Financial Services Reward – November 2021

Supporting Level 3 banks with CRD V from a reward perspective – what do you need to do?

Overview

The amended UK rules implementing Capital Rights Directive V ('CRD V') came into effect for banks, building societies and Prudential Regulation Authority ('PRA')-designated investment firms for performance periods beginning on or after 29 December 2020.

They introduced a number of changes to the remuneration rules from the previous CRD IV regime, which have been most prominent for Level 3 banks, as a result of the extension of the variable to fixed remuneration cap and performance adjustment (malus/clawback) requirements, which Level 3 firms were previously able to disapply.

The table below provides a checklist of key actions to enable Level 3 firms to ensure they are fully compliant with the CRD V remuneration requirements as they approach the end of the 2021 performance year.

The PRA's full Policy Statement detailing its guidance on how it expects firms to implement the CRD V remuneration requirements can be found here.

Key actions

	Further detail	Actions
Implementation of the variable to fixed remuneration ratio	• Under CRD V, all banks are required to limit variable remuneration to 1x fixed remuneration for all Material Risk Takers ('MRTs'), although this can be increased to 2x with shareholder approval. • There is a specific process required for shareholder approval. • This requirement was previously able to be disapplied by Level 3 firms.	• Consider whether to obtain shareholder approval for an increased variable pay cap of 2x fixed pay. • If variable pay previously in excess of 2x fixed pay, consider pay rebalancing for impacted individuals. • Ensure payments for FY21 onwards are compliant with the ratio.
Application of performance adjustment requirements (malus and clawback)	• All variable remuneration awarded to MRTs at all banks should be subject to malus and clawback. This requirement was previously able to be disapplied by Level 3 firms. • The PRA sets out specific expectations around the scenarios in which malus and clawback should be invoked, for example, employee misbehaviour or material error, material downturn in performance, or a material failure of risk management. • Clawback provisions should be applied for between 1 and 7 years (extendable to 10 in certain circumstances) following grant of the award depending on the category of MRT.	• Review and update current malus and clawback documentation to align with regulatory expectations. • Ensure all updates to policies flow through to process documentation. • Consider building details of clawback provisions into variable pay outcome communications – e.g. requiring MRTs to expressly attest to understanding that clawback provisions apply to their award

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	Further detail	Actions
Identification of Material Risk Takers ('MRTs')	• MRTs should be identified for FY21 under the revised qualitative and quantitative criteria. The PRA's statement on identifying MRTs for FY21 can be found here. • Firms should consider the PRA's criteria as a 'minimum standard' and apply their own risks and business operations when identifying MRTs.	• Review roles of employee population to match roles against the revised criteria, and apply additional internal criteria specific to your firm's business and risks. • Ensure proper documentation of the process undertaken to identify individuals as MRTs including rationale around any exclusions and input sought from CRO (or equivalent).
Application of buy-out requirements	• There are UK-specific requirements that apply to awards granted to MRTs in respect of the buy-out of unvested variable remuneration that now apply to Level 3 firms. The full requirements on buy-out awards can be found here. • From a structural perspective, the duration of retention, deferral, performance and clawback arrangements applied to the buy-out award, should be no shorter than the duration as was applied and remained outstanding in relation to the original (forfeited) awards. • From a process perspective, specific documentation will need to be provided by the new and previous employers in line with specific timescales as set out by the PRA.	• Update relevant policy documentation to ensure that the process around the grant of buy-out awards is compliant with regulatory requirements. • When granting a buy-out to an MRT or an MRT is joining another banking sector firm, ensure that all relevant documentation is provided/received.
Determination of proportionality status	• As under CRD IV, firms are required to comply with the CRD V remuneration requirements in a way that is appropriate to the size and complexity of their business. • The three-tier categorisation process therefore remains similar to that previously implemented under CRD IV, however the balance sheet thresholds have been slightly revised (£13bn average gross assets over 4 financial years).	• Check balance sheet asset test to determine proportionality level of the firm and document this assessment. • Consider likelihood and timescales of reaching the Level 2 proportionality thresholds, and plan appropriately for any near-future impacts.
Policy and documentation	• Update all relevant policy and process documentation to reflect any changes made as a result of the CRD V remuneration requirements including the requirement for remuneration policies and practices to be gender neutral.	

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