



## Financial Services Reward – recent regulatory developments September 2022

We have summarised below key reward regulatory developments impacting firms in the financial services sector in recent months.

### Key reward regulatory developments in the UK

#### Financial Conduct Authority (FCA) finalises new Consumer Duty rules – implications for remuneration

**Overview:** On 27 July 2022, the FCA published its final rules and guidance for a new Consumer Duty that aims to provide higher and clearer standards of consumer protection across financial services and requires firms to put their customers' needs first.

A number of changes to the rules under the Senior Managers & Certification Regime (SM&CR) are also being introduced in order to ensure that senior managers have enhanced accountability for delivering good customer outcomes within their areas of responsibility.

Firms that will become subject to the Consumer Duty when it takes effect (see below) will need to consider how the new rules and regulatory expectations impact their approach to remuneration and reward governance.

**Impacted firms:** All regulated financial services firms in the distribution chain that can influence material aspects of the design, target market or performance of a retail financial services product or service, even where they do not have a direct relationship with the retail customer.

**Timing:** The FCA has provided a two-phased approach for implementation:

- For new and existing products or services that are open to sale or renewal, the rules come into force on 31 July 2023.

- For closed products or services, the rules come into force on 31 July 2024.

Boards are expected to have agreed their implementation plans that include evidence of scrutiny and challenge by 31 October 2022. Firms should prepare to share the documentation with the FCA on request.

**Key provisions:** Under the new Consumer Duty, firms are expected to focus on ensuring good retail customer outcomes in relation to both products and services. Taking the view that culture is critical for delivering such outcomes, the FCA expects firms to reflect this priority in their strategy, business objectives and governance arrangements, and also in their people policies, including performance management, pay and bonuses. The FCA specifically notes that *“delivering good outcomes for customers should be reflected in the way in which people are managed and rewarded.”*

The FCA does not prescribe the way in which firms are expected to reflect the new Consumer Duty in their remuneration policies and practices but does note that it considers incentives and bonuses as being critical to the successful implementation of the new duty and that it expects firms to ensure that their reward policies and practices for incentives at all levels reflect the focus on ensuring good customer outcomes.

The FCA notes that firms *“should not use staff incentives, performance management or remuneration structures in a way that conflicts with their obligations”* under the new duty and should avoid remuneration structures that are capable of causing harm to customers.


Firms may wish to document how they consider that their incentive, performance management and remuneration structures are designed in a way that is consistent with the

objectives of the duty. Firms are expected to ensure that they have adequate arrangements in place that can help to detect and manage the risk of non-compliance with regulatory obligations which may arise from their remuneration structures or performance management practices.

With the FCA noting that risk functions should pay particular attention to the risks to consumers, the new rules expect firms to address any identified risks that retail customers may not receive good outcomes and any poor practices where good outcomes have not been delivered. These considerations are likely to be relevant both as part of the year-end risk assessment process and in decisions relating to individual year-end outcomes.

The new rules also require firms to ensure that retail customer outcomes are a *“central focus”* for Internal Audit. Firms may therefore see an increased focus on how remuneration arrangements impact customer outcomes as part of the annual review of remuneration policy implementation.

In light of the above, the FCA expects a firm’s Board to ensure that the duty is being considered in all relevant contexts, including through considering the impact of the firm’s governance and remuneration policies on delivering good customer outcomes and ensuring that customer outcomes are a key lens for the Risk and Internal Audit functions.

 A link to the FCA’s Policy Statement and guidance can be found [here](#).

### Prudential Regulation Authority (PRA) Consultation Paper on deferral arrangements for Material Risk Takers (MRTs) seeking senior public sector appointments

**Overview:** On 15 July 2022, the PRA published for consultation new guidance

regarding deferral arrangements for MRTs who seek senior public sector appointments relating to financial services.

**Impacted firms:** Banks, building societies and investment firms subject to the Remuneration Part of the PRA Rulebook.

**Timing:** With a deadline of 19 September 2022 for submitting responses to the consultation, the PRA intends to implement the changes to its Supervisory Statement on remuneration (SS2/17) on 12 December 2022.


**Key provisions:** The PRA is proposing to add a new section within its Supervisory Statement SS2/17 to address circumstances in which an MRT is seeking a senior public sector appointment linked to financial policy or financial services regulation and holds outstanding deferred equity awards which could potentially cause a conflict of interest to arise.

The PRA considers that, in general, unvested deferred equity awards that comprise the variable pay of MRTs should not be converted into awards over other instruments after the award has been made (or vice versa), even if an MRT moves roles or changes employer. The PRA makes clear that this expectation applies to all unvested, deferred sums, including those amounts which may have been deferred or awarded in instruments above the regulatory minimum.

However, the proposed amendments to SS2/17 would provide that, in *“exceptional circumstances”*, where there are potential conflicts of interest arising from the proposed public sector appointment that cannot otherwise be sufficiently mitigated, it may be appropriate for the deferred equity award to be converted into an award over another form of instrument, provided that the prior non-objection of the PRA has been obtained, and on the basis that the relevant deferral and retention requirements remain unchanged.

In “wholly exceptional circumstances”, the PRA notes that it may be prepared to agree to the deferred award being converted into a deferred award over cash, but highlights that, in these circumstances, a formal waiver from the payment in instruments rule would be required.

Such a waiver application would be considered carefully by the PRA, with the PRA needing to be satisfied that it would not be appropriate or sufficient for the potential conflict to be addressed through other means (including through converting the deferred equity award into a deferred award over another form of instrument).

 A link to PRA’s Consultation Paper can be found [here](#).

### Financial Reporting Council (FRC) publishes position paper on restoring trust in audit and corporate governance

**Overview:** The FRC published on 12 July 2022 a paper setting out next steps in the reform of the UK’s audit and corporate governance framework, including details of proposed amendments to the UK Corporate Governance Code (the Code).

**Timing:** The intention is that a revised Code will apply in relation to periods commencing on or after 1 January 2024 to allow for sufficient time for implementation. The FRC intends to consult on the revised Code and supporting material from Q1 of 2023.


**Key provisions:** The paper details the amendments to the Code which are being considered and confirms that updated *Guidance for Board Effectiveness* will also be published in order to align with the revised Code.

The focus of revisions to the Code include:

- Providing additional support in the existing Code provisions,

where reporting is currently considered to be weaker, for example in relation to engaging with the workforce on pay and the alignment of remuneration to purpose and values;

- Making necessary revisions to reflect the wider responsibilities of the Board and Audit Committee for expanded Sustainability and ESG reporting; and
- Updating the Code to ensure that it covers proposed changes to legal and regulatory requirements as set out in the Government Response to the consultation on strengthening the UK corporate governance framework, including strengthening reporting on malus and clawback arrangements.

 A link to the FRC’s full report can be found [here](#).

### FCA releases annual letter to Remuneration Committee Chairs

**Overview:** On 2 August 2022, the FCA released its annual letter to the Remuneration Committee Chairs. The letter outlines the FCA’s views and expectations on key topics for Remuneration Committees to consider as firms determine their year-end remuneration outcomes over the coming months. While addressed to Level 1 firms, the FCA publishes this letter on its website so that other Financial Services firms can see its supervisory priorities.

Firms should also note that the FCA has updated its main Remuneration webpage content to align with its focus on culture.

**Impacted firms:** Proportionality Level 1 banks, building societies and PRA-designated investment firms.

**Key provisions:** The key topics include a focus on culture and accountability and the new FCA Consumer Duty, as well as the rising cost of living, operational resilience, Environmental, Social and Governance (ESG) considerations and Diversity and Inclusion (D&I).

- In relation to culture and accountability, the FCA reminds firms that, where there is evidence of regulatory failings, there should be appropriate, timely and transparent adjustments to remuneration, including that of Senior Managers. The FCA notes that “where appropriate” it may follow-up with the firm to request evidence for this.
- The FCA highlights its recent publication of rules and regulatory guidance around a new Consumer Duty, which is intended to set higher and clearer expectations for the standard of care and customer service that firms should give to consumers at each stage of the product cycle. The FCA notes that firms’ remuneration policies should be designed to support the expectations set by the new Consumer Duty when it comes into effect from July 2023.
- With the rising cost of living in the UK, the FCA has also highlighted the need for Remuneration Committee Chairs to be mindful of this when reviewing workforce remuneration, as well as to consider it from a risk perspective (as both a current and future risk) when designing and reviewing remuneration practices and policies.
- Noting the importance of operational resilience for firms more broadly, the FCA makes clear that, in the event of service disruptions, data breaches or

other interruptions to a firm’s operations, it expects firms to respond appropriately, including in the making of remuneration adjustments where appropriate.

- The FCA highlights ESG as a continuing area of regulatory focus, with firms expected to consider whether incentives for senior leadership and other Material Risk Takers are aligned with wider ESG risks. The FCA also expects firms to consider whether linking progress against ESG commitments (from both a short-term and long-term perspective) to a “measurable proportion of pay” could be effective in encouraging individuals to take accountability for change.
- The FCA references the Consultation Paper on D&I that is expected to be published later this year (following the publication of the Discussion Paper in July 2021), which will consult on a package of measures to promote D&I within the Financial Services sector. Within this consultation, it is expected that there will be proposals to update the responsibilities of the Remuneration Committee to reflect the importance that the UK regulators attribute to the Remuneration Committee in establishing the right conditions for a healthy firm culture.

In addition to highlighting these key themes, the FCA has also specifically requested that Level 1 firms, when submitting their RPS, also provide an explanation of how the firm will take into account the impact of the current economic environment on bonus pools and individual outcomes. Level 1 firms are also now asked to provide details of how the firm’s ESG commitments, where these exist, are linked to the firm’s

remuneration policy, including any metrics and targets.



A link to the full letter can be found [here](#).

### Potential developments in FS Reward: PRA publishes Discussion Paper on its future approach to policy and new speculation over the banking sector bonus cap

**Overview:** On 8 September 2022, the PRA published a Discussion Paper describing how it proposes to approach policy-making following the UK’s departure from the EU.

The potential direction of travel for regulatory policy-making is worth noting more broadly and is also of interest from a remuneration standpoint, on account of the ways in which the PRA is considering improving the clarity of its policies by explaining their overarching purpose and intention in a more durable manner.

The PRA is considering the introduction of new explanatory ‘purpose statements’ for each policy topic area, noting that remuneration is one such area. The PRA notes that it could use these statements to summarise the purpose of the PRA’s policies in the relevant policy area, including how it helps the PRA to pursue its objectives. Such purpose statements could also explain how different policies in each regulatory area fit together in contributing to that purpose, as well as links between different policy areas.

If introduced, these purposes statements may provide further support for firms in understanding the expectations of the regulator in relation to the application of the UK remuneration rules and guidance and the expected interlinkage with other policy areas (such as the SM&CR).

In addition, there has been separate speculation that proposals are being considered to introduce reforms to

financial services sector remuneration, which may include the potential removal of the bonus cap which applies to banks, building societies and the largest investment firms which have remained subject to the rules implementing CRD V. While no formal proposals have yet been published, the rules relating to financial services pay may be among those areas that the Government considers reforming with a view to enhancing economic growth and so is an area that may develop further over the coming year.



A link to the PRA’s Discussion Paper can be found [here](#).

### Key reward regulatory developments at an EU and international level

#### European Banking Authority (EBA) publishes final guidelines on remuneration and gender pay gap benchmarking under the Capital Requirements Directive (CRD V) and the Investment Firm Directive (IFD)

**Overview:** On 30 June 2022, the EBA published its final guidelines on remuneration and gender pay gap benchmarking under both CRD V and IFD.

**Timing:** Both sets of guidelines will apply from 31 December 2022.

The first remuneration benchmarking data (excluding gender pay gap data) relating to the 2022 financial year will be provided by firms to EU national competent authorities in 2023.

The first data relating to gender pay will be collected in 2024 in relation to the 2023 financial year.

**Impacted firms:** For the purposes of CRD V, the EBA expects the remuneration benchmarking data to be collected from the largest firms (in terms of asset volume) in each EU

Member State, ensuring coverage of at least 60% of the banking system's asset volume in that Member State.

For the purposes of the IFD, the EBA expects the remuneration benchmarking data to be collected from at least the three largest investment firms (in terms of asset volume) in each EU Member State, ensuring where possible a coverage of at least 50% of total asset volume of all investment firms in that Member State. This will not include investment firms that are subsidiaries of investment firms for which data will be collected at the consolidated level.

Under both CRD V and the IFD, the gender pay gap data is expected to be collected from those same largest firms, but also from a sample of smaller firms selected by the national competent authority, including a sample of firms that rely on firm-level proportionality under the either regime. However, this data will only be requested from firms which have at least 50 employees on an individual entity basis (excluding members of the firm's management body in its supervisory function).

**Key provisions:** The amendments to the guidelines for CRD firms incorporate the additional requirements of CRD V.

This includes requiring firms to provide details of the number of MRTs in relation to whom the firm has relied on individual proportionality in order to disapply the rules relating to deferral and payment in instruments (and discretionary pension benefits), as well as the percentage of MRTs benefitting from that disapplication and the levels of their total fixed and variable pay.

Firms also need to disclose information relating to their use of fixed to variable pay ratios of higher than 1:1 further to shareholder approval, including the number of staff who have received variable remuneration in excess of 1:1 in line with that higher limit.

The new guidelines for IFD firms set out the templates that will need to be completed by firms which are required to submit their data and will also require firms to disclose whether they have relied on firm-level or individual level proportionality.



A link to the final guidelines under CRD V can be found [here](#).  
A link to the final guidelines under IFD can be found [here](#).

### EBA publishes final guidelines on high earner data collection under CRD V and IFD

**Overview:** On 30 June 2022, the EBA published its final guidelines on the high earner data collection exercise, with combined guidelines applying in relation to both CRD V and the IFD.

**Timing:** The guidelines apply from 31 December 2022, with data for the 2022 financial year to be provided by firms to the national competent authorities in 2023.

**Key provisions:** Under the updated high earners data collection exercise, separate templates have been provided for firms subject to CRD V and the IFD respectively.

One key change to note is that firms which are able to rely on proportionality at a firm-level (either under CRD V or under the IFD) will need to disclose how many high earners benefit from the disapplication of the rules on deferral and payment in instruments (and discretionary pension benefits).



A link to the EBA's final guidelines can be found [here](#).

### Basel Committee on Banking Supervision (BCBS) publishes final principles for the effective management and supervision of climate-related financial risk

**Overview:** On 15 June 2022, the BCBS published finalised principles for the effective management and supervision of climate-related financial risk.

These principles seek to improve banks' approach to risk management and prudential supervisors' practices in relation to climate-related financial risks.

**Timing:** The committee expects the principles to be implemented by banks and supervisors as soon as possible.

**Key provisions:** The BCBS has set out 18 high-level principles which are designed to encourage a principles-based approach to improving risk management and supervisory practices relating to climate-related financial risks.

Regarding remuneration, the BCBS principles state that *"the board and senior management should consider whether the incorporation of material climate-related financial risks into the bank's overall business strategy and risk management frameworks may warrant changes to its compensation policies, taking into account that these should be in line with the business and risk strategy, objectives, values and long-term interests of the bank."*

Within the principles, two of the most substantive changes are the strengthened link between climate-related financial risks and remuneration, as well as the need for consistency of business strategies and risk management with publicly stated climate objectives. While, in practice, many banks in the UK and the EU will already be taking these into account in response to regulatory requirements or supervisory expectations, the publication of these principles are a reminder of the regulatory focus on this area at an international level.



A link to the finalised BCBS principles can be found [here](#).



## Contact us:

If you would like to discuss this, or any other related matter, please speak to your usual Deloitte contact or any of the following:

### Stephen Cahill

Vice Chairman

020 7303 8801 - [email](#)

### Olivia Biggs

Partner

020 7007 2819 - [email](#)

### John Cotton

Partner

020 7007 2345 - [email](#)

### Clare Edwards

Partner

020 7007 1997 - [email](#)

### Juliet Halfhead

Partner

0121 695 5684 - [email](#)

### Iqbal Jit

Partner

020 7303 4101 - [email](#)

### Emily Buzzoni

Director

020 7303 2710 - [email](#)

### Sarah Keith

Director

020 7007 4927 - [email](#)

### Elliot Abrahams

Associate Director

020 7007 6289 - [email](#)

### Sean Davies

Associate Director

020 7303 4039 - [email](#)

### Susannah Hill

Associate Director

020 7303 8289 - [email](#)

### Rowena Gaukroger

Associate Director

020 7007 8975 - [email](#)

# Deloitte.

This publication has been written in general terms and we recommend that you obtain professional advice before acting or refraining from action on any of the contents of this publication. Deloitte LLP accepts no liability for any loss occasioned to any person acting or refraining from action as a result of any material in this publication.

Deloitte LLP is a limited liability partnership registered in England and Wales with registered number OC303675 and its registered office at 1 New Street Square, London, EC4A 3HQ, United Kingdom.

Deloitte LLP is the United Kingdom affiliate of Deloitte NSE LLP, a member firm of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee ("DTTL"). DTTL and each of its member firms are legally separate and independent entities. DTTL and Deloitte NSE LLP do not provide services to clients. Please see [www.deloitte.com/about](http://www.deloitte.com/about) to learn more about our global network of member firms.