

Insights

THE PRA'S AND FCA'S PROPOSALS TO REDUCE RESTRICTIONS ON BANKING BONUSES

RADICAL REMUNERATION REFORM?

Nov 27, 2024

SUMMARY

Yesterday the PRA and FCA published [PRA consultation paper 16/24](#) / [FCA consultation paper 24/23 – Remuneration reform](#), containing proposals for significant changes to the remuneration regime.

The UK's current remuneration regime was developed as part of a response to the 2008 global financial crisis, for which excessive and short-term risk taking in the banking sector was held partially responsible.

These new proposed changes are aimed at streamlining the regulatory framework, enhancing individual accountability, and bolstering the UK's international competitiveness. We consider the key proposals and their implications for financial services clients.

WHAT IS THE CURRENT REMUNERATION REGIME?

For dual-regulated firms, the current remuneration regime is an amalgamation of the rules in the [Remuneration Part](#) of the "CRR Firms" section of the PRA Rulebook and the Remuneration Code under [SYSC 19D](#) of the FCA Handbook. The rules, which derive from the EU Capital Requirements Directive IV and V, are designed to promote sound and effective risk management of systemically important financial institutions by aligning the long-term interests of those institutions and their staff whose professional activities have a material impact on the institution's risk profile, i.e. material risk takers or "MRTs" (also referred to as "Code staff").

Key provisions include requirements for the identification of MRTs, deferral of variable remuneration, and malus and clawback arrangements. The rules state that a significant proportion of variable remuneration is deferred over several years, to align incentives with the firm's risk profile

and long-term performance. Firms are required to implement robust governance frameworks to oversee remuneration policies and ensure compliance with regulatory standards.

WHY CHANGE?

The current regime has not been without criticism, primarily levied at the challenge internationally of attracting senior talent into UK banks, and the compliance burden. In August 2023, the FCA and PRA were given a new secondary competitiveness and growth objective, so it is no surprise that remuneration reform has come into focus.

In October 2023, the FCA and PRA [announced the removal](#) of the so-called bonus cap. The PRA's Business Plan 2024/25 indicated that regulators were *"considering further changes to the remuneration regime that is better suited to the UK's financial sector"* and would consult on those changes by the end of 2024. CP24/23 is the next step in effecting those plans. Just last month, on 17 October 2024, Sam Woods, PRA CEO, set out the thinking behind remuneration reform.

More generally, the proposals reflect a broader trend towards deregulation, as highlighted by Chancellor of the Exchequer, Rachel Reeves, in her recent [Mansion House speech](#). Reeves stated that regulation *"has gone too far"* following the last banking crisis, referencing her plans for Senior Managers and Certification Regime (**SM&CR**) reform and the FCA Handbook review, as well as expressly stating her support for remuneration reform saying:

"as the PRA have acknowledged... post-crisis pay structures made the UK an international outlier on deferral arrangements...so we will support their intention to consult on reducing the length of pay deferrals...helping firms to attract and retain talent."

WHAT ARE THE HEADLINE CHANGES?

REDUCE THE NUMBER OF MRTS AND SIMPLIFY THEIR IDENTIFICATION

The PRA and FCA propose to reduce the number of MRTs subject to the remuneration rules, and shift greater responsibility for identifying MRTs to firms themselves by removing the expectation on firms to seek regulatory approval to exclude certain individuals from the MRT categorisation. This will allow firms to tailor the identification process to their specific business models. This is expected to provide firms with greater flexibility and reduce the complexity of compliance, whilst ensuring that regulatory scrutiny is focused on those individuals whose roles have the most significant impact on a firm's risk profile.

REDUCE BONUS DEFERRAL PERIODS AND GIVE DISCRETION TO FIRMS ON RETENTION PERIODS

The deferral period for bonuses of the most senior bankers will be reduced to 5 years, down from the 7-year minimum currently applicable. This change is intended to make the remuneration

packages more attractive and competitive internationally.

For less senior bankers captured by the regime, the deferral period will be reduced to 4 years. This adjustment aims to balance the need for risk management with the desire to offer competitive remuneration.

Firms would also no longer be expected to set a retention period for deferred instruments (the current expectation is that retention periods are set between 6 and 12 months).

ENABLE LIMITED EARLIER PAYMENTS OF, AND RETURNS ON, REMUNERATION

Under the new proposals, part-payment of bonuses will be permitted from the time of grant of the award, rather than from year 3 as currently required. This change is designed to enhance the attractiveness of bonus schemes and align them more closely with industry practices.

The proposals include allowing the payment of dividends or interest on deferred instruments awarded to MRTs as part of their variable remuneration. This measure aims to ensure that deferred compensation remains competitive and retains its value over time.

IMPROVE THE LINK BETWEEN REMUNERATION AND INDIVIDUAL ACCOUNTABILITY

Bonuses will be more closely aligned to compliance with supervisory requirements, and the avoidance of risk-management failures. The proposals include introducing rules for firms to consider adjusting the remuneration of senior bankers in the event of failures of risk management and assessing performance against the regulator's supervisory priorities. In addition, the proposals include clarifying expectations for Remuneration Committees with regard to determining accountability for adverse risk events. This follows the theme of the [FCA's October 2023 letter to Chairs of Remuneration Committees](#), which aligned remuneration with compliance, culture, and accountability.

More generally, these proposals are noteworthy considering the anticipated changes to the SM&CR, which include the commitment to consult on removing the current Certification Regime.

REMOVING DUPLICATIVE REMUNERATION RULES

The FCA handbook will be streamlined by removing duplicative remuneration rules and instead cross-referring to the PRA rules. This simplification is expected to reduce the regulatory burden on firms and improve clarity.

These proposals sit alongside the [FCA's Call for Input](#) following the introduction of the Consumer Duty on simplifying and removing provisions from its Handbook, which closed on 31 October 2024, and the FCA's wider Handbook review.

WHAT DO THESE CHANGES MEAN FOR FIRMS?

The PRA and FCA's proposals in CP16/24 represent a significant shift in the regulatory landscape for senior bankers' remuneration. By reducing the number of individuals subject to the rules, simplifying the identification process, and making bonus schemes more attractive, the regulators aim to enhance the UK's competitiveness while maintaining robust risk management and accountability standards.

In the longer term, this is likely welcome news for firms, reducing the compliance burden and increasing their ability to attract talent and develop more flexible processes to reflect their businesses.

However, in the shorter term, there will be an increase in workload to:

- Identify what the proposals mean in practice for firms and determine whether firms want to respond to the consultation before the 13 March 2025 deadline; and
- Monitor the evolution of the proposals and, assuming that changes will be implemented, prepare accordingly.

We recommend that firms identify and review their existing internal policies and processes concerning remuneration and ensure that all stakeholders are aware of the proposals. We also recommend that firms consider how these changes correspond with internal performance review systems and timing of such reviews, given the proposed alignment with compliance and supervisory requirements, as well as the avoidance of risk-management failures.

If these changes are introduced as planned, there will be a need to update internal policies and processes and amend the accompanying systems to reflect altered payment structures. Experience tells us that it is always better to get ahead of regulatory reform projects.

RELATED PRACTICE AREAS

- Financial Services Corporate & Regulatory Team
- Employment & Labor

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