

Policy Statement | PS26/16

Buy-outs of variable remuneration

September 2016



BANK OF ENGLAND
PRUDENTIAL REGULATION
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This policy statement provides feedback to responses on Consultation Paper 2/16 'Buy-outs of variable remuneration' and final rules.

1 Overview

1.1 This Prudential Regulation Authority (PRA) Policy Statement (PS) provides feedback on responses to Consultation Paper (CP) 2/16 'Buy-outs of variable remuneration'.¹ The PS also includes final rules amending the Remuneration Part of the PRA Rulebook intended to ensure that the practice of buy-outs does not blunt the beneficial incentive effects of the existing rules on malus and clawback,² or allow employees to avoid the proper consequences of their actions.

1.2 This PS is relevant to banks, building societies and PRA-designated investment firms, including UK branches of non-EEA headquartered firms, and should be read alongside the Remuneration Part of the PRA Rulebook.

1.3 In response to consultation feedback the PRA has made changes to the proposed rules set out in CP2/16. These changes are described in Chapter 2. The PRA is required by the Financial Services and Markets Act 2000 (FSMA) to publish a statement on the impact of rules on mutuals where the final rule differs from the draft of the proposed rule.³ The PRA is also required by FSMA⁴ to publish a cost benefit analysis of any changes to the consultation proposals which the PRA considers to be significant.

1.4 The proposed amendments are responses to the consultation and do not depart materially from the original proposals. In particular, the requirement for the previous employer to provide employees with a remuneration statement is likely to reduce costs on firms by removing the need to trace all previous employers and determine the amounts of the buy-out award pertaining to each, shifting the responsibility to employees and former employers who should already have access to this information. As such, in the PRA's opinion, the impact of the rules as made is not significantly different from the impact of the proposed rules on mutuals or other deposit-takers.

2 Consultation responses

2.1 The PRA is required by FSMA to have regard to any representations made to the proposals in a consultation, to publish an account in general terms of those representations and its response to them, and to publish details of any significant differences in the rules as made.

2.2 In CP2/16 the PRA proposed a mechanism which would provide for the possibility of malus and clawback to be applied to a buy-out on the basis of a determination notified by the previous employer, known as a reduction notice (final rule 15A.9). The principal components of this mechanism were:

- a contract between the new employer and employee whereby, following receipt of the reduction notice from the previous employer, the new employer would have the ability to reduce the employee's buy-out through malus or clawback, by the amount in the reduction notice; and

1 January 2016; www.bankofengland.co.uk/pr/Pages/publications/cp/2016/cp216.aspx.

2 Remuneration 15.21 - 15.23.

3 Section 138K.

4 Section 138J(5).

- a requirement that the new employer acts on receipt of the reduction notice, except to the extent that the buy-out has already been subject to malus or clawback by the new employer.

2.3 The key issues raised in representations following the consultation and the PRA's response are summarised below.

The notification process

2.4 A number of respondents highlighted the perceived administrative burden on new employers being required to trace an individual's employment history and previous buy-out awards, and the requirement to notify multiple previous employers regarding the buy-out award. To address this concern the PRA will now require that, upon receipt of a request by the employee, previous employers must provide the employee with a remuneration statement containing details regarding unvested variable remuneration (final rule 15A.7). The employee may pass all or some of these statements to the new employer who may decide, on the basis of the statements provided to it, whether to provide a buy-out and if so the total amount. There is no obligation on the new employer to buy-out the full amount referred to in all of the statements, but the new employer is required not to provide a buy-out of more than the aggregate amount contained in statements provided to it (final rule 15A.4). A remuneration statement must contain the following information:

- material risk taker (MRT) status at each previous firm, including dates when the employee was or was not an MRT in the same firm;
- the amount of unvested variable remuneration which could be bought out, as applicable to the MRT status; and
- the duration of retention, deferral, performance adjustment and clawback arrangements which apply to this amount.

2.5 As compared to the CP proposals, the provision of remuneration statements to the employee would reduce the burden on recruiting employers. Once a buy-out is agreed, the new employer should use the information provided in the statement to identify previous employers and buy-out details. The new employer must then provide a buy-out notice to all relevant previous employers in relation to the unvested variable remuneration to which the buy-out may be attributed, as under the consultation proposal (final rule 15A.5). The PRA has clarified that a buy-out notice need not be sent to a previous employer where the buy-out cannot be attributed to unvested variable remuneration awarded by the previous employer to the employee. Any previous employer could then identify the current firm for which the employee works and make a determination as to the application of malus or clawback (final rule 15A.8).

The waiver process

2.6 Respondents requested clarity on the circumstances in which the waiver process would apply. Section 138A of FSMA enables rules to be waived on the condition that: the PRA is satisfied that compliance with the relevant rule would be unduly burdensome or would not achieve the purpose for which it was made; and that the waiver would not adversely affect the advancement of the PRA's objectives. The buy-out mechanism described above requires the new employer to act solely as an executor of the determination made by the previous employer without a requirement to exercise any discretion. As such, the PRA considers that, while any applications will be considered on an individual basis, firms are unlikely to need to make an application.

Definitions and implementation date

2.7 Respondents noted that the term 'determination' under draft Rule 15A.6(3) was unclear and could give rise to different interpretations. The PRA has therefore clarified that it is the final determination made by the previous employer that must be notified to the new employer.

2.8 Respondents requested that the rules explicitly disapply the ground for malus in relation to material downturn in financial performance under Remuneration 15.22(1)(b), which was referred to in the CP but not explicitly referred to in the rule. The final rules do not simply exclude all material downturn in financial performance as this could occur for a variety of reasons, including reasons for which malus or clawback should be applied. The PRA has however clarified the rules to make clear that malus and clawback may only be applied following employee misbehaviour or material error or material failure of risk management (Remuneration 15.22(a) and (c) and 15.23).

2.9 Respondents also suggested that the rules should be implemented during 2017 following a transitional period. The PRA will apply the rules to buy-out contracts concluded on or after 1 January 2017.

Appendix

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- 1 **PRA RULEBOOK: CRR FIRMS: REMUNERATION BUY-OUT RULES 2016 available at www.bankofengland.co.uk/pru/Pages/publications/ps/2016/ps2616.aspx**