

Senior Management Arrangements, Systems and Controls

Chapter 19G

MIFIDPRU Remuneration Code

19G.6 Variable remuneration

Remuneration and capital

- 19G.6.1 **R** A MIFIDPRU investment firm must ensure that variable remuneration does not affect the firm's ability to ensure a sound capital base.

Exceptional government intervention

- 19G.6.2 **R** A MIFIDPRU investment firm that benefits from exceptional government intervention must ensure that:
- (1) no variable remuneration is paid to members of its management body, unless it is justified to do so; and
 - (2) variable remuneration is limited to a portion of net revenue when its payment to staff that are not members of its management body would be inconsistent with:
 - (a) the maintenance of the firm's sound capital base; and
 - (b) its timely exit from exceptional government intervention.

- 19G.6.3 **G** An example of where it may be justifiable to pay variable remuneration to a member of the management body of a MIFIDPRU investment firm that benefits from exceptional government intervention is where that person was not in office at the time the exceptional government intervention was first required.

Assessment of performance

- 19G.6.4 **R** A non-SNI MIFIDPRU investment firm must ensure that where variable remuneration is performance-related:
- (1) the total amount of the variable remuneration is based on a combination of the assessment of the performance of:
 - (a) the material risk taker;
 - (b) the business unit concerned; and
 - (c) the overall results of the firm;
 - (2) the assessment of performance is part of a multi-year framework that ensures:
 - (a) the assessment of performance is based on longer-term performance; and

- (b) the payment of performance-based *remuneration* is spread over a period that takes account of the business cycle of the *firm* and its business risks.

19G.6.5 **R** When assessing individual performance to determine the amount of variable *remuneration* to be paid to an *individual*, a *MIFIDPRU investment firm* must take into account financial as well as non-financial criteria.

19G.6.6 **G**

- (1) For some *firms* it may be appropriate to give equal weight to financial and non-financial criteria for the purposes of **SYSC 19G.6.5R**. For other *firms* a slightly different split may be appropriate.
- (2) Non-financial criteria under **SYSC 19G.6.5R** should:
 - (a) form a significant part of the performance assessment process;
 - (b) override financial criteria, where appropriate;
 - (c) include metrics on conduct, which should make up a substantial portion of the non-financial criteria; and
 - (d) include how far the *individual* adheres to effective risk management and complies with relevant regulatory requirements.
- (3) Examples of non-financial criteria under **SYSC 19G.6.5R** include:
 - (a) measures relating to building and maintaining positive customer relationships and outcomes, such as positive customer feedback;
 - (b) performance in line with firm strategy or values, for example by displaying leadership, teamwork or creativity;
 - (c) adherence to the *firm's* risk management and compliance policies;
 - (d) achieving targets relating to:
 - (i) environmental, social and governance factors; and
 - (ii) diversity and inclusion.
- (4) A *firm* should ensure that when it assesses individual performance, the assessment process and any variable *remuneration* awarded in accordance with **SYSC 19G.6.4R** does not discriminate on the basis of the protected characteristics of an *individual* in accordance with the Equality Act 2010.

General requirements for awards of non-standard forms of variable remuneration

19G.6.7 **R**

- (1) A *non-SNI MIFIDPRU investment firm* must ensure that all guaranteed variable *remuneration*, retention awards, severance pay and buy-out awards falling under **SYSC 19G.6.8R** to **SYSC 19G.6.14G** are:
 - (a) subject to malus and clawback;
 - (b) in the case of *non-SNI MIFIDPRU investment firms* to which those rules apply:
 - (i) subject to the requirements in **SYSC 19G.6.19R** and **SYSC 19G.6.21G** (Shares, instruments and alternative arrangements), **SYSC 19G.6.22R** and **SYSC 19G.6.23G**

(Retention policy), and ■ SYSC 19G.6.24R to ■ SYSC 19G.6.29R (Deferral); and

(ii) included in the variable component of the variable to fixed ratio for the performance period in which the award is made.

(2) A *non-SNI MIFIDPRU investment firm* must ensure that each decision it makes to award variable remuneration falling within the scope of (1) is appropriate, taking all relevant circumstances into account.

Guaranteed variable remuneration

19G.6.8

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A *non-SNI MIFIDPRU investment firm* must not award, pay or provide guaranteed variable remuneration to a *material risk taker* unless:

- (1) it occurs in the context of hiring a new *material risk taker*;
- (2) it is limited to the first year of service; and
- (3) the *firm* has a strong capital base.

19G.6.9

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(1) Guaranteed variable remuneration is sometimes referred to as a 'sign-on bonus' or 'golden handshake'.

(2) Guaranteed variable remuneration can be used as a way to compensate new staff members where they have lost the opportunity to receive variable remuneration by leaving their previous employment during the performance period. These awards may be called 'lost opportunity bonuses'.

(3) The *FCA* expects *non-SNI MIFIDPRU investment firms* to award guaranteed remuneration only rarely and not as common practice.

Retention awards

19G.6.10

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Retention awards must only be paid to *material risk takers*:

- (1) after a defined event; or
- (2) at a specified point in time.

19G.6.11

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(1) Retention awards are bonuses which are dependent on an *individual* remaining in a role until a defined event or for a set period of time. For example, retention bonuses can be used under restructurings, in wind-down or in the context of specific projects within a *firm*.

(2) The payment of a retention award may be made dependent on the *material risk taker* meeting certain performance criteria that have been defined in advance.

(3) The *FCA* expects *non-SNI MIFIDPRU investment firms* to make retention awards to *material risk takers* only rarely and not as common practice.

Severance pay

- 19G.6.12** **R** (1) A *non-SNI MIFIDPRU investment firm* must ensure that payments to *material risk takers* relating to the early termination of an employment contract reflect the *individual's* performance over time and do not reward failure or misconduct.
- (2) A *non-SNI MIFIDPRU investment firm* must set out in its *remuneration policy* whether severance payments may be paid, and any maximum amount or criteria for determining the amount.

Buy-out awards

- 19G.6.13** **R** A *non-SNI MIFIDPRU investment firm* must ensure that *remuneration packages* relating to compensation for, or buy out from, a *material risk taker's* contracts in previous employment:
- (1) align with the long term interests of the *firm*; and
- (2) contain provisions on periods of retention, deferral, vesting and ex post risk adjustment that are no shorter than any corresponding periods that applied to unvested variable *remuneration* under the previous contract of employment, and which remained outstanding.

- 19G.6.14** **G** Buy-out awards involve a *firm* compensating a new staff member, or 'buying out' their previous contract with another employer, where the deferred variable *remuneration* of the staff member was reduced, revoked or cancelled by the previous employer. This could be because they terminated their contract or because the *individual* has to pay back some money, for example where the employer has paid for a training course or qualification for the *individual* that was attached to a retention clause.

Risk adjustment

- 19G.6.15** **R** A *non-SNI MIFIDPRU investment firm* must ensure that any measurement of performance used as a basis to calculate pools of variable *remuneration* takes into account all types of current and future risks and the cost of the capital and liquidity required in accordance with *MIFIDPRU*.

- 19G.6.16** **R** A *non-SNI MIFIDPRU investment firm* must ensure that the allocation of variable *remuneration* components within the *firm* takes into account all types of current and future risks.

- 19G.6.17** **R** For the purposes of **SYSC 19G.6.15R** and **SYSC 19G.6.16R**, a *non-SNI MIFIDPRU investment firm* must:
- (1) determine at what level the adjustments should be applied (for example at *business unit*, trading desk or individual level), which risks are relevant, and which risk adjustment techniques and measures are most appropriate; and
- (2) in considering all types of current and future risks, include both financial risks (for example economic profit or economic capital) and

non-financial risks (for example reputation, conduct and customer outcomes, values and strategy).

- 19G.6.18** R A *non-SNI MIFIDPRU investment firm* must ensure that its total variable remuneration is generally considerably contracted, including through malus or clawback arrangements, where the financial performance of the *firm* is subdued or negative.

Shares, instruments and alternative arrangements

- 19G.6.19** R A *non-SNI MIFIDPRU investment firm* to which this rule applies must ensure that at least 50% of the variable remuneration paid to a *material risk taker* in relation to a performance period consists of any of the following *eligible instruments*:

- (1) *shares*, or subject to the *firm's* legal structure, equivalent ownership interests;
- (2) *share-linked instruments*, or subject to the *firm's* legal structure, equivalent non-cash instruments;
- (3) instruments that comply with the requirements in ■ SYSC 19G Annex 1R; or
- (4) non-cash instruments (including those settled in cash) which reflect the instruments of the portfolios managed.

- 19G.6.20** R Where an *eligible instrument* that falls within the scope of ■ SYSC 19G.6.19R(1) or ■ (2) relates to an ownership interest in a *parent undertaking* of the *MIFIDPRU investment firm*, it will only satisfy the requirements of ■ SYSC 19G.6.19R where its value moves in line with the value of an equivalent ownership interest in the *MIFIDPRU investment firm*.

- 19G.6.21** G
- (1) Where a *MIFIDPRU investment firm* is unable to issue *eligible instruments*, the *firm* may apply to the *FCA* for a modification under section 138A of the *Act* to permit the *firm* to use alternative arrangements. The *firm* will need to provide a detailed explanation in its application of the alternative arrangements it is proposing to operate.
 - (2) The *FCA* may grant a modification under section 138A of the *Act* for these purposes only where it is satisfied that:
 - (a) compliance by the *firm* with the requirement to issue variable remuneration in *eligible instruments* would be unduly burdensome or would not achieve the purpose for which the *rules* were made; and
 - (b) granting the modification would not adversely affect the advancement of any of the *FCA's* objectives.
 - (3) As part of its assessment of whether the modification would adversely affect the advancement of its objectives, the *FCA* will consider whether the proposed alternative arrangements for variable remuneration achieve similar outcomes to the standard requirements

applicable to *eligible instruments*. In particular, the *FCA* will normally consider the following non-exhaustive list of factors:

- (a) whether the proposed alternative arrangement ensures suitable alignment between the interests of the staff member and the long-term interests of the *firm*, its *clients* and creditors;
 - (b) whether the proposed alternative arrangement is subject to a retention policy that is of sufficient length to align the incentives of the staff member with the long-term interests of the *firm*, its *clients* and creditors;
 - (c) whether the proposed alternative arrangement is clear and transparent to the staff member and contains sufficient detail on the applicable conditions;
 - (d) whether the *firm* will ensure that any amounts that are subject to deferral and retention arrangements cannot be accessed, transferred or redeemed by the staff member during the deferral and retention periods;
 - (e) whether the proposed alternative arrangement would facilitate the appropriate application of malus and clawback requirements;
 - (f) whether the proposed alternative arrangements adequately ensure that the value of the variable *remuneration* received does not increase during the deferral period through distributions or other payments on the instrument; and
 - (g) where the proposed alternative arrangements allow for predetermined changes of the value received as variable *remuneration* during deferral and retention periods, based on the performance of the *firm* or the managed assets, whether the following conditions would be met:
 - (i) the change of the value is based on predefined performance indicators that are based on the credit quality of the *firm* or the performance of the managed assets;
 - (ii) where deferral and retention must be applied, value changes are calculated at least annually and at the end of the retention period;
 - (iii) the rate of possible positive and negative value changes is equally based on the level of positive or negative credit quality changes or performance measured;
 - (iv) where the value change under (i) is based on the performance of assets managed, the percentage of value change should be limited to the percentage of value change of the managed assets;
 - (v) where the value change under (i) is based on the credit quality of the *firm*, the percentage of value change should be limited to the percentage of the annual total gross revenue in relation to the *firm's* total own funds.
- (4) If a *firm* cannot issue *eligible instruments* because of its legal structure, that is likely to be a reason for the *FCA* to conclude that requiring the *firm* to comply with ■ SYSC 19G.6.19R would not achieve the purpose for which that *rule* was made.

Retention policy

19G.6.22 **R** A *non-SNI MIFIDPRU investment firm* to which this rule applies must establish an appropriate retention policy for *eligible instruments* that is designed to align the interests of the staff member with the longer-term interests of the *firm*, its creditors and clients.

19G.6.23 **G**

- (1) In considering what is an appropriate retention policy for the purposes of **SYSC 19G.6.22R**, a *firm* should consider at least the following:
 - (a) the length of the deferral period referred to in **SYSC 19G.6.24R(1)**;
 - (b) the length of the *firm's* business cycle;
 - (c) the types of risks relevant to the role of the staff member; and
 - (d) how long it could take for the risks underlying the staff member's performance to crystallise.
- (2) The greater the impact of the *material risk taker* on the risk profile of the *firm* and of the assets managed, the longer the retention period should be. Different retention periods for different *material risk takers* may be appropriate, particularly where the applicable deferral periods differ.

Deferral

19G.6.24 **R**

- (1) A *non-SNI MIFIDPRU investment firm* to which this rule applies must not award, pay or provide a variable *remuneration* component unless at least 40% is deferred over a period which is at least 3 years.
- (2) Where the variable *remuneration* is a particularly high amount, and in all cases where the variable *remuneration* is £500,000 or more, at least 60% of the amount must be deferred.
- (3) Deferred variable *remuneration* must vest no faster than on a pro-rata basis.
- (4) The first deferred portion of the variable *remuneration* must not vest sooner than a year after the start of the deferral period.

19G.6.25 **R**

- (1) A *non-SNI MIFIDPRU investment firm* must take into account the factors in (2) when determining:
 - (a) the amount of variable *remuneration* to be deferred under **SYSC 19G.6.24R(1)** and (2);
 - (b) the length of the deferral period under **SYSC 19G.6.24R(1)**; and
 - (c) the speed of vesting of the variable *remuneration* for the purposes of **SYSC 19G.6.24R(3)**.
- (2) The factors referred to in (1) are:
 - (a) the *firm's* business cycle, the nature of its business and its risk profile;

- (b) the activities and responsibilities of the staff member in question and how these may impact the risk profile of the *firm* or the assets the *firm* manages;
- (c) whether the deferred variable *remuneration* is paid out in instruments or cash;
- (d) the amount of the variable *remuneration*; and
- (e) the ratio of variable to fixed *remuneration*.
- 19G.6.26** G (1) Where appropriate, a *firm* should tailor the proportion of deferred variable *remuneration*, the deferral period and the speed of vesting in different ways for different categories of *material risk taker*.
- (2) The *FCA* considers that it may be appropriate for the most senior *material risk takers* at a *firm* (for example members of the *management body*), to be subject to a deferral period longer than the 3-year minimum.
- (3) It may be appropriate for *firms* to apply different proportions of deferred variable *remuneration*, deferral periods or vesting arrangements to the portion of variable *remuneration* paid out in cash and the portion paid out in instruments.
- (4) In the *FCA*'s view, the higher the amount of the variable *remuneration*, and the higher the ratio of variable to fixed *remuneration*, the more appropriate it is likely to be to defer a greater proportion of the variable *remuneration*.
- (5) In certain circumstances variable *remuneration* below £500,000 may still be considered 'particularly high' and so subject to 60% deferral. A *firm* should take into account the average *remuneration* at the *firm*, the ratio of the variable to fixed *remuneration* of the *material risk taker*, and the amount of variable *remuneration* compared to that of other staff at the *firm*.
- (6) After the first deferred portion of the variable *remuneration* vests in accordance with ■ SYSC 19G.6.24R(4), the *FCA* does not expect vesting to take place more often than once a year.
- 19G.6.27** R A non-SNI MIFIDPRU investment *firm* must pay out at least 50% of the variable *remuneration* deferred under ■ SYSC 19G.6.24R in instruments falling within ■ SYSC 19G.6.19R.
- 19G.6.28** G The *FCA* considers it good practice for the deferred portion to contain a higher proportion of instruments than the non-deferred portion.
- 19G.6.29** R A non-SNI MIFIDPRU investment *firm* may only pay to a *material risk taker* interest or dividends on an instrument which is subject to deferral under SYSC 19G.24R where:

- (1) the rate of interest or level of dividends paid on that instrument is no higher than would have been paid to an ordinary holder of such an instrument; and
- (2) payment is not made before the date on which the instrument vests.

Performance adjustment

19G.6.30 **R**

A *non-SNI MIFIDPRU investment 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 on the basis of the performance of the *firm*, the *business unit* and the *material risk taker* concerned.

19G.6.31 **R**

A *non-SNI MIFIDPRU investment firm* must:

- (1) ensure that all of the total variable remuneration is subject to in-year adjustments, malus or clawback arrangements;
- (2) set specific criteria for the application of malus and clawback; and
- (3) ensure that the criteria for the application of malus and clawback in particular cover situations where the *material risk taker*:
 - (a) participated in or was responsible for conduct which resulted in significant losses to the *firm*; and/or
 - (b) failed to meet appropriate standards of fitness and propriety.

19G.6.32 **R**

A *non-SNI MIFIDPRU investment firm* must:

- set minimum malus and clawback periods as part of its remuneration policies;
- ensure that malus can be applied until the award has vested in its entirety; and
- ensure that the clawback period spans at least the combined length of any deferral and retention periods.

19G.6.33 **G**

- (1) The effect of **SYSC 19G.6.31R(1)** is that (save in the circumstances explained in (2)) a *non-SNI MIFIDPRU investment firm* must include in its remuneration policy the possibility of applying in-year adjustments, malus and clawback to the variable remuneration of its *material risk takers*. Where performance adjustment is required, the appropriate tool or tools (in-year adjustments, malus or clawback) should then be applied.
- (2) A *non-SNI MIFIDPRU investment firm* that is not required by **SYSC 19G.6.24R** to apply deferral will not be able to apply malus, so should foresee the use of in-year adjustments and clawback arrangements only. Alternatively, the *firm* may choose to use deferral, which would enable the use of malus arrangements in addition to in-year adjustments and clawback.

- (3) A *non-SNI MIFIDPRU investment firm* should ensure that the malus and clawback periods it sets and applies allow sufficient time for any potential risks to crystallise. This may mean that different periods are set for different categories of *material risk takers*.
- (4) In setting appropriate malus and clawback periods, a *non-SNI MIFIDPRU investment firm* should take into account all relevant factors, including:
 - the nature of the *material risk taker's* activities;
 - the *material risk taker's* impact on the risk profile of the *firm* or of the assets it manages; and
 - the length of the business cycle that is relevant for the *material risk taker's* role.
- (5) For a *non-SNI MIFIDPRU investment firm* that satisfies the conditions in ■ SYSC 19G.1.1R(2)(a) or ■ (b), the *FCA* considers that 3 years will generally be an appropriate starting point for the *firm's* consideration of the appropriate clawback period.
- (6) The *FCA's* 'General guidance on the application of ex-post risk adjustment to variable remuneration' provides further detail of the *FCA's* expectations on *firms'* use of malus and clawback arrangements.

19G.6.34 G

- (1) In the *FCA's* view, malus should be applied when, as a minimum:
 - (a) there is reasonable evidence of staff member misbehaviour or material error;
 - (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) In the *FCA's* view, clawback should, in particular, be applied in cases of fraud or other conduct with intent or severe negligence which led to significant losses.

Discretionary pension benefits
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19G.6.35 R

- (1) A *non-SNI MIFIDPRU investment firm* must ensure that:
 - (a) any *discretionary pension benefits* it awards or pays to *material risk takers* are:
 - (i) in line with its business strategy, objectives, values and long-term interests; and
 - (ii) paid only in *eligible instruments*;
 - (b) it applies malus and clawback arrangements to *discretionary pension benefits* in the same way as to other elements of variable remuneration.
- (2) A *non-SNI MIFIDPRU investment firm* to which this paragraph applies must ensure that:

- (a) where a *material risk taker* leaves the *firm* before retirement age, any *discretionary pension benefits* are held by the *firm* for a period of 5 years; and
- (b) where a *material risk taker* reaches retirement age, any *discretionary pension benefits* are subject to a 5-year retention period by that *individual*.

Personal investment strategies

19G.6.36 R A *non-SNI MIFIDPRU investment firm* must take all reasonable steps to ensure that *material risk takers* do not use personal hedging strategies or *remuneration-* and liability-related *contracts of insurance* to undermine the *remuneration rules* in the *MIFIDPRU Remuneration Code*.

19G.6.37 G Actions a *firm* may take under ■ SYSC 19G.6.36R include requesting an undertaking or declaration from its *material risk takers* and implementing policies regarding dealing in *financial instruments*.

Avoidance of the MIFIDPRU Remuneration Code

19G.6.38 R A *non-SNI MIFIDPRU investment firm* must not pay *variable remuneration* through financial vehicles or methods that facilitate non-compliance with the *MIFIDPRU Remuneration Code* or *MIFIDPRU*.