UK Financial Services Authority Update on the Remuneration Code

By Lex Verweij and Julian Ingleby
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OVERVIEW

In an effort to streamline and focus the supervisory process, the UK's Financial Services Authority (FSA) recently issued guidance on the proportionality structure in its Remuneration Code. The requirements that were previously structured as four Tiers based on either assets or regulatory capital have been redrafted in a new three-level system based solely on the firm's total assets.

While the FSA has written to firms to tell them that they have been reclassified, there is a good deal of confusion in the market about what that means. How should firms respond? What are other market participants doing about this change?

At McLagan, our analysts have studied the guidance documents regarding the rule change and summarized its structure and likely impact in this paper.

HISTORY

Previously, the FSA Remuneration Code was applied based on the proportionality Tier into which a firm fell. Firms in Tiers one and two were subject to the most stringent requirements while those in Tiers three and four were exempt from some of the more arduous remuneration and disclosure rules.

The determination of specifically which Tier a firm belonged to was based upon either the capital resources of that firm or its asset value (for firms headquartered in the European Economic Area or outside the EEA respectively). With the amending of the original Remuneration Code that classification system ends.

NEW PROPORTIONALITY RULES

The updated '*General guidance on Proportionality*' for the FSA Remuneration Code (SYSC 19A) and Pillar 3 Disclosures on Remuneration (BIPRU 11) specifies that firms will now be categorized by a three-Level proportionality system, where some Levels will be exempt from certain code requirements. The FSA has said that, "The proposed approach [will] allow the FSA to focus its resources on the most significant firms who pose risks to financial stability".

Highlights of the new framework are detailed below:

- The allocation of firms to proportionality Levels is based on "relevant total assets" – the average of total assets on the last three accounting dates for UK and European Economic Area (EEA) firms or the last three calendar year-ends for non-EEA firms.

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- A single set of criteria now slots both UK/EEA and non-EEA firms into the new Levels, whereas previously asset values were used for non-EEA firms and capital resources were applied for UK/EEA firms.

- UK, EEA or third-country banks or other investment firms that have "relevant total assets" are categorized as follows:
    - Level One - greater than £50 billion
    - Level Two - between £15 -£50 billion
    - Level Three – less than £15 billion

It is important to note that previous thresholds were lower so some smaller firms ended up in the more restrictive Tiers - ≤£2 billion / £2-£25 billion / £25 billion+. Therefore the new Level structure will target requirements at the highest risk, biggest firms, and will reduce the regulatory burden on some firms.

The proportionality rules themselves are largely unchanged. The guidance sets out which elements of the Remuneration Code the FSA suggests it would normally be appropriate for firms to disapply under the proportionality principle.

The table below summarises the rules.

New proportionality Level	Type of firm	Relevant total assets average at last 3 accounting period / year ends	FSA Code requirements that it will 'normally be appropriate' to disapply
Level 1	UK banks, building societies. BIPRU 730k firm that is also a full scope BIPRU investment firm	Exceeds £50bn	Full disclosure requirements* apply including quantitative disclosure of aggregate Code Staff remuneration
Level 2	UK banks, building societies. BIPRU 730k firm that is also a full scope BIPRU investment firm	Exceeds £15bn and Does not exceed £50bn	Reduced disclosure requirements* vs Level 1 (quantitative Code Staff disclosure limited to the split of fixed vs variable and number of beneficiaries)
Level 3	UK banks, building societies Any full scope BIPRU investment firms not in Levels 1 or 2	Does not exceed £15bn *No total asset test*	1) Reduced disclosure requirements* vs Level 2 (limited to some aggregate remuneration disclosures) 2) Minimum deferral % for Code Staff variable remuneration 3) Part-payment in shares / other instruments and retention 4) Performance adjustment (malus / clawback) 5) Remuneration Committee desirable but not mandatory
	plus limited licence and limited activity firms		*As above plus* *6) Ratios between fixed and variable remuneration*

** Note disclosure requirements sit in BIPRU so only apply to 'BIPRU firms' - banks, building societies and certain investment firms*

It is also important to note that the removal of Tier 4 does not result in firms previously in that Tier being able to disapply less. The new Level 3 has special provisions that apply to the same firms and are equivalent to the old position.

The other rules are substantially unchanged (e.g., rules on groups with more than one remuneration code firm; rules on part-year Code Staff).

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LIKELY IMPACTS

The largest impact is on firms that move to a lower level of regulation as a result of the change in thresholds. These firms should identify the additional flexibility they now have and consider whether policy changes are appropriate. For smaller UK firms with a parent company in a country with less onerous regulation this change should enable the adoption of a more consistent global policy. Other firms might consider whether an argument could be constructed to move to a lower Level, based on the broader characteristics of the business rather than asset size alone.

The other impact of which proportionality Level a firm sits in is in supervision. The regulator plans to focus more time and attention on Level 1 versus Level 2, and on Level 2 versus Level 3.

CONCLUSION

Because the FSA has raised the bar in asset value thresholds in the new Levels, some firms will actually find their compliance burden reduced. However, all FSA- regulated firms should reassess where they fall within the new Levels structure now. And, once determined, they should evaluate the potential impact on reporting and disclosures and establish a plan for implementation.

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