



## Financial Sector

### Remuneration and Compliance Briefing 2016



This briefing is relevant for in-house legal, risk and compliance, and HR professional in banks, building societies and investment firms.

#### Clawback and deferral

Applicable to banks, building societies and PRA-designated investment firms, including UK branches of non-EEA headquartered firms. These rules apply to all material risk takers at such firms, including Senior Managers under the Senior Managers Regime.

The Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA) have introduced changes to the rules on clawback and deferral, which will apply to performance periods beginning 1 January 2016. The changes will apply to banks, building societies and PRA-designated investment firms, including UK branches of non-EEA headquartered firms.

#### Deferral

Senior Managers will now be subject to seven year deferral requirements, with no vesting prior to the third anniversary of the award and then no faster than on a pro rata basis. For Risk Managers (i.e those who are members of the management body, head of a function or material business unit and their direct reports), excluding those covered by the new Senior Manager Regime (discussed below), a five year deferral requirement will be applicable, with vesting on a pro rata basis thereafter. All other material risk takers will be subject to a minimum three to five year deferral period, with vesting no faster than on a pro rata basis.

#### Clawback

In line with the PRA, the FCA will introduce a minimum clawback period (reclaiming awards which have vested) for material risk takers for performance periods beginning on or after 1 January 2016. The FCA and PRA have also introduced powers to extend the clawback period in certain circumstances by a further three years, in addition to the seven year period, for PRA-designated Senior Managers where there are outstanding internal or regulatory investigations.

Affected firms should review their existing plan rules, remuneration policies and employment contracts to ensure that the new requirements are reflected.



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## Senior Managers Regime

Applicable to all banks, building societies, credit unions and PRA-regulated investment firms and UK branches of foreign firms.

The Senior Managers Regime, proposed by the FCA and PRA as a result of a troubled period for the financial services sector, will apply from 7 March 2016 to banks, building societies, credit unions and PRA-regulated investment firms. The regime will also be applicable to UK branches of foreign firms. There will be concessions for smaller firms with less than £250 million in assets. The Senior Managers Regime will replace the Approved Persons Regime. From 2018, the Senior Managers Regime will also apply to the wider financial services industry.

1. **New approval regime** - There will be an approval regime for senior managers, replacing the current system. Designated senior manager functions and responsibilities must be allocated within the firm, ensuring all key responsibilities are assigned. Firms will be required to screen applicants to determine their suitability and must continue to assess their fitness and propriety. An application will then have to be made to the regulator for approval. There are grandfathering provisions for individuals already approved under the previous regime. Firms must also provide Statements of Responsibility to senior managers, setting out the matters they will be responsible for, ensuring they understand their roles. Senior managers have a statutory duty to take reasonable steps to prevent regulatory breaches in their areas of responsibility.
2. **Management Responsibilities Map** - Firms must have a Management Responsibilities Map detailing the management and governance arrangements of the firm (including the prescribed responsibilities). The aim of this is to ensure that no function is left unallocated.
3. **Annual Certification** - There will be a certification regime for staff who carry out a regulatory function which could cause a "significant harm" to customers or the firm. Such staff will be annually internally certified to ensure that they remain fit and proper persons to carry out the relevant roles.
4. **Code of Conduct** - A new Code of Conduct will also be applicable to senior managers and to individuals who have been certified under the scheme.
5. **Criminal offence** - There will be a new criminal offence of reckless misconduct in the management of a bank, limited to individuals who are subject to the senior managers regime (excluding credit unions). The maximum sentence is seven years in prison and/or unlimited fine.

## EBA Guidelines

Applicable to banks, building societies and some investment firms. Also applicable to branches and subsidiaries of firms and branches of non-EEA firms.

The European Banking Authority (EBA) recently published final guidelines on sound remuneration policies, which will be applicable from 1 January 2017. The guidelines replace the previous guidelines drafted by the Committee of European Banking Supervisors. In addition, the EBA published an opinion on the application of the proportionality principle to the remuneration provisions of the Capital Requirements Directive.

The draft guidelines effectively proposed the removal of the proportionality principle, such that the requirements would apply to all firms regardless of their size or scale. However, the final guidelines and opinion have differed slightly from this proposal. The final guidelines and opinion state that certain firms should be allowed to disapply the rules relating to minimum deferrals and the use of instruments (as currently applies in the UK). However, the proportionality principle would not apply to the bonus cap which applies to all material risk takers.

The guidelines also make other notable changes in relation to the treatment of LTIPs and share-linked instruments.

Following the translation of the guidelines into the official European Languages, regulatory bodies in each of the member states will have two months to "comply or explain" in relation to the guidelines. If changes are made to the Directive, regulatory bodies will have no discretion in relation to this. The FCA, in conjunction with PRA and HM Treasury, will be reviewing the changes proposed by the guidelines and their application to the UK market over the coming months. Where deemed necessary, the FCA will consult on any necessary changes to existing domestic rules and guidance.



## What should affected firms be doing now?

- Review remuneration policies, plan rules and employment contracts to ensure new clawback and deferral rules are reflected
- Review recruitment and promotion processes for roles involving senior manager functions
- Provide senior managers with a statement of responsibility and ensure employment contracts reflect their statutory duties
- Put systems in place for annual certification process for those in position which could cause significant harm
- Update staff handbooks and manuals to incorporate new code of conduct
- Consider scope of existing D&O cover in relation to senior manager responsibilities

Key Dates	
1 January 2016	Extended deferral and clawback rules will be applicable to performance periods beginning on or after this date.
1 January 2016	Senior Managers Regime applications can be submitted.
8 February 2016	Deadline for firms to inform the PRA and FCA of approved persons who are senior managers. Applications must be submitted with the firm's responsibilities maps and statement of responsibilities for the approved person.
7 March 2016	Senior Manager Regime applicable from this date.
2016	FCA to publish a policy statement on the UCITS V implementation and other changes to the handbook affecting investment funds.
Early 2016	European Securities and Markets Authority to publish their final report and final UCITS V remuneration guidelines on sound remuneration policies.
Early 2016	HM Treasury to publish consultation on the enactment of UCITS V.
18 March 2016	UCITS V Directive to be applicable in Member States.
18 September 2016	In accordance with UCITS V, prospectuses must be updated by this date.
1 January 2017	EBA guidelines on sound remuneration policies applicable from this date.

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