

Chapter 19D

Dual-regulated firms Remuneration Code

19D.3 Remuneration principles

Application: groups

19D.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 *dual-regulated firms Remuneration Code* within *UK consolidation groups* and *non-EEA sub-groups*).

[Note: article 92(1) of CRD]

19D.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 in this section on a consolidated basis (or sub-consolidated basis). In the *FCA's* view, the application of this section at *group, parent undertaking and subsidiary undertaking* levels in **■ SYSC 19D.3.1R(1)** is in line with article 109(2) of the *CRD* on the application of systems and controls requirements to *groups* (as in **■ SYSC 12.1.13R**).

Application: categories of staff and proportionality

19D.3.3 **R**

- (1) This section applies in relation to *dual-regulated firms Remuneration Code staff*, except as set out in (3).
- (2) When establishing and applying the total *remuneration* policies for *dual-regulated firms 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 *dual-regulated firms remuneration principles proportionality rule*).
- (3) Paragraphs (1) and (2) do not apply to the requirement for significant *firms* to have a *remuneration committee* (**■ SYSC 19D.3.12R**).

[Note: article 92(2) of CRD]

[Note: In addition to the *guidance* in this section about the *dual-regulated firms remuneration principles proportionality rule*, the *FCA* provides *guidance* on the division of *firms* into categories for the purpose of providing a framework for the operation of the *dual-regulated firms remuneration*

principles proportionality rule. This guidance is available on the FCA website at <https://www.fca.org.uk/firms/being-regulated/remuneration-codes>.]

19D.3.4 **R**

- (1) *Dual-regulated firms Remuneration Code staff* comprises:
 - (a) an *employee* of a *dual-regulated firm* whose professional activities have a material impact on the *firm's* risk profile, including any *employee* who is deemed to have a material impact on the *firm's* risk profile in accordance with Regulation (EU) 604/2014 of 4 March 2014 (Regulatory technical standards to identify staff who are material risk takers); or
 - (b) subject to (2) and (3), an *employee* of an *overseas firm* in ■ SYSC 19D.1.1R(1)(d) (i.e., an *overseas firm* that would have been a *UK bank, building society* or *UK designated investment firm* if it had been a *UK domestic firm*) whose professional activities have a material impact on the *firm's* risk profile, including any *employee* who would meet any of the criteria set out in articles 3 or 4(1) of Regulation (EU) 604/2014 of 4 March 2014 if it had applied to him.
- (2) An *overseas firm* in ■ SYSC 19D.1.1R(1)(d) (i.e., an *overseas firm* that would have been a *dual-regulated firm* if it had been a *UK domestic firm*) may deem an *employee* not to be a *dual-regulated firms Remuneration Code staff* where:
 - (a) the *employee*:
 - (i) would meet the criteria in article 4(1) of Regulation (EU) No 604/2014 of 4 March 2014;
 - (ii) would not meet any of the criteria in article 3 of Regulation (EU) No 604/2014 of 4 March 2014; and
 - (iii) was awarded total remuneration of less than €750,000 in the previous year;
 and
 - (b) the *overseas firm* determines that the professional activities of the *employee* do not have a material impact on its risk profile on the grounds described in article 4(2) of Regulation (EU) 604/2014 of 4 March 2014.
- (3) Where the *overseas firm* deems an *employee* not to be *dual-regulated firms Remuneration Code staff* as set out in (2), it must notify the *FCA*, applying the approach described in article 4(4) of Regulation (EU) 604/2014 of 4 March 2014.

[**Note:** article 92(2) of *CRD* and articles 3 and 4 of Regulation (EU) No 604/2014 of 4 March 2014.]

19D.3.5 **G**

Where an *overseas firm* in ■ SYSC 19D.1.1R(1)(d) (i.e., an *overseas firm* that would have been a *dual-regulated firm* if it had been a *UK domestic firm*) wishes to deem an *employee* who earns more than €750,000 not to be *dual-regulated firms Remuneration Code staff*, the *overseas firm* may apply for a *waiver* of the requirement in ■ SYSC 19D.3.4R in respect of that *employee*.

- 19D.3.6** **R** A *firm* must:
- (1) maintain a record of its *dual-regulated firms Remuneration Code staff* under the general record-keeping requirements (■ SYSC 9); and
 - (2) take reasonable steps to ensure that its *dual-regulated firms 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 *dual-regulated firms Remuneration Code* to be rendered void and recoverable by the *firm*.

Remuneration Principle 1: Risk management and risk tolerance

- 19D.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: article 92(2)(a) of CRD]

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

- 19D.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: article 92(2)(b) of CRD]

Remuneration Principle 3: Avoiding conflicts of interest

- 19D.3.9** **R** A *firm* must ensure that its *remuneration* policy includes measures to avoid conflicts of interest.
- [Note: article 92(2)(b) of CRD]

Remuneration Principle 4: Governance

- 19D.3.10** **R** A *firm* must ensure that its *management body* in its *supervisory function* adopts and periodically reviews the general principles of the *remuneration* policy and is responsible for overseeing its implementation.
- [Note: article 92(2)(c) of CRD and Standard 1 of the *FSB Compensation Standards*]
- 19D.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 *management body* in its *supervisory function*.
- [Note: article 92(2)(d) of CRD and Standard 1 of the *FSB Compensation Standards*]

- 19D.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) A *firm* in (1) must ensure that:
- (a) the *remuneration committee* is constituted in a way that enables it to exercise competent and independent judgement on *remuneration* policies and practices and the incentives created for managing risk, capital and liquidity;
 - (b) the chairman and the members of the *remuneration committee* must be members of the *management body* who do not perform any executive function in the *firm*;
 - (c) the *remuneration committee* is 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 *management body*; and
 - (d) when preparing those decisions, the *remuneration committee* must take into account the long-term interests of shareholders, investors and other stakeholders in the *firm* and the public interest.

[Note: article 95 of *CRD* and Standard 1 of the *FSB Compensation Standards*]

19D.3.13 R A *firm* that maintains a website must explain on the website how it complies with the *dual-regulated firms Remuneration Code*.

[Note: article 96 of the *CRD*]

- 19D.3.14** 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 *dual-regulated firms 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) Guidance on what the *supervisory function* might involve is set out in ■ SYSC 4.3.3G (responsibility of senior personnel, in particular, the *supervisory function*).

Remuneration Principle 5: Control functions

19D.3.15 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 *employees*; 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: article 92(2)(e) of CRD and Standard 2 of the FSB Compensation Standards]

19D.3.16 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 19D.3.15R(2)).

19D.3.17 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 19D.3.12R or, if such a committee has not been established, by the governing body in its supervisory function.

[Note: article 92(2)(f) of CRD]

19D.3.18 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) [deleted]
- (3) [deleted]

Remuneration Principle 6: Remuneration and capital.....

19D.3.19 R

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

[Note: article 94(1)(c) of the CRD and Standard 3 of the FSB Compensation Standards]

19D.3.20 G

[deleted]

Remuneration Principle 7: Exceptional government intervention

19D.3.21 **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 members of its *management body*; and
- (3) no variable or discretionary *remuneration* of any kind is paid to members of its *management body* unless this is justified.

[Note: article 93 of the *CRD* and Standard 10 of the *FSB Compensation Standards*]

19D.3.22 **G** The *FCA* would normally expect it to be appropriate for the ban on paying variable *remuneration* to members of the *management body* of a *firm* that benefits from exceptional government intervention to apply only to members of the *management body* who were in office at the time that the intervention was required.

Remuneration Principle 8: Profit-based measurement and risk adjustment

19D.3.23 **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: article 94(1)(j), (k) of the *CRD* and Standard 4 of the *FSB Compensation Standards*]

19D.3.24 **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. The *FCA* expects that a *firm* will apply qualitative judgements and common sense in the final decision about the performance-related components of variable *remuneration* pools.

(2) [deleted]

- (3) We consider good practice in this area to be represented by those *firms* who provide a quantitative reference or starting point that explicitly includes risk-adjusted metrics, before the application of more discretionary factors. Common measures include those based on economic profit or economic capital. Whichever technique is chosen, the full range of future risks should be covered, including non-financial risks such as reputation, conduct, *client* outcomes, values and strategy.
- (4) The *FCA* expects a *firm* to be able to provide it with details of all adjustments that the *firm* has made whether through application of formulae or the exercise of discretion. This will enable the *FCA* to consider whether the *firm's* risk adjustment framework is sufficiently robust. Where discretion has been applied, the *firm* should be able to provide a clear explanation for, and quantification of such adjustments.
- (5) 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.

19D.3.25 **R** A *firm* must have a clear and verifiable mechanism for measuring performance, with risk adjustment applied thereafter in a clear and transparent manner.

19D.3.26 **G** A *firm* may apply discretionary factors to the extent that is appropriate and consistent with the overall aims of the risk adjustment exercise. Where such further adjustments have been made, *firms* should provide clear quantification and explanation to ensure their risk adjustment frameworks are sufficiently transparent.

19D.3.27 **R** A *firm* must base assessments of financial performance used to calculate variable *remuneration* components or pools of variable *remuneration* components principally on profits.

19D.3.28 **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) [deleted]

19D.3.29 **R** (1) A *firm's* risk-adjustment approach must reflect both ex-ante adjustment (which adjusts remuneration for intrinsic risks that are inherent in its business activities) and ex-post adjustment (which adjusts remuneration for crystallisation of specific risks events).

(2) 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, including through malus or clawback arrangements.

[Note: article 94(1)(n) of CRD and Standard 5 of the *FSB Compensation Standards*]

19D.3.30 **G** [deleted]

Remuneration Principle 9: Pension policy.....

19D.3.31 **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 19D.3.56R(1); and
- (3) when an *employee* reaches retirement, *discretionary pension benefits* are paid to the *employee* in the form of instruments referred to in ■ SYSC 19D.3.56R(1) and subject to a five-year retention period.

[Note: article 94(1)(o) of the CRD]

Remuneration Principle 10: Personal investment strategies.....

- 19D.3.32 **R**
- (1) A firm must ensure that its *employees* undertake not to use personal hedging strategies to undermine the risk alignment effects embedded in their *remuneration* arrangements.
 - (2) A firm must ensure that its *employees* do not use *remuneration-* or *liability-related contracts of insurance* to undermine the risk alignment effects embedded in their *remuneration* arrangements.
 - (3) A firm must maintain effective arrangements designed to ensure that *employees* comply with their undertaking.

[Note: article 94(1)(p) of the CRD and Standard 14 of the *FSB Compensation Standards*]

19D.3.33 **G** In the FCA's view, circumstances in which a *person* will be using a personal hedging strategy include (and are not limited to) 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: Non-compliance with the dual-regulated firms Remuneration Code.....

19D.3.34 **R** A firm must ensure that variable *remuneration* is not paid through vehicles or methods that facilitate non-compliance with obligations arising from the *Remuneration Code*, the *EU CRR* or the *CRD*.

[Note: article 94(1)(q) of the CRD]

Remuneration Principle 12: Remuneration structures - introduction

19D.3.35 **G**

- (1) Taking account of the *dual-regulated firms remuneration principles proportionality rule*, the FCA does not generally consider it necessary for a *firm* to apply the *rules* 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 19D.3.44R);
 - (b) retained *shares* or other instruments (■ SYSC 19D.3.56R);
 - (c) deferral (■ SYSC 19D.3.59R); and
- performance adjustment (■ SYSC 19D.3.61R).

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

19D.3.36 **R**

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

19D.3.37 **R**

A *firm* must ensure that the *remuneration* policy makes a clear distinction between criteria for setting:

- (1) basic fixed *remuneration* that primarily reflects an *employee's* professional experience and organisational responsibility, as set out in the *employee's* job description and terms of *employment*; and
- (2) variable *remuneration* that reflects performance in excess of that required to fulfil the *employee's* job description and terms of *employment* and that is subject to performance adjustment in accordance with the *dual-regulated firms Remuneration Code*.

[Note: article 92(2)(g) of the CRD]

19D.3.38 **R**

A *firm* must not award variable *remuneration* to a *non-executive director* acting as such.

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

19D.3.39 **R**

- (1) A *firm* must ensure that where *remuneration* is performance-related:
- (a) the total amount of *remuneration* is based on a combination of the assessment of the performance of:
 - (i) the individual;
 - (ii) the business unit concerned; and
 - (iii) the overall results of the *firm*; and

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

[Note: article 94(1)(a) of the CRD and Standard 6 of the FSB Compensation Standards]

19D.3.40 **G**

- (1) The non-financial criteria in ■ SYSC 19D.3.39R(1)(b) should include:
 - (a) the extent of the *employee's* adherence to effective risk management, and compliance with the *regulatory system* and with relevant overseas regulatory requirements; and
 - (b) metrics relating to conduct, which should comprise a substantial portion of the non-financial criteria.
- (2) Aligning variable awards to sustainable financial performance requires *firms* to make appropriate ex-ante adjustments to take account of the potential for future unexpected losses. Performance measures commonly used (such as earnings per *share* (EPS), total shareholder return (TSR) and return on equity (RoE)) are not suitably adjusted for longer-term risk factors and have a tendency to incentive highly leveraged activities.

19D.3.41 **G**

Poor performance, such as poor risk management or other behaviours contrary to *firm* values, can pose significant risks for a *firm* and non-financial metrics should override metrics of financial performance where appropriate.

19D.3.41A **G**

A *firm* should note that the requirement in ■ SYSC 19D.3.39R(1)(b) for financial and non-financial criteria to be taken into account applies wherever *remuneration* is performance-related including within any assessment of future performance.

19D.3.42 **R**

A *firm* must clearly explain the performance assessment process in ■ SYSC 19D.3.39R to relevant *employees*.

19D.3.43 **R**

A *firm* must ensure that the assessment of performance is set in a multi-year framework in order to ensure that:

- (1) the assessment process is based on longer-term performance; and
- (2) 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: article 94(1)(b) of CRD]

Remuneration Principle 12(c): Remuneration structures - guaranteed variable remuneration, buy-outs and retention awards

19D.3.44 **R**

- (1) A *firm* must ensure that guaranteed variable *remuneration* is not part of prospective *remuneration* plans.

- (2) A *firm* must not award, pay or provide guaranteed variable remuneration unless:
 - (a) it is exceptional;
 - (b) it occurs in the context of hiring new *dual-regulated firms Remuneration Code* staff;
 - (c) the *firm* has a sound and strong capital base; and
 - (d) it is limited to the first year of service.

[Note: article 94(1)(d) and (e) of the *CRD* and Standard 11 of the *FSB Compensation Standards*]

19D.3.45 R A *firm* must ensure that *remuneration* packages relating to compensation for, or buy out from, an *employee's* contracts in previous *employment* align with its long-term interests including appropriate retention, deferral and performance and clawback arrangements.

[Note: article 94(1)(i) of *CRD*]

19D.3.46 G (1) Guaranteed variable *remuneration* should be subject to the same requirements applicable to variable *remuneration* awarded by the *firm* including deferral, malus and clawback.

- (2) The *FCA* expects that guaranteed variable awards and retention awards should not be common practice for *dual-regulated firms Remuneration Code* staff and should be limited to rare, infrequent occurrences. The *FCA* expects a *firm* to provide prior notification to the *FCA* of any proposed retention awards.

19D.3.47 G Retention awards should form part of variable *remuneration* for the purpose of ■ SYSC 19D.3.48R.

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

19D.3.48 R A *firm* must set an appropriate ratio between the fixed and variable components of total *remuneration* and ensure that:

- (1) fixed and variable components of total *remuneration* are appropriately balanced;
- (2) the level of 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; and
- (3) subject to ■ SYSC 19D.3.49R, the level of the variable component of total *remuneration* must not exceed 100% of the fixed component of total *remuneration* for each *dual-regulated firms Remuneration Code* staff.

[Note: article 94(1)(f) and 94(1)(g)(i) of the *CRD*]

19D.3.49 **R** A *firm* may set a higher maximum level of the ratio between the fixed and variable components of total *remuneration* provided:

- (1) the overall level of the variable component does not exceed 200% of the fixed component of the total *remuneration* for each *dual-regulated firms Remuneration Code staff*; and
- (2) is approved by the shareholders or owners or members of the *firm* in accordance with **SYSC 19D.3.50R**.

[**Note:** article 94(1)(g)(ii) of *CRD*]

19D.3.50 **R** A *firm* must ensure that any approval by its shareholders or owners or members, for the purposes of **SYSC 19D.3.49R**, is carried out in accordance with the following procedure:

- (1) the *firm* must give reasonable notice to all its shareholders or owners or members of its intention to seek approval of the proposed higher ratio;
- (2) the *firm* must make a detailed recommendation to all its shareholders or owners or members that includes:
 - (a) the reasons for, and the scope of, the approval sought;
 - (b) the number of staff affected and their functions; and
 - (c) the expected impact on the requirement to maintain a sound capital base;
- (3) the *firm* must:
 - (a) without delay, inform the *FCA* of the recommendation to its shareholders or owners or members, including the proposed higher ratio and the reasons therefor; and
 - (b) demonstrate to the *FCA* that the proposed higher ratio does not conflict with its obligations under the *CRD* and the *EU CRR*, having particular regard to the *firm's own funds* obligations;
- (4) the *firm* must ensure that *employees* who have an interest in the proposed higher ratio are not allowed to exercise, directly or indirectly, any voting rights they may have as shareholders or owners or members of the *firm* in respect of the approval sought; and
- (5) the higher ratio is approved by a majority of:
 - (a) at least 66% of the shares or equivalent ownership rights represented, if at least 50% of the shares or equivalent ownership rights in the *firm* are represented; or
 - (b) at least 75% of the shares or equivalent ownership rights represented, if less than 50% of the shares or equivalent ownership rights in the *firm* are represented.

[**Note:** article 94(1)(g)(ii) of the *CRD*]

19D.3.51 **R** A *firm* must notify the *FCA* without delay of the decisions taken by its shareholders or members or owners including any approved higher maximum ratio.

[**Note:** article 94(1)(g)(ii) of the *CRD*]

19D.3.52 **R** A *firm* may apply a discount rate to a maximum of 25% of an *employee's* total variable *remuneration* provided it is paid in instruments that are deferred for a period of not less than five years.

[**Note:** article 94(1)(g)(iii) of the *CRD*]

19D.3.53 **R** In applying the discount rate in **■ SYSC 19D.3.52R**, a *firm* must apply the *EBA* Guidelines on the applicable notional discount rate for variable remuneration published on 27 March 2014.

[**Note:** the *EBA* Guidelines on the applicable notional discount rate for variable remuneration can be found at: <http://www.eba.europa.eu/documents/10180/643987/EBA-GL-2014-01+%28Final+Guidelines+on+the+discount+rate+for+remuneration%29.pdf/e8b3b3f6-6258-439d-a2d9-633e6e5de5e9>]

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

19D.3.54 **R** A *firm* must ensure that payments relating to the early termination of a contract reflect performance achieved over time and are designed in a way that does not reward failure or misconduct.

[**Note:** article 94(1)(h) of the *CRD* and Standard 12 of the *FSB Compensation Standards*]

19D.3.55 **G** [deleted]

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

19D.3.56 **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 possible, other instruments that in each case adequately reflect the credit quality of the *firm* as a going concern and are appropriate for use as variable remuneration, such as:
 - (i) those which are eligible as *additional tier 1 instruments* or *tier 2 instruments*; or
 - (ii) those that can be fully converted to *common equity tier 1 instruments* or written down;

(where the expressions in italics are defined, with the conditions for eligibility, in the Definition of the Capital part of the *PRA* Rulebook).

- (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 19D.3.59R and the portion not deferred.

[Note: article 94(1)(l) of the *CRD* and Standard 8 of the *FSB Compensation Standards*]

19D.3.57 **G** [deleted]

19D.3.58 **G** [deleted]

Remuneration Principle 12(g): Remuneration structures - deferral

- 19D.3.59 **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:
 - (a) for dual-regulated firms Remuneration Code staff who do not perform a *PRA-designated senior management function*, three to five years, with no vesting taking place until one year after the award, and vesting no faster than on a pro-rata basis.
 - (b) for dual-regulated firms Remuneration Code staff who perform a *PRA-designated senior management function*, seven years, with no vesting taking place until three years after the award, and vesting no faster than on a pro-rata basis.
 - (2) In the case of a variable *remuneration* component:
 - (a) of £500,000 or more, 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 on the basis set out in ■ SYSC 19D.3.59R(1).
 - (3) Subject to (1), 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: article 94(1)(m) of the *CRD* and Standards 6 and 7 of the *FSB Compensation Standards*]

- 19D.3.60 **G**
- (1) Deferred *remuneration* paid in:
 - (a) *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*;
 - (b) cash should also be subject to performance criteria.

- (2) The *FCA* 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 *dual-regulated firms 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 *dual-regulated firms Remuneration Code staff* in the levels of variable remuneration paid.

Remuneration Principle 12(h): Remuneration structures - performance adjustment (affordability, malus, clawback)

19D.3.61 **R**

A *firm* must ensure that:

- (1) 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 individual concerned;
- (2) any variable remuneration is subject to clawback, such that it is only awarded if an amount corresponding to it can be recovered from the individual by the *firm* if the recovery is justified on the basis of the circumstances described in ■ SYSC 19D.3.62R(2) and ■ SYSC 19D.3.64R;
- (3) any variable remuneration is subject to clawback for a period of at least seven years from the date on which the variable remuneration is awarded; and
- (4) for *dual-regulated firms Remuneration Code staff* who perform a *PRA-designated senior management function*, it can, by notice to the employee to be given no later than seven years after the variable remuneration was awarded, extend the period during which variable remuneration is subject to clawback to at least ten years from the date on which the variable remuneration is awarded, where:
 - (a) the *firm* has commenced an investigation into facts or events which it considers could potentially lead to the application of clawback were it not for the expiry of the clawback period; or
 - (b) the *firm* has been notified by a regulatory authority (including an overseas regulatory authority) that an investigation has been commenced into facts or events which the *firm* considers could potentially lead to the application of clawback by the *firm* were it not for the expiry of the clawback period; and
- (5) it considers on an ongoing basis whether to use the power in (4).

[Note: article 94(1)(n) of the *CRD* and Standards 6 and 9 of the *FSB Compensation Standards*]

19D.3.62 **R**

A *firm* must:

- (1) set specific criteria for the application of malus and clawback; and

- (2) ensure that the criteria for the application of malus and clawback in particular cover situations where the *employee*:
 - (a) participated in, or was responsible for, conduct which resulted in significant losses to the *firm*; or
 - (b) failed to meet appropriate standards of fitness and propriety.

[**Note:** article 94(1)(n) of the *CRD* and Standards 6 and 9 of the *FSB Compensation Standards*]

[**Note:** The *FSA* also gave *guidance* on the application of the requirements on risk adjustments. This *guidance* is available on the *FCA* website at <https://www.fca.org.uk/firms/being-regulated/remuneration-codes>.]

19D.3.63 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 any of (1) or (2) may be relied on as tending to establish contravention of ■ SYSC 19D.3.61R(1) on performance adjustment.

19D.3.64 R

- (1) A *firm* must make all reasonable efforts to recover an appropriate amount corresponding to some or all vested variable remuneration where either of the following circumstances arise during the period in which clawback applies (including any part of such period occurring after the relevant *employment* has ceased):
 - (a) there is reasonable evidence of *employee* misbehaviour or material error; or
 - (b) the *firm* or the relevant business unit suffers a material failure of risk management.
- (2) A *firm* must take into account all relevant factors (including, where the circumstances described in (1)(b) arise, the proximity of the *employee* to the failure of risk-management in question and the *employee's* level of responsibility) in deciding whether, and to what extent it is reasonable, to seek recovery of any or all of their vested variable remuneration.

19D.3.65 G

The *governing body* (or, where appropriate, the *remuneration committee*) should approve performance adjustment policies, including the triggers under which adjustment would take place. The *FCA* 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

19D.3.66 G

■ SYSC 19D Annex 1 makes provision about voiding and recovery.

19D.3.67 R

- (1) Subject to (2) to (7), the *rules* in ■ SYSC 19D Annex 1.1R to 1.6R apply in relation to the prohibitions on *dual-regulated firms Remuneration Code staff* being *remunerated* in the ways specified in:
 - (a) ■ SYSC 19D.3.44R (guaranteed variable *remuneration*);
 - (b) ■ SYSC 19D.3.59R (deferred variable *remuneration*);
 - (c) ■ SYSC 19D.3.61R(2) (performance adjustment – clawback); and
 - (d) ■ SYSC 19D Annex 1.10R (replacing payments recovered or property transferred).
- (2) Paragraph (1) applies only to those prohibitions as they apply in relation to a *firm* that satisfies either Condition 1 or Condition 2 as set out in (3) and (4).
- (3) Condition 1 is that the *firm* is a *UK bank, a building society, or a UK designated investment firm*, that has relevant total assets exceeding £50 billion.
- (4) Condition 2 is that the *firm*:
 - (a) is either a *full credit institution or a UK designated investment firm*; and
 - (b) is part of a *group* containing a *firm* that has relevant total assets exceeding £50 billion and that is a *UK bank, a building society or a UK designated investment firm*.
- (5) For the purposes of this *rule*, 'relevant total assets' means the arithmetic mean of the *firm's* total assets as set out in its balance sheet on its last three *accounting reference dates*.
- (6) This *rule* does not apply in relation to the prohibition on *dual-regulated firms Remuneration Code staff* being *remunerated* in the way specified in ■ SYSC 19D.3.44R (guaranteed variable *remuneration*) if both the conditions in paragraphs (2)(b) and (2)(c) of that *rule* are met.
- (7) This *rule* does not apply in relation to *dual-regulated firms 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.
- (8) In relation to (7):
 - (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:
 - (A) its value to the recipient when awarded;
 - (B) its market value when awarded; and
 - (C) the cost of providing it;
 - () 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
 - () it is to be assumed that the member of *dual-regulated firms Remuneration Code staff* will remain so for the duration of the relevant performance year.

19D.3.68 G

- (1) Sections 137H and 137I of the *Act* enable the *FCA* to make *rules* that render void any provision of an agreement that contravenes specified prohibitions in the *dual-regulated firms Remuneration Code*, and that provide for the recovery of any payment made, or other property transferred, in pursuance of such a provision.
- (2) ■ SYSC 19D.3.66R and ■ SYSC 19D.3.67R (together with ■ SYSC 19D Annex 1) are:
 - (a) *rules* referred to in (1) that render 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; and
 - (b) the exception to the general position set out in section 138E(2) of the *Act* that a contravention of a *rule* does not make any transaction void or unenforceable.