

    (2) If the *firm* is part of such a *group*, its *proportionality tier* will depend on a two-stage process (as provided in paragraphs 27 and 28).

    (This requires all *Remuneration Code firms* that are part of the *group* to fall into the highest *proportionality tier* that any individual *Remuneration Code firm* in the group would fall into on the assumption that it was a *solo Remuneration Code firm*.)

23. Individual *guidance* may vary the *proportionality tier* into which a *firm* would otherwise fall under paragraphs 24 to 28.

Solo Remuneration Code firms

24. A *solo Remuneration Code firm's proportionality tier* depends on whether it is—

    (1) a *BIPRU firm*, or

    (2) a *third country BIPRU firm*.

BIPRU firms

25. The following table shows the *proportionality tier* into which a *solo Remuneration Code firm* that is a *BIPRU firm* falls:

    (1) A *firm* of the description given in the second column falls into the *proportionality tier* listed in the first column.

    (2) Where applicable, the *firm's proportionality tier* will further depend on whether it held *capital resources* on its last *accounting reference date* of the amount listed in the third column of the table.

Table 2: Proportionality tiers: solo Remuneration Code firms which are BIPRU firms

Proportionality tier	**Type of firm**	**Capital resources on last accounting reference date of firm** (where applicable)

Proportionality tier one	*UK Bank*.	Exceeding £1 billion.
	Building society.	Exceeding £1 billion.
	BIPRU 730k firm that is a *full scope BIPRU investment firm*.	Exceeding £750 million.
Proportionality tier two	*UK Bank*.	Exceeding £50 million, but not exceeding £1 billion.
	Building society.	Exceeding £50 million, but not exceeding £1 billion.
	BIPRU 730k firm that is a *full scope BIPRU investment firm*.	Exceeding £100 million, but not exceeding £750 million.
Proportionality tier three	*UK Bank*.	Not exceeding £50 million.
	Building society.	Not exceeding £50 million.
	Any *full scope BIPRU investment firm* that does not fall within *proportionality tier one* or *proportionality tier two* (in accordance with this Table).	Not applicable.
Proportionality tier four	*BIPRU limited licence firm*.	Not applicable.
	BIPRU limited activity firm.	Not applicable.

Third country BIPRU firms

26. The following table shows the *proportionality tier* into which a *solo Remuneration Code firm* that is a *third country BIPRU firm* falls:

    (1) A *firm* of the description given in the second column falls into the *proportionality tier* listed in the first column.

    (2) Where applicable, the *firm's proportionality tier* will further depend on whether it held relevant total assets on the last relevant date of the amount listed in the third column of the table.

    (3) In (2)—

        (a) "relevant total assets" means the total assets of the *firm* that cover the activities of the branch operation in the *United Kingdom*;

        (b) "relevant date" means 31 December 2010, and each subsequent anniversary.

    The limit confining relevant total assets to those that cover the activities of the branch operation in the *United Kingdom* is taken from *SUP*

16.12.3R(1)(iv), which relates to a reporting requirement in relation to *non-EEA banks* (among others). The *FSA* considers that a *firm* which needs to ascertain its relevant total assets should, as appropriate, apply an analogous methodology to that used by a *non-EEA bank* in completing data element A14 of FSA044 (so, for example, the general policy on valuation set out in *GENPRU* 1.3 should be applied).

These definitions are intended to apply on an interim basis, as FSA044 is to be withdrawn. The *FSA* will in due course consider whether to revise the definitions relating to the tier thresholds for *third country BIPRU firms*.

Table 3: Proportionality tiers: solo Remuneration Code firms which are third country BIPRU firms

Proportionality tier	**Type of firm**	**Relevant total assets on last relevant date** (where applicable)
Proportionality tier one	*Third country BIPRU firm* that is not a *limited licence firm* or *limited activity firm.*	Exceeding £25 billion.
Proportionality tier two	*Third country BIPRU firm* that is not a *limited licence firm* or *limited activity firm.*	Exceeding £2 billion, but not exceeding £25 billion.
Proportionality tier three	*Third country BIPRU firm* that is not a *limited licence firm* or *limited activity firm.*	Not exceeding £2 billion.
Proportionality tier four	*Limited licence firm.*	Not applicable.
	Limited activity firm.	Not applicable.

Groups with more than one Remuneration Code firm

27. 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 tier* into which it would fall on the assumption that it was a *solo Remuneration Code firm*.

    (2) Where each *Remuneration Code firm* falls into the same *proportionality tier* on the assumption that it was a *solo Remuneration Code firm*, each *firm* falls into that *proportionality tier*.

    (3) Where the *Remuneration Code firms* fall into different *proportionality tiers* on the assumption that they were *solo Remuneration Code firms*, each *firm* falls into the highest *proportionality tier*.

(4) For the purposes of (3), *proportionality tier one* is the highest and *proportionality tier four* is the lowest.

28. Appendix 1 provides examples of this approach. A *firm* which has a higher *proportionality tier* as a result of the *guidance* in paragraph 27 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 tier* (as discussed in paragraphs 5 and 6 of Appendix 1).

PART D: GUIDANCE TO FIRMS IN PARTICULAR PROPORTIONALITY TIERS

Purpose of proportionality tiers

29. In relation to the *remuneration principles proportionality rule*, the *proportionality tiers* provide the following:

    (1) A framework for the *FSA's* supervisory approach, and a broad indication of the *FSA's* likely expectations.

    (2) *Guidance* on which *remuneration* principles may normally be disapplied under the *remuneration principles proportionality rule*.

    As noted above, this is initial *guidance* in an evolving field.

30. The *proportionality tiers* also provide *guidance* on the separate but similar proportionality *rules* that apply in relation to—

    (1) *remuneration* committees (Part F), and

    (2) Pillar 3 disclosures in relation to *remuneration* (Part G and Appendix 2).

Firms to continue to consider proportionality in their individual circumstances, etc.

31. It follows from the nature of the *remuneration principles proportionality rule*, and the limited purposes noted in paragraph 29, that the *proportionality tiers* 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.

32. A *firm* should bear in mind that the *Remuneration Code* may require different responses from *firms* that fall into the same *proportionality tier*. This is illustrated by the following example:

    (1) Firm A is a global bank with capital resources of £10 billion, with substantial investment banking business, foreign exchange exposures and a complex business model seeking aggressive growth. It falls into *proportionality tier one*.

    (2) Firm B is a large mortgage and savings bank with capital resources of £1.5 billion and a comparatively simple, conservative business model. It falls into *proportionality tier one*.

    (3) Firm C is a large building society, with capital resources of £800 million and a comparatively simple, conservative business model. It falls into *proportionality tier 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 tier*. 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 tiers

33. The *Banking Consolidation Directive* can be interpreted such that it may not be necessary for certain *firms* to apply certain *remuneration* principles at all.[2] This has been endorsed and elaborated in the *CEBS Guidelines*.[3]

34. In the view of the *FSA*, it will normally be appropriate for a *firm* in *proportionality tier three* or *proportionality tier four* to disapply under the *remuneration principles proportionality rule* the following *rules*—

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

    (2) deferral (*SYSC* 19A.3.49R), and

    (3) performance adjustment (*SYSC* 19A.3.51R).

35. The following *guidance* applies to *firms* in *proportionality tier four* that are *limited licence firms* or *limited activity firms*:[4]

    (1) In the view of the *FSA*, it will normally be appropriate for such a *firm* to disapply under the *remuneration principles proportionality rule* the *rule* on ratios between fixed and variable components of total *remuneration* (*SYSC* 19A.3.44R).

    (2) The *FSA* also endorses the *CEBS Guidelines* where they state that such *firms* may "take into account the specific features of their types of activities" in applying the "requirement on the multi-year framework …, in particular the accrual and ex-ante risk adjustment aspects of it" as discussed further in section 4.2.2.a of the *Guidelines*.[5]

36. However, *firms* should also note that some *remuneration* principles set specific numerical criteria (such as on the minimum period of deferral, the minimum portion to be deferred and the minimum portion to be issued in *shares*). The following *guidance* applies where such principles apply to *Remuneration Code staff* and are not capable of disapplication under the approach set out above. In such circumstances, the *FSA*, in line with the *CEBS Guidelines*, does not consider that the *remuneration principles proportionality rule* permits a *firm* to apply lower numerical criteria.[6] (For the avoidance of doubt, this *guidance* does not apply where a *firm* chooses to use deferral or issuance in shares more widely than required by *SYSC* 19A.3, for example in order to comply with the *Remuneration Code general requirement*.)

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[2] *Banking Consolidation Directive*, Annex V, paragraph 23 provides that the principles should be applied by *firms* "in a way and to the extent that is appropriate to their size, internal organisation and the nature, the scope and complexity of their activities" (emphasis added).

[3] *CEBS Guidelines*, paragraphs 19 to 23.

[4] Under the approach set out in paragraphs 24 to 26, *proportionality tier four* will compromise only *limited licence firms* or *limited activity firms*. However, a firm other than a *limited licence firm* or *limited activity firm* could conceivably fall into *proportionality tier four* as a result of individual *guidance*.

[5] *CEBS Guidelines*, paragraph 20.

[6] *CEBS Guidelines*, paragraph 19.

PART E: GUIDANCE ABOUT PART-YEAR REMUNERATION CODE STAFF

Introduction

37. *SYSC* 19A.3.34G provides *guidance* on when the *FSA* does not generally consider it necessary for a *firm* to apply to certain *Remuneration Code staff* certain *rules* relating to *remuneration* structures. This Part provides further *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.

38. In giving this *guidance*, the *FSA* has taken account of the *remuneration principles proportionality rule*.

Part-year Remuneration Code staff for more than three months

39. 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) The *FSA* does 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).

(5) Sub-paragraph (6) applies where one or both of the conditions in (3) are not satisfied (and accordingly where the *firm* should apply in relation to A the rules referred to in (4)).

(6) Where this sub-paragraph applies, the *FSA* generally considers 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.3.49R), and

(c) performance adjustment (*SYSC* 19A.3.51R).

(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* for the entire 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 A1's *Remuneration Code staff* role A1's fixed *remuneration* increases to £250,000. For the performance year, A1 is awarded variable *remuneration* of £120,000.

(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 £40,110 (£120,000 multiplied by 122/365). A1's total qualifying *remuneration* is £123,670. 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*, so 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 £40,110.

(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 period of 1 July 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*, so 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 adjustment must be applied to A2's qualifying variable *remuneration* of £50,000.

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

40. Paragraphs 41 and 42 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*.

41. Where this paragraph applies, the *FSA* does 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), and

(3) performance adjustment (*SYSC* 19A.3.51R).

42. Where this paragraph applies, the guidance in paragraph 39(2), (3) and (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 "B").

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

43. Paragraph 44 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 as *Remuneration Code staff*.

44. The guidance in paragraph 39 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.

PART F: REMUNERATION COMMITTEES

General

45. Remuneration Principle 4 (Governance) provides, in *SYSC* 19A.3.12R(1), that a *firm* that is significant in terms of its size, internal organisation and the nature, the scope and the complexity of its activities must establish a *remuneration* committee.

46. The following table provides *guidance* on when the *FSA* considers it would be appropriate for a *remuneration* committee to established under SYSC 19A.3.12R, based on the *proportionality tier* into which the *firm* falls (as determined in accordance with Part C of this *guidance* statement (as supplemented by Appendix 1))—

Table 4: Guidance on whether SYSC 19A.3.12R remuneration committee required

Proportionality tier	**SYSC 19A.3.12R remuneration committee?**
Proportionality tier one and *proportionality tier two*	The *FSA* considers that such a *remuneration* committee should be established.
Proportionality tiers three and *proportionality tier four*	The *FSA* considers that it would be desirable for such a *remuneration* committee to be established, and would normally expect larger *proportionality tier three* and *proportionality tier four* firms to do so. But the *FSA* accepts that it may be appropriate for the *governing body* of the *firm* to act as the *remuneration* committee.

Subsidiaries of overseas groups / third country BIPRU firms

47. This *guidance* relates, broadly speaking, to a *Remuneration Code firm* which is a *third country BIPRU firm*, or a *BIPRU firm* that is part of a *group* not subject to consolidated supervision by the *FSA*.

48. The *FSA* accepts that it may be possible for certain such *firms* to justify on the ground of proportionality not establishing under *SYSC* 19A.3.12R at solo level a *remuneration* committee. However, in such circumstances, it would be necessary to show how the functions which would otherwise have been performed by such a *remuneration* committee would be discharged. The *FSA* would expect as a minimum to be satisfied that the operational arrangements ensured sufficient independence from those performing executive functions at *firm* or *group* level, and were discharged with sufficient authority.

PART G: PILLAR 3 REMUNERATION DISCLOSURES (BIPRU 11)

Requirement to make Pillar 3 remuneration disclosures

49. *BIPRU* 11 requires certain *Remuneration Code firms* to disclose a series of qualitative and quantitative information relating to *remuneration* (*BIPRU* 11.3 and *BIPRU* 11.5.18R). The basis of the disclosure (which may be on a consolidated basis) is set out in *BIPRU* 11.2.

50. *BIPRU* 11 applies only to certain *Remuneration Code firms* (in that it applies to *BIPRU firms*, but not *third country BIPRU firms*).

Pillar 3 remuneration disclosures & proportionality

51. Two proportionality tests apply in relation to the requirement to make Pillar 3 disclosures in relation to *remuneration*:

    (1) A *BIPRU 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* (*BIPRU* 11.5.20R(1)).

    (2) *BIPRU firms* must comply 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 (*BIPRU* 11.5.20R(2)).

52. The *FSA* considers that it is appropriate to give *guidance* on these proportionality tests by reference to the *proportionality tiers* determined in accordance with Part C of this *guidance* statement (as supplemented by Appendix 1). However, as the disclosure requirement applies only to *BIPRU firms*, when applying the guidance in paragraph 27, only *Remuneration Code firms* which are *BIPRU firms* should be taken into account.

53. In relation to the proportionality test referred to in paragraph 51(1), the *FSA* considers that a *firm* should be regarded as “significant” if it falls into *proportionality tier one*.

54. In relation to the proportionality test set referred to in paragraph 51(2), the table in Appendix 2 sets out the categories of information that the *FSA* considers *firms* in different *proportionality tiers* should disclose.

Appendix 1: Supplemental guidance on dividing firms into proportionality tiers

Groups with more than one Remuneration Code firm: examples

1. The following non-exhaustive examples illustrate the operation of the *guidance* provided in paragraph 27 of Part C. (It should be borne in mind that in each case individual *guidance* could vary the outcome of the operation of the *guidance* provided in that paragraph.)

2. Example 1:

   (1) Firm A is the *parent undertaking* of Firm B.

   (2) Firm A is a *UK bank* that had *capital resources* of £1.5 billion 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 tier one* and Firm B falls into *proportionality tier four*.

   (4) As a result of the guidance at paragraph 27 of Part C, both Firms A and B fall into *proportionality tier one*.

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 *UK bank* that had *capital resources* of £1.5 billion on its last *accounting reference date*.

   (3) On the assumption that they were *solo Remuneration Code firms*, Firm C falls into *proportionality tier four* and Firm D falls into *proportionality tier one*.

   (4) As a result of the guidance at paragraph 27 of Part C, both Firms C and D fall into *proportionality tier one*.

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 *BIPRU 730k firm* that is a *full scope BIPRU investment firm* and that had *capital resources* of £500 million on its last *accounting reference date*.

      (c) Firms G and J are *limited activity firms*.

      (d) Firm I is a *UK bank* that had *capital resources* of £20 million on its last *accounting reference date*.

   (3) On the assumption that they were *solo Remuneration Code firms*—

      (a) Firm F falls into *proportionality tier two*,

(b) Firms G and J fall into *proportionality tier four*, and

(c) Firm I falls into *proportionality tier three*.

(4) As a result of the guidance at paragraph 27 of Part C, Firms F, G, I and J all fall into *proportionality tier two*.

Role of individual guidance

5. Individual *guidance* may vary the *proportionality tier* into which a *firm* would fall under the general *guidance* set out in Part C and supplemented by this Appendix. In consequence, the definitions and thresholds provided in Part C do not provide an immutable classification. The *CEBS Guidelines* also provide guidance on applying proportionality between different institutions.[7]

6. The following provide non-exhaustive high level examples of where the *FSA* might consider providing individual *guidance* to vary a *proportionality tier*:

(1) Where a *firm* was just below the threshold for a particular *proportionality tier* (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 tier*.

(2) Where a *group* of *firms* contained several *firms* falling into a common *proportionality tier*, but where the aggregate prudential risk posed by the *group* suggested that a higher *proportionality tier* was more appropriate.

(3) Where a *firm* falls into a higher *proportionality tier* as a result of the guidance at paragraph 27 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.

[7] *CEBS Guidelines*, paragraphs 24 and 25.

APPENDIX 2: PILLAR 3 DISCLOSURE REQUIREMENTS BY PROPORTIONALITY TIER

BIPRU 11.5.18R disclosure requirement	Relevant proportionality tier			
	Proportionality tier one	**Proportionality tier two**	**Proportionality tier three**	**Proportionality tier four**
BIPRU 11.5.18R (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”).	✓	✓	✓	✓
BIPRU 11.5.18R(2) (‘information on the link between pay and performance’).	✓	✓	✓	✓
BIPRU 11.5.18R(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’).	✓	✓		
BIPRU 11.5.18R(4) (‘information on the performance criteria on which the entitlement to shares, options or variable components of remuneration is based’).	✓			
BIPRU 11.5.18R(5) (‘the main parameters and rationale for any variable component scheme and any other non-cash benefits’).	✓			
BIPRU 11.5.18R(6) (‘aggregate quantitative information on remuneration, broken down by business area’).	✓	✓	✓	✓
BIPRU 11.5.18R(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:				
BIPRU 11.5.18R(7)(a) (‘the amounts of remuneration for the financial year, split into fixed and variable remuneration, and the number of beneficiaries’).	✓	✓	✓	
BIPRU 11.5.18R(7)(b) (‘the amounts and forms of variable remuneration, split into cash, shares, share-linked instruments and other types’).	✓			
BIPRU 11.5.18R(7)(c) (‘the amounts of outstanding deferred remuneration, split into vested and unvested portions’).	✓			
BIPRU 11.5.18R(7)(d) (‘the amounts of deferred remuneration awarded during the financial year, paid out and reduced through performance adjustments’).	✓			
BIPRU 11.5.18R(7)(e) (‘new sign-on and severance payments made during the financial year, and the number of beneficiaries of those payments’).	✓			
BIPRU 11.5.18R(7)(f) (‘the amounts of severance payments awarded during the financial year, number of beneficiaries and highest such award to a single person’).	✓			

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