Consultation Response

CP12/20 Capital Requirements Directive V (CRD V)

30 September 2020

The Association for Financial Markets in Europe (AFME) welcomes the opportunity to comment on **CP12/20 CAPITAL REQUIREMENTS DIRECTIVE V (CRD V)**. AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.

AFME is the European member of the Global Financial Markets Association (GFMA) a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia.

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We summarise below our high-level response to the consultation, which is followed by answers to the individual questions raised.

Executive Summary

We welcome the opportunity to comment on the PRA's consultation paper on transposition of the CRD V requirements in the UK. Our comments to the PRA relate to the remuneration proposals and have been drafted to align with our comments to the FCA on its consultation paper CP20/14 'Updating the Dual-regulated Firms Remuneration Code to Reflect CRD V' ("FCA CP").[1]

Our key concern is that the approaches taken by the PRA and FCA should align (ideally expressed also in the same format) and, where possible, not go beyond what is required by CRD V. In particular, we request a single, clear approach to the categorisation of Material Risk Takers ("MRTs") and the application of deferral and clawback rules. Many of AFME's members are dual-regulated firms, meaning that inconsistencies between the two sets of requirements will cause unnecessary operational complexity as well as confusion for affected staff. In particular, we suggest:

- A single set of MRT categories referenced by both the PRA and FCA;
- A single high earner threshold for both the PRA and FCA;
- A consistent approach to the 'Risk Manager' category; and
- A streamlined approach to clawback, with a 7-year term applied in most cases.

[1] FCA CP20/14 https://www.fca.org.uk/publications/consultation-papers/cp20-14-updating-dual-regulated-firms-remuneration-code-reflect-crd-v

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Furthermore, inconsistencies between the UK and EU approaches will also bring challenges for cross-border businesses, where staff may be assessed as MRTs against multiple sets of criteria. For this reason, alignment with EU Member States' interpretations of CRD V is preferable wherever possible. We also suggest that this is taken into consideration when the regime is applied to branches in the UK.

Finally, we note the following other key points from our response:

- Clarity in relation to part-year MRTs, notable the retention of the 3-month minimum term;
- That the Remuneration Code for Dual-Regulated Firms should not be applied to IFPRU investment firms of CRD groups which will be subject to UK Investment Firm Prudential Regime (IFPR);
- Acknowledgement of the practical challenges of applying remuneration policies where groups hold a participating interest in any entity, but not control; and
- Clear guidance on currency thresholds, including the conversion of all Euro thresholds to suitable Sterling figures.

We remain available to discuss any of the points made in our response in further detail.

Questions

Comments on the Remuneration Proposals ("Consultation Paper" Part 3), Amendments to the PRA Rulebook Remuneration Part ("Appendix 1 Annex A") and Revised Supervisory Statement SS2/17 (Appendix 3 Part 3, "Revised SS2/17")

In the Revised SS2/17 paragraph 1.9, we suggest that the PRA awaits the updated Guidelines on Sound Remuneration Policies that are expected from the EBA ("EBA Guidelines"), rather than referring back to the 2015 Guidelines[2].

Proportionate application of remuneration requirements - application to individuals

We recognise that the changes to the thresholds for applying a proportionate approach for individuals reflect the requirements of CRD V and are therefore mandatory. However, these changes will bring more people into scope of deferral, retained shares, and the holding and retention periods for discretionary pension benefits; and we do not believe that this will substantially further the objectives of promoting effective risk management and discouraging excessive risk-taking (due to the low absolute value of variable pay used). Indeed, some of the individuals captured as MRTs may not be of significant seniority, for example if they are caught by virtue of their committee membership, and this could even discourage such individuals from taking on committee roles (despite the experience and exposure that can be gained). We would therefore welcome a further review of these thresholds once the EU Exit Transition Period ends.

Categories of MRTs

We are extremely concerned by the complex categorisation of MRTs, both in relation to the CRD V rules and between the PRA and FCA approaches.

In applying remuneration rules, CRD V differentiates only between two categories: those MRTs who are members of the management body or senior management and those MRTs who are not. However, the PRA and FCA rules, particularly in relation to deferrals and clawback, variously distinguish MRTs according to the following criteria:

- For the PRA and FCA: individuals performing a PRA senior management function;
- For the FCA: individuals performing a FCA senior management function;

[2] https://eba.europa.eu/regulation-and-policy/remuneration/guidelines-on-sound-remuneration-policies

- For the PRA, individuals who do not perform a PRA senior management function but are a member of the management body or senior management;
- For the PRA: individuals who are 'higher paid' MRTs, for which Appendix 1 Annex A, paragraph 1.3 uses two defining criteria:
    - annual variable remuneration exceeds 33% of their total remuneration, and
    - total remuneration exceeds £500,000;
- For the FCA: individuals earning over £500,000 (i.e. a single criterion that is distinct from the PRA's 'higher-paid' category); and
- For the PRA: individuals who are 'higher paid' MRTs but who also meet certain qualitative criteria (this corresponds to the former concept of 'Risk Managers' although this term has not been retained).

The number of categories, as well as the lack of alignment between the PRA and FCA, will not only cause administrative complexity for firms, increasing the cost of compliance, but will also make it much more challenging to set out a clear and consistent remuneration policy for staff.

We strongly suggest that the PRA and FCA should align their approaches and produce a single set of categories for firms to reference across both sets of requirements, possibly set out in tabular form.[3] This should include:

- The PRA and FCA both referencing requirements for individuals performing (1) a PRA senior management function or (2) FCA senior management function, even where these requirements are different (currently the FCA CP references both, but the PRA only references PRA senior management functions);
- A consistent approach to 'higher-paid' individuals. In this respect, we suggest that the FCA's single criterion of total remuneration exceeding £500,000 is more in line with the current approach and should be retained, rather than the two criteria proposed by the PRA. Alternatively, we would strongly suggest consideration of alignment with the threshold set for at least 60% deferral in paragraph 5.44 of the current SS2/17, i.e. total variable remuneration exceeding £500,000; and
- A consistent approach to the 'Risk Manager' category, which should also exclude the quantitative criteria set out in 3.1(c).

Furthermore (and linked to our comments on the treatment of branches below), we note that many firms will be subject to EU Member State MRT identification requirements as well as those of the UK. From this perspective, consideration of the simplicity of the approach taken by CRD V is important, to reduce fragmentation between the UK and EU and the resulting possibility that individuals working for multiple entities may be subject to differing and overlapping MRT thresholds.

In relation to how the complexity of categories specifically affects deferrals and clawback, please see our comments on each below.

Waivers and exclusions

In Appendix 1 Annex A, paragraph 3.2 has been removed. Furthermore, revised SS2/17 paragraph 3.6 refers to waiver applications only for employees earning total compensation more than €750,000. We would appreciate clarity as to the procedure for those earning below €750,000, i.e. to specify that notification to the PRA/FCA for these employees is no longer required.

[3] By way of example, we note Table A on page 8 of the joint policy statement PRA PS12/15 and FCA PS15/16 https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/policy-statement/2015/ps1215

Treatment of branches

The Consultation Paper paragraph 3.25-6 proposes to align treatment of branches to the treatment of PRA-authorised firms. However, we suggest that, in light of the UK's departure from the EU, this will cause cross-jurisdictional overlap and complexity, for example where individuals are assessed against MRT thresholds for both UK and EU (see also our comments on currency thresholds below). This would also feed into other areas such as MRT identification against qualitative thresholds, application of MRT pay-out process rules and governance.

Instead we suggest an approach which aligns with the intention of the PRA to harmonise with CRD V, namely that, where the parent entity of the branch is in the EU and subject to CRD V, the rules of the parent entity continues to apply.

Additionally, we would welcome clarity as to whether firms should assess materiality to the branch, or to the parent entity. Assessing materiality in relation to the branch would further increase complexity of MRT identification where firms have multiple subsidiaries in Europe.

Part-year MRTs

Both the PRA and the FCA consultations propose an amendment to part year MRTs 'in line with CRD V restrictions on disapplication of rules at an individual level' (see deletion of SS2/17 paragraph 3.18). For those employees who perform a role that would be typically designed as an MRT role for less than 3 months of a performance year, could the PRA confirm that they should not be identified as an MRT in the performance year in question? We note paragraph 89 of the EBA Guidelines on Sound Remuneration Policies ("EBA Guidelines")[4] "*Institutions should ensure that staff that fall or are likely to fall under the criteria in Article 3 for a period of at least three months in a financial year are treated as identified staff*" which supports this interpretation. Identification as an MRT for such a short period may disincentivise individuals from taking on such a role towards the end of a performance year. Additionally, in practice, the first couple of months of a new role are often also a period of adjustment, in which individuals may not yet have taken on full decision-making responsibility within the role. Those leaving a MRT role might also be affected, for example where there are handover periods or gardening leave.

Furthermore, we would appreciate clarity as to the arrangements for individuals travelling from overseas to work in the UK for a short-term assignment of less than 3 months. Currently, such individuals are not automatically subject to the MRT rules and we would request the continuation of this flexibility.

Revised SS2/17 paragraph 3.13 requires that the structural requirements apply to all variable pay. We assume that this would only be in cases where an individual is hired into an MRT role (i.e. where annualisation of fixed comp for bonus cap purposes is permitted).

Deferral and clawback – misalignment between PRA and FCA rules

Further to our comments above on the categorisation of MRTs, we also note that there are differences between the proposed PRA and FCA remuneration rules for dual-regulated firms which creates unnecessary complexity for such firms and also increases operational administrative burden for firms.

We have set out below the differences we believe exist between the proposed PRA and FCA remuneration rules:

a) Deferral period for PRA SMFs: For individuals earnings below £500,000 the proposed FCA rules prescribe a five-year deferral period, however, it appears the proposed PRA Rules15.17(1) prescribe a four-year deferral period.
b) Misalignment in deferral periods: The PRA rules propose a five-year deferral period for individuals that fall within the proposed Rule 15.17(2)(a). However, the proposed FCA rules for dual-regulated firms allows firms to apply a four-to-five-year deferral period.

[4] https://eba.europa.eu/regulation-and-policy/remuneration/guidelines-on-sound-remuneration-policies

c) Relaxation of deferral and clawback periods: the PRA has proposed that firms can apply lower deferral and clawback periods for MRTs whose total compensation is not more than £500,000 and variable pay is not more than 33% of total compensation. Whereas FCA proposes a lower deferral and clawback period for those with earnings not more than £500,000 (with no reference to the percentage of total compensation made up by variable pay).

d) Clawback periods: For some categories of MRTs the clawback period that would need applied under the FCA rules would differ from the PRA rules.

We would highly recommend that the PRA and FCA align their remuneration rules for dual-regulated firms. In the absence of such clarity, our members are concerned that both the firms and the PRA/FCA will enter into debate as to the correct deferral and clawback periods for certain categories of individuals as part of each annual pay review round. This will increasing the administrative and operational burden for firms, as well as the adding difficulty in explaining the application of the rules to affected staff.

Deferral periods – comparison with CRD V

In relation to deferrals, we note that to comply with the CRD V provisions, the minimum deferral period for MRTs has been increased from three years to four years and the minimum deferral period for members of management and senior management has been set at five years. However, we note that the proposed Rule 15.17(2)(a), as drafted, goes both beyond CRD V and current PRA rules. Specifically, the application of the five-year deferral period for individuals who meet the criteria in Rule 3.1(1)(c). We believe that this divergence of approach from the EU will significantly increase complexity for firms operating cross-border.

As CRD V now mandates a five-year deferral period for members of management body and senior management and this has been incorporated into the PRA Rules we would ask that the PRA and FCA consider the following options to avoid fragmentation between the UK and EU:

a) Option 1: Completely align the deferral periods with the requirements under CRD V
   - Five-year deferral period for members of management and senior management (as proposed under the rules); and
   - Four-year deferral for all other MRTs

   This approach would align the UK rules with the CRD V rules. While it would represent a shortening of the deferral period for PRA SMFs, the clawback period would continue to apply for a minimum of 7 (and up to 10) years.

b) Option 2: Align the population subject to five-year and four-year deferral periods with the requirements under CRD V
   - Seven-year deferral for MRTs in PRA-designated senior management functions (PRA SMFs)
   - Five-year deferral period for other members of management and senior management and MRTs in FCA designated senior management functions (as proposed under the rules)
   - Four-year deferral for all other MRTs.

   This approach would maintain the longer deferral period for PRA SMFs but align the deferral period for all other MRTs with the requirements in CRD V and also maintain alignment between the PRA and FCA rules for dual-regulated firms. It would also reduce inconsistency in the approach between UK and EU firms post the EU exit transition period.

c) Option 3: Ensure the five-year deferral period is not extended to individuals not previously captured under PRA rules and CRD V requirements

- The proposed rules 15.17(2)(a)(i) extends the application of the five-year deferral period for individuals who meet the criteria in Rule 3.1(1)(c) (these individuals would not have been subject to five-year deferral period under the current PRA rules). As this goes beyond the current PRA remuneration rules and the requirement in CRD V, we would propose Rule 15.17(2)(a)(i) is only limited to individuals who meet the criteria in Rule 3.1(1)(a) to (b).

This approach would ensure the five-year deferral period is not extended to individuals who not subject to the five-year deferral under the current PRA remuneration rules and who are also not required to be subject to a five-year deferral period under CRD V.

If the PRA chooses to retain the current drafting, we would welcome additional clarity on certain aspects of the current drafting of Appendix 1, Annex A paragraph 15.17. In particular, we would welcome clarity on the minimum deferral periods for:

1. MRTs who performs a PRA senior management function ("PRA SMF"), but who are not considered to be a higher paid MRT (i.e. who earns less than £500,000 total remuneration). There is some overlap with the population identified as members of the management body and senior management, but the two populations are not identical. We suggest this may be a four year deferral but it is unclear; and
2. MRTs who meet the criteria in 3.1(1)(a) to (c) or whose professional activities meet the qualitative criteria set out in Article 6(1), 6(2) or 6(5) of the EBA's Final Report on Revised Technical Standards to identify MRTs[5] (collectively "Risk Manager MRTs" – a term that is not retained in the PRA's proposals), but who are not considered to be a higher paid MRT. We suggest this may be a four year deferral but it is unclear.

The differentiation by total compensation threshold for PRA SMFs and other MRTs (i.e. higher-paid vs non-higher-paid) is also likely to cause an administrative burden and employee confusion. We also suggest that such a threshold may challenge the principle behind determining Risk Managers based on their roles & responsibilities, irrespective of remuneration levels.

Clawback

Please refer to our comments above on streamlining the overall approach to the categorisation of MRTs. We would then like to make the following comments specifically on the application of clawback.

We note that in paragraph 3.30 of the Consultation Paper and Appendix 1 Annex A paragraphs 15.20 and 15.20, the PRA proposes to apply a proportionate approach to clawback periods applied to MRTs. Whilst we recognise the drivers for the proposed changes and the positive intent in reducing clawback periods for some MRTs, these will be operationally very difficult to manage as we expect employees may move between MRT categories, earning more or less than £500,000 year on year. This will lead to different clawback periods being applied to different awards; and potentially there being different treatment of the up-front portion of awards from one year to the next.

The current approach of applying 7 year clawback to all awards from the date of grant is simpler to manage, is easier for colleagues in scope of the remuneration rules to understand and, since instances of clawback are generally limited, does not have a negative proportionality impact. Given that a standardised clawback period for all MRTs is not inconsistent with the requirements of the EBA Guidelines on Sound Remuneration Policies, our preference would be to retain the current approach. If the PRA wishes to retain some element of proportionality, we suggest only two levels: 7 years, except for remuneration not subject to deferral, in which case the clawback period should be 1 year.

[5] https://eba.europa.eu/eba-publishes-revised-standards-identify-staff-material-impact-institution%E2%80%99s-risk-profile

If the PRA wishes to retain the proposed tiered system, we note the following in relation to the current drafting: that, per Appendix 1 Annex A 15.20A (2), the clawback period for PRA Senior Managers would be 8 years (the longer of deferral + retention or 7 years). We presume that this is not the intention and suggest that it should be amended to 7 years.

Retention periods

It would be helpful if both the PRA and FCA could clarify whether they intend to retain the EBA Guidelines' (paragraph 267) approach to retention periods, namely 12 months for all employees, other than Risk Managers, who have a 6 month period.

Firm-wide performance adjustment policy

In relation to Revised SS2/17 paragraph 4.10, we suggest that it should be amended as follows *"The PRA generally expects all firms to have a firm-wide policy on performance adjustment (and group-wide policy, where appropriate), including also in respect of individuals who are not MRTs, as appropriate".* For example, shared services & control functions will not necessarily have provisions in place to allow ex-post adjustment based on performance downturns to the same extent as front-line businesses. They will have in place other measures such as in-year adjustment, malus and clawback.

Reporting requirements

Whilst no change is proposed to the reporting requirements, we would appreciate clarity as to whether the templates for tables 1a and 1b will change to reflect the new MRT criteria. Where changes are to be made, we encourage the PRA to consider the appropriate sequencing to allow firms sufficient time to prepare.

We would also welcome a review of regulatory reporting in respect of remuneration. In particular, we would welcome clarity on whether Remuneration Benchmarking and High Earners Reports which we share with the PRA for onward transmission to the EBA will be required once the EU Exit Transition Period ends (Chapters 17 and 18 of the Remuneration Part of the PRA Rulebook).

IFPRU Firms in CRD Groups

We suggest that the Remuneration Code for Dual-Regulated Firms should not be applied to investment firms of CRD groups which will be subject to UK Investment Firm Prudential Regime (IFPR). This is on the basis that standalone IFPR entities would not be subject to CRD rules but only to IFPR remuneration rules, which includes a 3-year deferral period (as opposed to a 4-year period under CRD V), and no bonus cap. Not allowing investment firms of banking groups to only apply the IFPR rules (and disapply the CRD V rules) would create challenges for them in terms of employee attraction and retention, as these entities compete against standalone investment firms for talent.

Instead we propose that the PRA and FCA:

- only apply the Remuneration Code for Dual-Regulated firms to individuals of IFPR firms that have a material impact on the banking group's risk profile (i.e. who meet the qualitative MRT criteria for the banking group); and
- apply the IFPR Remuneration Code[6] to IFPR firm staff who meet only the quantitative remuneration criteria (which are the same under CRD and under the IFPR).

3. What further information can firms with assets below £15 billion provide on the cost and benefits of the PRA's proposals? More broadly, do you agree with the PRA that the approach consulted upon is proportionate?

We are supportive of the PRA maintaining its current approach (paragraph 3.24 of the consultation) where all firms within a group continue to be subject to the same remuneration rules as those applicable

[6] FCA Handbook SYSC 19A

to the highest proportionality level firm in the group, as is the case in paragraph 2.10 in the current version of SS2/17. However, in applying the rules at consolidated and sub-consolidated levels to all entities within a 'group', we wish to highlight a concern with the continuing reference to section 421 of FSMA (as set out in paragraph 3.5 of the consultation).

Our concern is that applying remuneration requirements based on the FSMA section 421 definition would include any entities in which a group has a participating interest, which can be as low as 20%. This is not a level at which a group can exercise control over the entity.

Groups understand the need for a good corporate governance framework across subsidiaries that adheres to any local legal and regulatory requirements. However, there is not the same ability to control entities in which a group only has a participating interest. It cannot mandate such entities to remunerate their employees in a way that is consistent with that group's deferral and clawback requirements, the bonus cap, rules relating to identification of MRTs and the application of a compliant remuneration policy to name some of the requirements.

By way of example, there are companies where multiple regulated firms may each have interests on or around 20%. If each such firm is subject to different regulatory requirements it will create practical difficulties in terms of how a single remuneration policy for such company can ensure the required level of compliance for each investor firm. Even where investor firms are subject to the same remuneration requirements, there can still be divergences between each firm's remuneration policies and application of the rules.

Therefore we would ask the PRA (and a similar request will be made in response to the FCA CP) to acknowledge the practical challenges in following the section 421 FSMA definition where groups hold a participating interest but not control.

4. Do you have any views on the design and amount of currency thresholds following the end of the EU Exit Transition Period?

Setting a Sterling value for currency thresholds is a helpful amendment to provide consistency year on year by removing the impact of exchange rate fluctuations between Euros and Sterling. However, we would be grateful for clarification on the frequency with which the PRA will review these thresholds, especially in the event of a material and sustained change in the prevailing exchange rate.

In addition, guidance for non-UK firms as to how conversions to the new thresholds should be managed would be appreciated, in order to ensure a consistent approach across the industry. For example, whether specified exchange rate sources should be used.

In relation to specific thresholds:

- The €500,000 has been converted to £440,000 in the table in Consultation Paper paragraph 3.32, however the figure of £500,000 appears elsewhere (for example in relation to the definition of higher-paid MRTs in Appendix 1 Annex A paragraph 3.1). Alignment of these thresholds (ideally at £500,000) would be preferable to reduce complexity.
- Further, we note that the PRA has not provided a Sterling equivalent for €750,000. The FCA consultation uses a translated value of £658,000. It would be helpful for the PRA to include the same value that the FCA has used.
- With that in mind, it may make sense for thresholds such as £440,000 and £658,000 to be rounded (for example to £450,000 and £660,000) to make their neater figures for inclusion in remuneration policies.

There are also still instances in the amendments to the Rulebook where Euro thresholds are retained, which may become confusing. We suggest that all should be converted to the appropriate Sterling thresholds.

Next steps

AFME welcomes the opportunity to submit comments, and would be pleased to engage further as the regulatory process continues.

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