



Financial Services Reward – April 2021

We have summarised below key reward regulatory developments impacting firms in the financial services sector over the past quarter.

PRA publishes Consultation Paper on the revised definition of a 'higher paid Material Risk Taker'

Overview: On 26 April 2021, the Prudential Regulation Authority ('PRA') published a Consultation Paper ('CP'), setting out its proposal to correct an error in the definition of 'higher paid Material Risk Taker' in the Remuneration Part of the PRA Rulebook. The definition of 'higher paid Material Risk Taker' is relevant to determining the minimum deferral and clawback periods applicable to Material Risk Takers under the amended Capital Requirements Directive

('CRD V') remuneration rules in the UK. The Consultation Paper follows the PRA's statement published on 25 February 2021, which clarified the PRA's position in relation to this definition.

Firms in scope: UK regulated banks, building societies and systemic investment firms subject to the CRD.

Timing: The consultation period ends on 26 May 2021 and the PRA intends to publish its final policy in Q2 2021.

The PRA's statement and Consultation Paper address an error identified by the PRA in the amended remuneration rules

that were published in December 2020 as part of the PRA's implementation of CRD V.

The current definition of a 'higher paid Material Risk Taker' (as stated in the rules published in December 2020) requires an individual to be treated as a 'higher paid Material Risk Taker' when:

- (a) their annual variable remuneration exceeds 33% of their total remuneration; and*
- (b) their total remuneration exceeds £500,000.*

The above definition has been identified as an error by the PRA. An individual

should instead be treated as a 'higher paid Material Risk Taker' where either condition (a) or (b) above is satisfied.

In the Consultation Paper, the PRA proposes to amend the Remuneration Part of the PRA Rulebook and the Supervisory Statement SS 2/17 'Remuneration' to reflect this. The PRA proposes that the implementation for the changes resulting from the CP would take effect upon publication of the final policy.

In order to avoid retroactive application of the amended definition, the PRA proposes that firms would not be required to apply the corrected definition in relation to remuneration payable in respect of the first performance year beginning on or after 29 December 2020 that has been paid, vested, or is subject to an obligation to pay or vest created, before the date of the publication of the final rule.

The Financial Conduct Authority ('FCA') is aware of the PRA's position and, in order to maintain alignment, is also intending to consult on amending this rule.



A link the PRA's statement can be found [here](#).



The PRA's Consultation Paper can be found [here](#).

FSB peer review report on the UK's implementation of FSB remuneration standards

Overview: On 14 April 2021, the Financial Stability Board ('FSB') published a report setting out its findings from a peer review of the UK's implementation of the FSB's Principles and Implementation Standards of Sound Compensation Practices.

Firms in scope: This may be of interest to all financial services firms across the banking, asset management and insurance sectors.

The UK is the first FSB member jurisdiction to undergo a peer assessment of the effectiveness of the implementation of rules relating to remuneration in the financial services sector. The FSB's review largely took place before the UK's implementation of the amendments under the CRD V so the report does not cover these changes to a great extent.

The FSB found that the PRA and FCA have implemented reforms that are consistent with the FSB's Principles and Implementation Standards, across the banking, asset management and insurance sectors.

The report recognises that the UK regulators have adopted a risk-based and proportionate regulatory and supervisory approach, noting the strong co-operation and information-sharing between the regulators and clear communication with the industry about the regulators' expectations on remuneration, which has helped firms understand and embed the requirements over time. The FSB also recognises that other initiatives, such as the Senior Managers and Certification Regime ('SM&CR') and research published on conduct and culture, have complemented the UK remuneration rules.

The FSB notes that the UK regulators are increasingly focused on evaluating the effectiveness of the remuneration regime and that firms are required to periodically review the design and implementation of their remuneration policies. The report notes that the UK is the first FSB jurisdiction to conduct an effectiveness review with a focus on performance adjustment and the mechanisms for applying this.

The FSB considers that some of the UK regulators' approaches can serve as examples of good practice for other jurisdictions to consider. These include setting expectations through public communication to Remuneration Committee Chairs; a supervisory approach that focuses on close interaction between prudential and conduct rules and reinforces accountability with links to compensation outcomes; and a focus on evaluating the regime's effectiveness.

The FSB believes the UK can take additional steps to further strengthen compensation frameworks in the financial services sector, as follows:

- Reviewing the interaction between the UK's remuneration framework and the SM&CR, including how the interplay between SM&CR and remuneration rules reward "diligent and proactive risk management".
- Reviewing the current reporting and

other data collection from Level 1 banks and investment firms to determine whether there is a basis to streamline these into more targeted data requests, and considering whether a more structured approach to collecting data from other firms, for example Level 2 and 3 banks and investment firms, would be useful for the PRA/FCA to perform trend or industry analysis on the compensation practices of these firms.

- As part of the UK regulators' initiative to assess the effectiveness of remuneration rules, they should also consider complementing business as usual supervision practices and the data analytics performed on the Remuneration Policy Statement ('RPS') submissions (for Level 1 banks and investment firms) with additional thematic reviews and onsite visits.
- Consider supplementing the Solvency II remuneration requirements with more detailed guidance for the insurance sector in order to ensure effective risk alignment and avoid potential inconsistent interpretations by firms.



A link to the final report can be found [here](#).

In a joint statement also published on 14 April 2021, the PRA and FCA have welcomed the FSB's findings. They note the recommendations to further strengthen the UK's remuneration framework, which they intend to work together to take forward, balanced against other regulatory priorities.

The statement notes that the FCA plans to consult on a new remuneration regime for investment firms shortly, as part of the new UK Investment Firm Prudential Regime.



The link to the PRA's and FCA's joint statement can be found [here](#).

European Commission approves the final Regulatory Technical Standards on identifying Material Risk Takers under the CRD V

Overview: The European Commission approved on 25 March 2021 the final Regulatory Technical Standards ('RTS') on the criteria to identify categories of

staff whose professional activities have a material impact on a firm's risk profile under the revised CRD V.

Firms in scope: EU regulated banks, building societies and Class 1 investment firms*

**Investment firms which are not categorised as systemically important and exposed to the same types of risks as credit institutions will become subject to the new Investment Firm Regulation and Directive ('IFR / IFD').*

Timing: The new RTS will take effect on the fifth day after its publication in the EU's Official Journal.

The provisions in the final RTS substantively reflect the provisions in the draft RTS published by the European Banking Authority ('EBA') on 18 June 2020 (our more detailed alert on which can be found [here](#)). Nevertheless, there are some minor amendments to the drafting (and a fair amount of re-ordering) of the provisions.

The current RTS will be repealed when the new RTS take effect. However, the final RTS expressly states that investment firms, which will become subject to the new IFD, should continue to apply the current ('CRD IV') RTS criteria until 26 June 2021.

Given the delay in the publication of the final new RTS, there remains some uncertainty in some EU jurisdictions regarding the first performance year in relation to which firms will be expected to apply the new criteria. From a UK standpoint, however, the updated UK CRD remuneration rules refer to the draft RTS as published on 18 June 2020, and therefore are now expected to be applied.

However, there may be further guidance from the UK regulators on this point in due course.



A link to the final RTS can be found [here](#).

FCA publishes its draft remuneration rules under the new Investment Firm Prudential Regime (IFPR)

On 19 April 2021, the FCA published its Consultation Paper setting out its

proposals for the implementation of the Investment Firm Prudential Regime, including new remuneration rules for UK investment firms.

The IFPR requirements will come into effect for remuneration awarded in relation to performance periods beginning on or after 1 January 2022.



A summary of the key changes impacting UK investment firms can be found [here](#).



The FCA's full Consultation Paper can be found [here](#).

EBA publishes two final draft Regulatory Technical Standards for Investment Firms

Overview: On 21 January 2021, the EBA published two final draft Regulatory Technical Standards under the IFD:

- i. on the criteria firms should use to identify Material Risk Takers ('MRTs') under the IFD – which can be found [here](#).
- ii. on the use of instruments and possible alternative arrangements for MRT variable remuneration under the IFD – which can be found [here](#).

These final draft RTS follow the draft public consultation launched on 4 June 2020. Our alert in relation to the consultation can be found [here](#). There have been some changes, particularly in the RTS on MRTs, following the feedback received during the consultation phase which we have set out below.

Firms in scope: MiFID investment firms based in the EU, which are not categorised as systemically important and undertaking 'bank-like' activities.

Timing: There is currently not a set date for application. The final RTS will take effect on the 20th day after its publication in the EU's Official Journal, though the EBA has not given an indication of when this will be. As the IFD will apply from 26 June 2021, it is expected that these RTS will apply from this date.

Application in the UK: From a UK perspective, given that the Brexit transition period has ended, UK investment firms will not be required to comply with these RTS for the purposes of identifying staff in the UK; rather, they will need to apply the new rules on MRT identification as set out in the new MIFIDPRU Remuneration Code as finalised by the FCA (see section above). However, UK firms with IFD regulated entities in the EU will need to ensure that their EU entities apply the new RTS when these take effect.

i) RTS on the criteria to identify MRTs under the IFD

Following feedback received during the consultation phase, some changes have been made to the qualitative and quantitative criteria as follows:

Qualitative criteria

Managerial responsibilities: Article 3(4)

– This criteria has been revised now requiring firms to identify staff members (in firms with a total balance sheet equal to or more than **EUR 100 million**), with managerial responsibility for business units that provide at least one of the below services:

- Execution of orders on behalf of clients;
- Dealing on own account;
- Portfolio management;
- Investment advice;
- Underwriting of financial instruments and/or placing of financial instruments on a firm commitment basis; and
- Placing of financial instruments without a firm commitment basis.

The consultation previously proposed identifying a staff member who had managerial responsibility for a business unit that contributed to more than [10%/20%] of the investment firm's total own funds requirement.

Managerial responsibility in certain key areas that have direct impact on the investment firm's risk profile or assets under management: Article 3(8)

– This criteria has now been revised to require firms to identify staff members (where an investment firm is authorised to

provide at least one of the services listed under Article 3 (4) – see above) responsible for managing one of the following activities:

- economic analysis;
- information technology;
- information security; and
- outsourcing arrangements of critical or important functions.

The consultation previously proposed identifying staff members who provide information technology or security that are relevant for the investment firm's business activities, such as, but not limited to, the execution of client orders, the execution of trading activities and the management or safeguarding of assets under both discretionary portfolio management and non-discretionary advisory arrangements of an ongoing nature.

Quantitative criteria

Absolute threshold of EUR 500,000

(Article 4(1) (a)) – This criteria has now been revised to require firms to identify staff members who been awarded total remuneration which is equal to or greater than EUR 500,000.

The consultation previously proposed to identify the staff member that had

been awarded total remuneration equal to or greater than EUR 500,000 and equal to or greater than the average of the remuneration of members of the management body and senior management in or for the preceding financial year. The second part of the test has now been removed.

Removal of the absolute threshold of EUR 750,000

– The RTS has removed the criteria proposed in the consultation for a firm to identify the staff member that had been awarded total remuneration which is equal to or greater than EUR 750,000 or more.

Same remuneration bracket (Article 4(1)(c))

– This criteria has been slightly revised to require firms identify the staff member who was in or for the preceding financial year awarded total remuneration that is equal to or greater than the lowest total remuneration awarded in that financial year to a member of staff who meets one or more of the qualitative criteria 1, 3, 4, 8 or 9. Criteria 7 (staff member responsible for managing, monitoring or mitigating material risks) which was originally proposed in the draft RTS has now been removed from this specific criteria.

ii) RTS on classes of instruments for the purposes of variable remuneration

The RTS have generally retained the proposals set out in the consultation with some clarifications in respect of its provisions on the use of 'alternative arrangements' to meet the payment in instruments requirement. Specifically, Article 6 has introduced some updated wording to reflect the feedback from the consultation that deferral does not apply for every investment firm (i.e. those firms that benefit from the application of proportionality).

It is worth noting that the EBA have removed the original reference around firms possibly having to comply with the RTS with regard to remuneration awarded for the performance year 2021. This aligns with the timing set out in the draft EBA Guidelines on remuneration under the IFD (published in December) which require the application of the remuneration requirements to performance years starting after 31 December 2021.

Please do let us know if it would be useful to discuss or if you have any questions on any of the above.

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