Burges Salmon

MIFIDPRU Remuneration Code: Employer Guide 2022

What is it and how does it apply to you?

Contents

Overview

There is going to be a new remuneration code relevant to investment firms authorised under the Markets in Financial Instruments Directive.

The new remuneration code - known as the "**MIFIDPRU Code**" - creates a single remuneration code for all FCA investment firms. A new SYSC 19G in the FCA Handbook replaces the current IFPRU Remuneration Code (SYSC 19A) and the BIPRU Remuneration Code (SYSC 19C).

Firms should apply the new MIFIDPRU Code from the start of their next performance period beginning **on or after 1 January 2022** (and please note that it is the performance period rather than the date on which the remuneration is awarded or paid out that is relevant).

A copy of the FCA's policy statement (PS 21/9) including the new rules can be found here.

Guidance

Proportionality

Although the introduction of another remuneration code (albeit a consolidating one) seems to suggest yet more regulation and compliance, the new rules are actually sympathetic to the precept that smaller investment firms should only comply with a limited number of remuneration rules.

Which rather begs the question, what is a smaller firm?

Under the new regime, investment firms are divided into two categories:

- **Small and non-interconnected (SNI) firms**, being firms that are lower risk to customers and clients; and
- **Non-SNI firms**, being larger more complex firms.

Non-SNI firms can then be further sub-divided into ***regular Non-SNI firms*** and *larger Non-SNI firms*.

Depending on how your firm is classified it then needs to adhere to a set of remuneration rules that are either 'basic', 'standard' or 'extended'.

If you are classed as an **SNI firm**, you are only required to apply the basic rules.

Click here to see a summary of the basic rules – appendix 1

If you are classed as a **regular Non-SNI firm** you are required to apply the basic *and* standard rules.

Click here to see a summary of the standard rules – appendix 2

If you are classed as a **larger Non-SNI firm**, you are required to apply the basic, standard *and* extended rules.

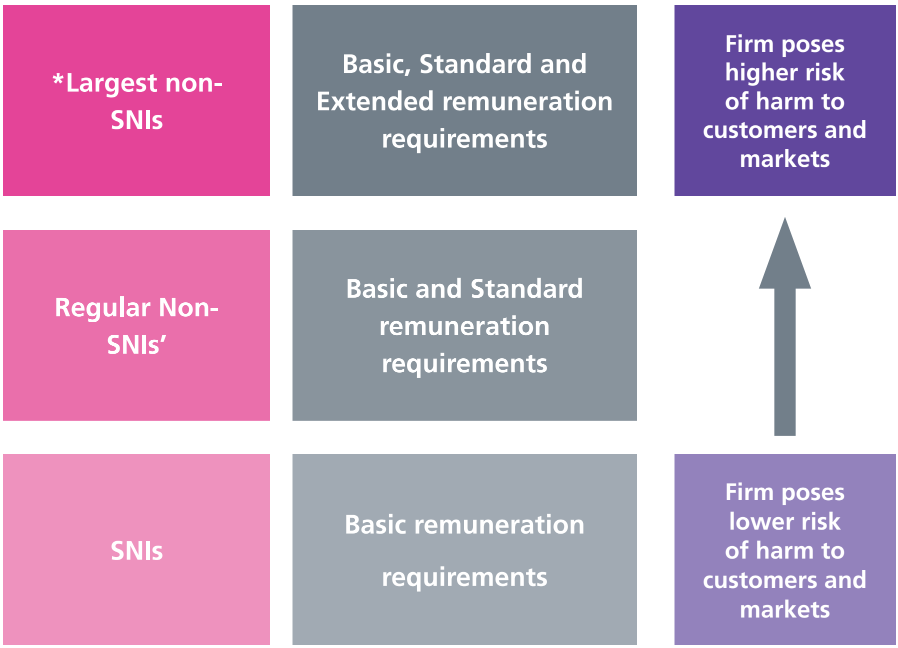
Click here to see a summary of the extended rules – appendix 3

The basic rules should be a continuation of what a firm is already doing (remuneration-wise) and so for many **SNI firms** that are currently within the scope of the IFPRU or BIPRU remuneration codes the basic rules are likely to be less onerous.

There is also a degree of proportionality built into the rules for **Non-SNI firms** where, depending on whether certain value thresholds are met, only the most detailed extended rules apply, thereby recognising the different risks that **larger Non-SNI firms** pose versus **regular Non-SNI firms** or indeed versus **SNI firms** generally. These thresholds are considered further below.

The FCA anticipates that only around 100 **larger Non-SNI firms** will be required to comply with the ‘extended’ requirements.

Of course, as always and regardless of which rules apply, all firms are encouraged to upgrade and comply with some or all of the additional rules to help ensure better risk management and more appropriate incentives for staff. So even if your firm is only required to follow the basic rules, it is encouraged to consider upgrading to the standard rules or higher.



*based on total on- and off-balance sheet assets, size of trading book and size of derivatives business.
A new UK prudential regime for MiFID investment firms Consultation Paper CP21/7*** April 2021

Material risk takers

For **SNI firms**, the basic rules are general principles and so apply to all staff in all firms.

But for **Non-SNI firms**, the additional rules to be applied are only relevant to those individuals identified as **Material Risk Takers** or "**MRTs**".

Non-SNI firms must identify their MRTs on an annual basis and whilst there are criteria for doing this, they are only a starting point. This is because **Non-SNI firms** are required to identify ALL individuals whose professional activities could have a material impact on the risk profile of the firm or the assets it manages and ALL types of risk should be considered, e.g. prudential, operational, market, conduct and reputational. This is a wider pool of individuals than Senior Managers under SMCR.

In pure remuneration terms, under the standard rules, performance-related variable remuneration must be paid to MRTs: i) based on combined assessments of the performance of the individual, the relevant business unit and the firm overall; and ii) subject to malus and clawback provisions (explained further below).

In addition, under the extended rules: i) at least 50% of an MRT's variable remuneration must be paid in shares, share-linked instruments or alternative arrangements approved by application to the FCA; ii) those instruments must be subject to an appropriate retention policy; iii) at least 40% (or 60% for 'particularly high amounts', in any case meaning variable remuneration of £500,000 or more) of an MRT's variable remuneration must be deferred for at least 3 years, not vesting faster than on a pro rata basis; and iv) discretionary pension benefits (treated as variable remuneration) paid to MRTs must comply with further holding and instruments requirements.

There is, though, a *de minimis* exemption to the above pay-out process rules, but only where the extended rules apply. So, for **larger Non-SNI firms** to which the extended rules apply, the rules relating to discretionary pension benefits, payment in instruments and deferrals to MRTs do not apply where an individual has:

- variable remuneration of £167,000 or less; and
- variable remuneration which makes up one-third or less of their total remuneration.

This represents a change in approach from the current criteria as there is no longer any consideration of the total amount of remuneration payable (fixed and variable) – the focus is entirely on variable remuneration.

Interest and dividends

MRTs are permitted to accrue interest and dividends during the deferral period but firms will not be permitted to pay them to MRTs until the point of vesting. This is permitted provided that the interest rate or level of dividends paid is not higher than that which would have been paid to an ordinary holder of the instrument. Firms are not required to include the dividends or interest when calculating the pay ratio.

Firms that form part of a group

Where an FCA investment firm is part of a larger group the FCA may grant permission for the group to apply a group capital test, the result being that at the group level, no prudential consolidation is required.

Where no prudential consolidation is required each FCA investment firm within the group is then required to apply the basic, standard or extended remuneration rules on an individual entity basis.

However, where prudential consolidation is required, the relevant remuneration rules (basic or standard) should be applied at both the level of the individual entity and at the consolidated level.

Note that the extended rules do not apply on a consolidated basis. This means that an entity within a consolidation group is subject to the rules on pay-out in instruments, deferral, retention and pay-out of discretionary pension benefits only if it exceeds the thresholds and not solely because another entity in the group exceeds the thresholds.

Malus and clawback

Non-SNI firms will need to apply malus and clawback to variable remuneration. Malus periods should continue until the award has fully vested. Clawback periods should span the combined length of the deferral period (which ideally should be 3 years from grant) as well as any retention period.

The FCA have published FG21/5: General guidance on the application of ex-post risk adjustment to variable remuneration. Although this guidance sets out how the FCA would expect **Non-SNI firms** to comply with the rules on malus and clawback (including how they should be invoked in an effective, timely, consistent and transparent way), it is of relevance to **ALL investment firms** that are thinking about implementing a malus and clawback policy.

Variable to fixed ratio

Non-SNI firms must set an appropriate ratio between the variable and fixed components of the total remuneration and set the ratio out in the firm's remuneration policy. When setting the ratio, all 'potential scenarios' must be considered and the maximum ratio should reflect the highest amount of variable remuneration that can be awarded to MRTs.

Governance - Remuneration Committees

The FCA is proposing that **larger Non-SNI firms** would be required to have risk, nomination and remuneration committees in place. This replaces the existing requirements for 'significant IFPRU' firms.

Although the FCA had proposed to require firms to implement these committees at individual entity level, it has conceded that firms may be able to rely on group level remuneration committees provided that appropriate requirements are met in relation to composition, powers, knowledge and skills. The requirement for risk and nomination committees at individual entity level remains.

The FCA is proposing that 50% of these committees must be non-executive, including the chair – which in practice means that each committee must have at least two non-executive members.

Guaranteed / retention / buy-out awards and severance pay

Guaranteed variable pay, sometimes referred to as a 'sign-on bonus' or 'golden handshake' should be awarded by **Non-SNI firms** only rarely, in the context of hiring new MRTs, in the first year of service and where the firm has a strong capital base.

Similarly, retention awards should only be paid to MRTs who remain in role until a defined event or a specified point in time.

Both the ability to make severance payments in relation to the early termination of employment and their amount should be set out in the firm's remuneration policy and should reflect the individual's performance over time and not reward failure or misconduct.

Buy-out awards (where one firm effectively compensates a new employee for remuneration foregone) should be aligned with the long-term interests of the firm and remain subject to the same pay-out terms e.g. same deferral and vesting schedule and the same malus and / or clawback provisions.

Partnerships, carried interest and profit-sharing

The MIFIDPRU Code contains guidance to help determine which types of payments to partners and members of LLPs should be treated as remuneration and which should be treated as return on equity. It is the FCA's view that for the purposes of a partnership, a 'reasonable portion' of the profit share of a partner (or member of an LLP) would be considered remuneration where the partner or member works full-time for the firm.

The FCA have confirmed that the MIFIDPRU Code applies to carried interest, which must be valued at the time of its award. There is also a new rule where the requirements on pay-out instruments, deferral, retention and ex-post risk adjustment do not apply to carried interest arrangements where: i) the value of the carried interest is determined by the performance of the fund in which the carried interest is held; ii) the period between award and payment of the carried interest is at least 4 years; and iii) there are provisions for the forfeiture or cancellation of carried interest (that include at least situations in which the MRT participated in or was responsible for conduct which resulted in significant losses to the firm and situations in which the MRT failed to meet appropriate standards of fitness and propriety).

With regards to co-investment arrangements, originally the FCA proposed that the return on investment would be categorised as remuneration where the investment was made by the individual using a loan from their employer. Now, it is the case that the returns on a co-investment arrangement would be considered remuneration only where the investment was made using a loan provided by the firm or a member of the group to which the firm belongs and the loan was not provided to the individual on commercial terms or had not been repaid in full by the time the return on the investment was paid.

Remuneration policy design

The FCA has proposed that **all investment firms** must have a gender-neutral remuneration policy in place for all staff to cover all the key components of the MIFIDPRU Code. Importantly this must cover aspects such as:

- the firm's risk appetite and risk strategy;
- ESG factors;
- the firm's culture and values;
- measures to avoid conflicts of interest; and
- measures to promote risk awareness and prudent risk taking.

Current remuneration policies which do not expressly consider these factors are likely to require review.

The FCA have made available a Remuneration Policy Statement template. This is a tool which **all FCA investment firms** can use to document their remuneration policies and practices, and how these comply with the applicable parts of the MIFIDPRU Remuneration Code. There is also a template which **Non-SNI firms** can use to record their material risk takers (MRTs) and the structure of their remuneration. These templates are not compulsory, so firms may choose to document their remuneration policies and MRTs in a different way.

Annual review of remuneration policy by control functions

Non-SNI firms should further ensure that their remuneration policies and practices are subject to an annual independent internal review by staff engaged in control functions. The guidance clarifies what the review should include and that it can be outsourced (in whole or in part) e.g. to advisers.

Remuneration reporting

Under the MIFIDPRU Code, **all FCA investment firms** must continue to make high-level public disclosures in relation to their remuneration practices. The extent of the disclosure required is tailored according to which remuneration rules a firm is subject to: basic, standard or extended.

SNI firms subject to the basic rules will only need to report basic information about numbers of staff and the extent of fixed and variable remuneration awarded in the relevant year.

Regular Non-SNI firms subject to the standard rules will need to split out the above information between MRTs and non-MRTs and report the ex-post adjustments made to variable remuneration.

Larger Non-SNI firms subject to the extended rules will also need to report information on the remuneration awarded to their highest 3 earners.

Firms which are not part of a consolidation group and firms that are part of a group subject to the group capital test can complete the remuneration report on an individual basis. FCA investment firms which are part of a consolidated group may complete a single report on the consolidated basis.

To support these new requirements, the FCA has introduced a MIFIDPRU Remuneration Report template (MIF008) and accompanying guidance notes to replace the current Remuneration Benchmarking Information Report and High Earners Report. As for current reports, the FCA suggests that the new report should be submitted within 4 months of the firm's annual accounting reference date.

Next Steps

What to do first?

We recommend that firms assess their categorisation to determine which of the ‘basic’, ‘standard’ or ‘extended’ remuneration rules apply to them.

What to do next?

Once you know which of the ‘basic’, ‘standard’ or ‘extended’ rules apply to your firm, you should proceed to review your existing remuneration policies and practices to identify any gaps.

Non-SNI firms in particular will also want to assess which individuals should be identified as MRTs and what changes, if any, need to be made to the pay structures and practices relevant to those individuals.

Are you classed as an SNI firm?

An **SNI firm** is subject to the basic rules.

To qualify as an **SNI firm**, you must not carry out activities that:

- have the greatest potential to cause harm to your customers or to the markets in which you operate; and
- are on such a scale that it would cause harm to customers or to the markets in which you operate.

To take account of the scale of activities (and in addition to the requirement that FCA investment firms are not permitted to deal on own account and should be assessed on a group basis), there are also quantitative thresholds and criteria that need to be considered.

Are you classed as a regular or larger Non-SNI firm?

A **Non-SNI firm** needs to determine whether it is subject to the 'standard' rules or the 'extended' ones.

A firm will be a **larger Non-SNI firm**, subject to all of the remuneration rules (i.e. the extended rules), where the value of its on-and off-balance sheet assets over 4-years is a rolling average of:

- more than £300m; or
- more than £100m but less than £300m and has trading book business of over £150m and / or derivatives business of over £100m.

A **regular Non-SNI firm** below these thresholds is subject to the standard rules only.

Action points

Firms should be taking the following steps now as part of their preparation for implementation:

- Determine whether your firm is an **SNI firm** or a **regular** or **larger Non-SNI firm**.
- Assess whether the basic, standard or extended rules apply.
- Consider how the rules may apply on a group consolidated basis, if relevant.
- If the standard or extended rules apply, identify your MRTs using the new criteria - you should review their reward structures and consider what changes, if any, are required. Inform MRTs of their status and explain the practical implications.
- Review your existing remuneration policy. For **Non-SNI firms**, this should include consideration of appropriate fixed/variable remuneration ratios for different categories of staff.
- For **Non-SNI firms**, consider what, if any, malus/clawback provisions are required and over what period.
- Review your employment contracts and any bonus documentation and confirm that you have the necessary contractual power to introduce any changes required by the new rules. For LLPs, check your partnership agreements.
- Review the composition of your board committees, and for **larger Non-SNI firms** consider the FCA's new rules on remuneration, nomination and risk committees.
- For larger **Non-SNI firms**, identify any shares or share-instruments to be used for variable remuneration to MRTs and consider applying to the FCA to agree alternative arrangements if necessary.

<table>
<tr><th colspan="2">Basic remuneration requirements</th></tr>
<tr><td>Firm's remuneration policy must:
be proportionate to the size, internal organisation and nature, as well as to the scope and complexity, of its activities.
be gender-neutral.
be consistent with, and promote, sound and effective risk management.
be in line with the firm's business strategy and objectives, and take into account long term effects of investment decisions taken.
contain measures to avoid conflicts of interest, encourage responsible business conduct and promote risk awareness and prudent risk-taking.</td><td>Governance and oversight:
Management body must adopt and periodically review the remuneration policy, and have responsibility for overseeing its implementation.
Staff with control functions must be independent from the business units they oversee, and be remunerated according to objectives linked to their functions.
Remuneration of senior staff in risk management and compliance functions must be directly overseen by the remuneration committee or management body.</td></tr>
<tr><td>Fixed and variable remuneration:
The remuneration policy must make a clear distinction between the criteria applied to determine fixed and variable remuneration.
The fixed and variable components of the total remuneration must be appropriately balanced.
When assessing individual performance, both financial and non-financial criteria must be taken into account.</td><td>Restrictions on variable remuneration:
Variable remuneration must not affect the firm's ability to ensure a sound capital base.
A firm which benefits from extraordinary public financial support must not pay any variable remuneration to members of the management body.</td></tr>
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<table>
<tr><th colspan="2">Standard remuneration requirements</th></tr>
<tr><td colspan="2">Basic remuneration requirements</td></tr>
<tr><td>Performance assessment:
Performance-related variable remuneration of MRTs must be based on a combination of the performance of the individual, the relevant business unit and the firm overall.
Performance assessment must be based on a multi-year period.</td><td>Restrictions on non-performance-related variable remuneration of MRTs:
Guaranteed variable remuneration.
Retention awards.
Buy-out awards.
Severance pay.</td></tr>
<tr><td>Ex ante and ex post risk adjustment
Firms must take into account all types of current and future risks when:
measuring performance to calculate bonus pools.
awarding and allocating bonuses.
Firms must:
have in-year adjustments, malus and clawback arrangements in place.
set minimum malus and clawback periods.
determine triggers for malus and clawback.</td><td>Other requirements on firms:
Set a ratio between variable and fixed remuneration.
Ensure remuneration policy is subject to an annual review by control functions.
Discretionary pension benefits must be in line with business strategy, objectives, values and long term interests of the firm.
Take all reasonable steps to ensure MRTs do not undermine the remuneration rules.
Must not pay variable remuneration through vehicles or methods that facilitate non-compliance.</td></tr>
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<table>
<tr><th colspan="2">Extended remuneration requirements</th></tr>
<tr><td colspan="2">Basic remuneration requirements</td></tr>
<tr><td colspan="2">Standard remuneration requirements</td></tr>
<tr><td>Pay-out of variable remuneration:
• At least 50% to be paid out in shares, instruments or using alternative arrangements approved by the FCA.Must be subject to an appropriate retention policy.</td><td>Deferral and vesting:
• At least 40% of variable remuneration to be deferred for at least 3 years.
• At least 60% to be deferred where the variable remuneration is a particularly high amount, and always where it is £500,000 or more.
• Must not vest faster than pro rata.</td></tr>
<tr><td>Discretionary pension benefits:
• Where MRT leaves the firm before retirement, firm must hold the pension benefits for 5 years. Where MRT retires, the firm must pay out the pensions benefits and MRT must retain them for 5 years.</td><td>Remuneration committees:
• Chair and at least 50% of members must be non-executive members of the management body (where legal structure of firm permits).
• Modification of requirement possible for group level committees.</td></tr>
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Key Contacts

Nigel Watson

Partner

T: (0) 131 314 2147
M: (0) 7891 399 410
E: nigel.watson@burges-salmon.com

Katie Russell

Partner

T: (0) 131 314 2143
M: (0) 7811 309 665
E: katie.russell@burges-salmon.com

James Green

Director

T: (0) 117 939 2252
M: (0) 7814 703 657
E: james.green@burges-salmon.com

www.burges-salmon.com

One Glass Wharf, Bristol BS2 0ZX **T** +44 (0) 117 939 2000 **F** +44 (0) 117 902 4400
Atria One, 144 Morrison Street, Edinburgh EH3 8EX **T** +44 (0)131 314 2112 **F** +44 (0)131 777 2604
6 New Street Square, London EC4A 3BF **T** +44 (0) 20 7685 1200 **F** +44 (0) 20 7980 4966

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