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BANK OF ENGLAND

News release

PRA and FCA statement on compliance with the EBA guidelines on Sound Remuneration Policies

The Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA) have notified the European Banking Authority (EBA) that the regulators will comply with all aspects of the EBA Guidelines on Sound Remuneration Policies, except for the provision that the limit on awarding variable remuneration to 100% of fixed remuneration, or 200% with shareholder approval (the bonus cap), must be applied to all firms subject to the Capital Requirements Directive (CRD).

The approach to the bonus cap under the Guidelines represents an interpretation of CRD with which neither the PRA nor the FCA agree. The PRA and FCA take a proportionate, risk-based approach to applying the bonus cap based on the wording under Article 92(2) CRD, which states: *"competent authorities shall ensure that … institutions comply with the following principles [including the bonus cap] in a manner and to the extent that is appropriate to their size, internal organisation and the nature, scope and complexity of their activities".*

The PRA and FCA take the view that the "extent" of application in a proportionate manner may include not applying a remuneration principle in its entirety based on the size, internal organisation and the nature, scope and complexity of the activities of the firm in question. The PRA and FCA consider that the CRD proportionality principle applies equally to all numerical requirements, including the bonus cap, deferral, payment in instruments, and ex-post risk adjustment.

Andrew Bailey, Deputy Governor, Prudential Regulation, Bank of England and CEO of the PRA said

"We have had an extensive debate on the issue of proportionality with our European counterparts. The PRA attaches a great deal of importance to the principle of applying policies in a proportionate manner consistent with the legal provisions. We have followed the principle of proportionality, which in practice means that smaller firms which pose less risk to the safety and soundness of the financial system face lower regulatory requirements. This is a sensible outcome."

All large and systemically important CRD-regulated firms must continue to apply the bonus cap. In parallel, the PRA and FCA will retain the current approach of requiring smaller firms to determine an appropriate ratio between fixed and variable remuneration for their business whilst not applying the bonus cap.

Since the introduction of the bonus cap, a number of firms have markedly increased fixed pay as a percentage of total pay, whilst total pay remained stable during the same period. The PRA and FCA believe that the shift to fixed remuneration makes it more difficult for firms to adjust variable remuneration to reflect their financial health, and limits deferral arrangements that put remuneration at risk should financial or conduct risks subsequently come to light.

The blanket extension of the bonus cap to all firms regulated under CRD would, in the PRA and FCA's view, exacerbate these impacts, and fails to recognise the different incentives and consequences for risk-taking across all CRD-regulated firms by disregarding the size, internal organisation, nature, scope and complexity of their activities.

All CRD-regulated firms must comply with all other aspects of the Guidelines, and all existing domestic requirements. The PRA and FCA are considering whether any rule changes are required to implement the guidelines and, if necessary, will consult in due course.

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