inbrief

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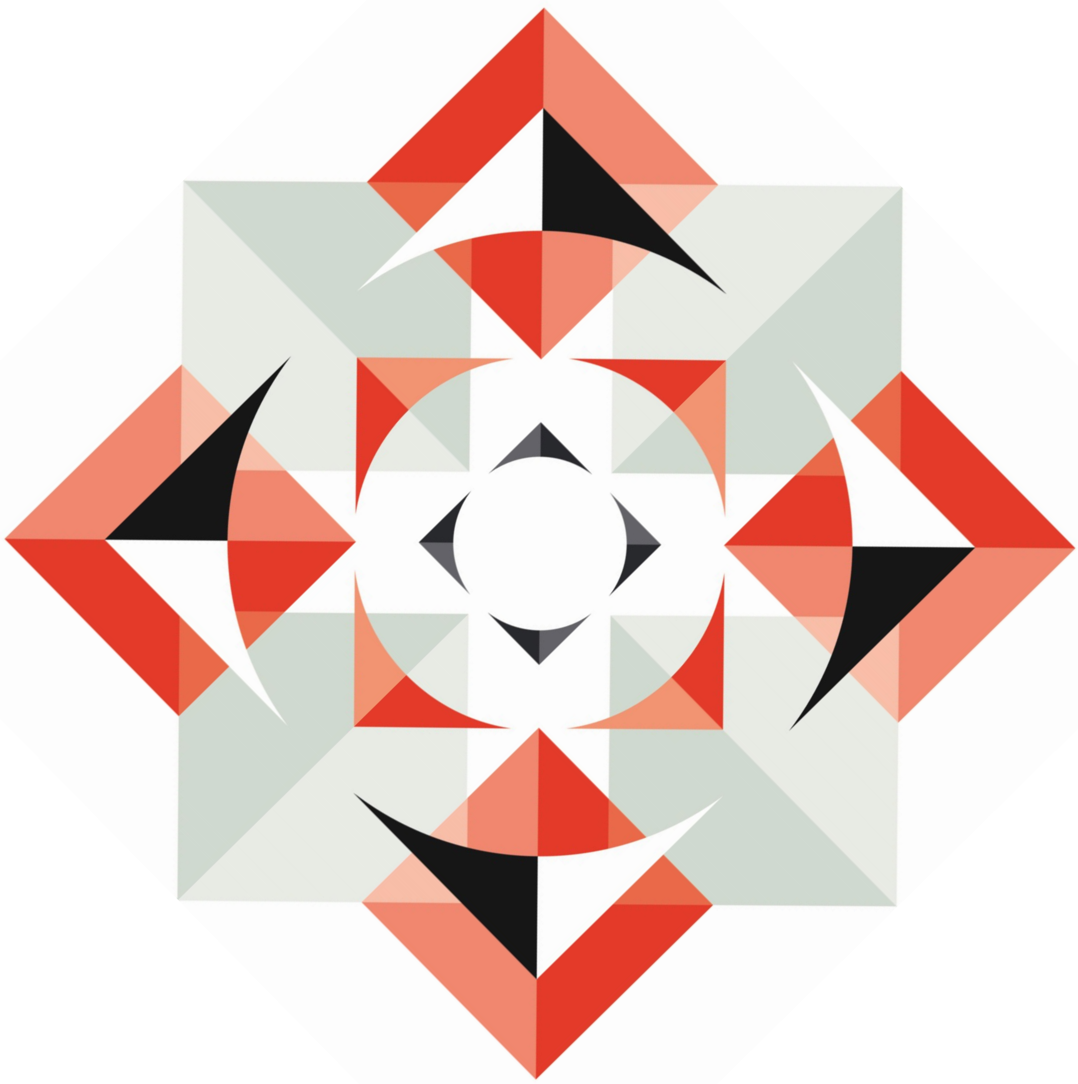
Remuneration codes

For banks, building societies and investment firms



Inside

Introduction

The financial services industry has been the focus of wide-ranging reform over the past few years as a result of both UK Government and European initiatives. In January 2014, a package of reforms implementing the fourth set of amendments to the EU Capital Requirements Directive ("CRD4") took effect. These reforms built on the remuneration requirements of the third set of amendments to the Capital Requirement Directive ("CRD3") which aimed to align remuneration principles in banks, building societies and investment firms across the EU. In particular, CRD3 imposed restrictions affecting the structure and timing of bonus payments. CRD4 went a step further and imposed restrictions on the quantum of variable remuneration under the so-called "bonus cap".

This Inbrief gives an overview of the various Remuneration Codes issued by the Prudential Regulation Authority ("PRA") and the Financial Conduct Authority ("FCA") (collectively the "UK Regulators") which take into account the requirements of "CRD4" and other developments.

What are the Remuneration Codes?

The first Remuneration Code was issued in August 2009[1] as part of the Financial Services Authority's ("FSA's") regulatory response to the banking crisis. It applied with effect from 1 January 2010 to the UK's largest banks, building societies and broker dealers (approximately 26 firms in total) and required those firms to ensure that their remuneration policies, practices and procedures were consistent with, and promoted, effective risk management. With effect from 1 January 2011, this Remuneration Code was substantially revised and the number of firms within its scope significantly extended, to take account of the requirements of CRD3. The Remuneration Code was revised again with effect from 1 January 2014 to take into account the requirements of CRD4.

There are currently seven Remuneration Codes:

> the CRR Remuneration Code[2] which applies to "CRR firms" (banks, building societies and PRA-designated investment firms);

> the IFPRU Remuneration Code[3] which applies to IFPRU investment firms and relevant overseas firms;

> the AIFM Remuneration Code[4] which applies to alternative investment fund managers;

> the BIPRU Remuneration Code[5] which applies to BIPRU investment firms regulated by the FCA. The BIPRU Remuneration Code is the same as the 2011 Remuneration Code referred to above;

> the dual-regulated firms Remuneration Code[6] which applies to CRR firms;

> the UCITS Remuneration Code[7] which applies to UK UCITS management companies; and

> the MiFiD Remuneration Incentives Code[8] which applies to those individuals who may have a direct or indirect impact on investment services and/or ancillary services provided by a firm or on its corporate behaviour.

This note focuses on the CRR Remuneration Code, the dual-regulated firms Remuneration Code and the IFPRU Remuneration Code (collectively referred to as the "Codes").

The requirements of the Codes are supplemented by a variety of guidance, supervisory statements and opinions not only from the UK Regulators but also from the European Banking Authority ("EBA"). Of key importance is the EBA's final guidelines on sound remuneration policies (the "Guidelines") issued on 21 December 2015. The UK Regulators have confirmed that all UK firms subject to CRD4 must comply with all aspects of the Guidelines, except that smaller firms are generally not required to apply the bonus cap (see below).

Which firms are caught by the Codes?

Both the CRR Remuneration Code and the dual-regulated firms Remuneration Code apply to CRR firms. This is because CRR firms are subject to regulation by the PRA for prudential purposes and by the FCA for conduct purposes. Other firms may also be subject to more than one Code, for example, the IFPRU Remuneration Code and the AIFM Remuneration Code.

The AIFM Remuneration Code applies to FCA-regulated IFPRU investment firms. IFPRU investment firms include those firms that deal with their own account as well as firms that underwrite financial instruments and/or place financial instruments (whether on a with or without firm commitment basis). Firms that safe keep and administer financial instruments for the account of clients, including custodianship and cash/collateral management, are also classified as IFPRU investment firms.

The Codes are applied proportionately according to the firm's size and internal organisation and the nature, scale and complexity of its activities. As part of this approach, the UK Regulators categorises firms into three proportionality levels under the Codes depending on their total assets with differing minimum expectations for each level. Level one firms are subject to the most stringent requirements whilst level three firms are subject to the least stringent requirements.

Are firms established outside of the EEA caught by the Codes?

Yes. UK groups are required to apply the Codes globally to all their regulated and unregulated entities whilst UK subsidiaries of non-EEA groups must apply the Codes to all entities within their subgroup including those based outside the UK. The Codes apply to UK branches of non-EEA firms. UK branches of firms whose home state is within the EEA are not required to apply the Codes since they are subject to their home state's equivalent rules.

Which individuals are subject to the Codes?

The Codes potentially apply to all staff (including employees, secondees from non-UK group companies who are working in the UK, and consultants). Firms are required to apply certain requirements under the Codes (e.g. restrictions on guaranteed bonuses and ensuring the termination payments are not a reward for failure or misconduct) on a firm-wide basis. It is also considered best practice for all firms to defer a proportion of discretionary variable pay. However, the implications of the Codes depend on whether the staff are material risk-takers and/or whether the staff satisfy the "De Minimis Concession" (see below). In addition, "senior managers" under the Senior Managers Regime are subject to more stringent deferral and clawback rules. Senior managers are individuals who are carrying out a designated senior management function and, in broad terms, are the most senior and influential individuals in the business.

In December 2013, the EBA, concerned by the different approaches taken by the different EU national regulators to identify material risk-takers, published a Delegated Regulation[9] which requires individuals working in firms within the scope of CRD4 to be identified as material risk-takers if they satisfy one or more of the following criteria:

> qualitative criteria relating to the role and decision-making power of the staff member (e.g. a member of the firm's management body or senior management);

> internal criteria developed by each firm to identify material risk-takers based on the firm's specific risk profile; and

> quantitative criteria based on the individual's remuneration.

The quantitative criteria apply to individuals who: (a) were awarded total remuneration of EUR 500,000 or more in the preceding financial year; and/or (b) are within the top 0.3% of staff who have been awarded the highest total remuneration in the preceding financial year; and/or (c) in the preceding financial year were awarded remuneration at least equal to the lowest total remuneration awarded to senior management or other risk-takers.

There is a facility for firms to demonstrate that a particular staff member who is only caught under the quantitative criteria is not a material risk-taker. However, if the individual is awarded total remuneration of at least EUR 750,000 or is within the 0.3% of highest earners, the firm will require prior approval from the appropriate UK Regulator if it wishes to do so. To exclude an individual who is awarded total annual remuneration of EUR 1,00,000 or more, the appropriate UK Regulator will also need to seek prior approval from the EBA.

If an individual who is a material risk-taker satisfies the De Minimis Concession, some of the requirements of the Codes may be relaxed, provided that the individual's treatment remains consistent with the general principle of ensuring remuneration policies are consistent with and promote effective risk management.

An individual will satisfy the De Minimis Concession for a performance year if:

> total remuneration for that performance year is not more than £500,000; and

> variable remuneration for that performance year is not more than 33% of the individual's total remuneration.

Remuneration structure

The main principles of the Codes relating to the different remuneration structures are set out below.

"Ratio of fixed pay to variable pay" means that each firm must set appropriate ratios between fixed pay and variable pay to ensure that fixed pay is a sufficiently high proportion of total remuneration to allow for the possibility of paying no variable pay.

"**Variable pay**" is defined as remuneration which reflects "a sustainable and risk adjusted performance as well as performance in excess of that required to fulfil the employee's job description as part of the terms of employment". This includes not only discretionary and guaranteed bonuses, but also long term cash and equity incentive plans.

"**Fixed pay**" is defined as remuneration which "primarily reflect[s] relevant professional experience and organisational responsibility as set out in an employee's job description as part of the terms of employment." This includes salary and benefits.

Under CRD4, variable pay in respect of services and performance of material risk-takers on or after 1 January 2014 should generally not exceed 100% of fixed pay. Firms are able to increase the cap to 200% of fixed pay if at least 66% of the firm's shareholders agree (or at least 75% of shareholders if less than 50% of the total shares or ownership rights are represented).

The Codes set out the procedures firms should follow to obtain a shareholder resolution to increase the cap on variable pay. In the UK Regulators' view, the 75%, 66% and 50% are references to the percentages of the share or ownership voting rights represented. The percentages do not reference the firm's whole issued share capital, ownership rights or the number of individual shareholders or owners. The UK Regulators expect firms to seek a resolution of the shareholders or owners of the ultimate EEA parent. For UK-headquartered banking groups or subsidiaries of EEA-headquartered groups, this requires a resolution of the shareholders of the ultimate EEA parent. In the case of UK subsidiaries of non-EEA firms, the PRA and FCA currently accept a resolution of the immediate non-EEA parent company. Branches of non-EEA firms require a vote by the shareholders of the non-EEA firm.

There are special rules set out in the Guidelines dealing with when variable pay (including long-term incentive plans) should be taken into account for the purposes of the bonus cap and how it should be valued. In addition, up to 25% of variable pay will benefit from a discount if it is paid in equity or debt instruments which are deferred for at least five years. The calculation of the discount rate should take into account the following three factors: (a) the normal average inflation rate; (b) the average interest rate of EU Government Bonds; and (c) an incentive factor linked to the length of the deferral period. The incentive factor for a five-year deferral period is 10%, increasing by 4% for each additional year of deferral.

In an attempt to minimise the impact of the cap, many firms initially sought to increase fixed pay by increasing basic pay and/or using role-based allowances paid in cash and/or shares. However, from 1 January 2015, role-based allowances are treated as variable pay unless they satisfy certain conditions. To come within the definition of fixed pay, the allowances must relate to the individual's role and responsibilities rather than the individual's performance. The EBA consider that role-based allowances must be non-discretionary, pre-determined, transparent, permanent, non-revocable, not dependent on performance and not provide an incentive to take risks. The Guidelines also indicate that, when deciding whether remuneration is fixed or variable, the way in which it is paid should also be taken into account. In other words, paying remuneration in shares or other instruments rather than in cash may result in that remuneration being treated as variable pay, depending on the terms of the share or other instrument awarded.

Discretionary variable pay

The amount of the discretionary variable pay pool should be based on profit, adjusted for current and future risks, and take into account the cost and quantity of the capital and liquidity required. All PRA–authorised firms, when determining the size of their annual bonus pools, should deduct a prudential valuation adjustment figure from fair value accounting profit. The UK Regulators make it clear that Earnings Per Share and Total Shareholder Return (two common performance measures) are not properly adjusted for longer term risk and firms should take this into account when developing risk adjustment methods.

Firms must ensure that performance-related bonuses are assessed in a multiyear framework taking into account the performance of the individual, the relevant business unit, and the overall results of the firm.

In assessing the individual's performance, both financial and non-financial metrics (such as compliance with effective risk management policies and regulatory requirements), should be considered.

At least 40% of variable pay awarded to material risk-takers who do not satisfy the De Minimis Concession in a level one or level two firm must be deferred over a period of at least three to seven years, depending on the seniority of the relevant individual. The business cycle, the nature of the business, its risks, and the activities of the individual in question must be taken into account when the variable pay is of a particularly high amount or where the variable pay is paid to an executive director of a level one firm, at least 60% must be deferred. The UK Regulators indicate that generally £500,000 is a particularly high amount, but in appropriate circumstances the threshold may be lower.

In relation to the length of deferral periods, for performance periods beginning on or after 1 January 2016, PRA-regulated firms, including those that are dual-regulated, must defer variable pay as follows:

> **Senior managers** who retain the greatest influence over the strategic direction of the business will be subject to the seven-year deferral requirement with no vesting until three years after award and vesting no faster than on a pro-rata basis thereafter;

> **Risk managers,** excluding those covered by the Senior Manager Regime, who have responsibility for managing or supervising risk-taking or significant risk functions will be subject to the five-year deferral requirement with vesting no faster than on a pro-rata basis. (This includes members of the management body, risk managers and their direct reports, heads of material business units and their direct reports, heads of function and managers of material risk-takers);

> **All other material risk–takers** should be subject to deferral for a minimum three-year period, with vesting no faster than on a pro-rata basis. This includes individuals exposing the firm to credit risk or trading book/market risk, individuals approving the introduction of new products, individuals who are members of the local risk committee, and material risk-takers identified solely under the quantitative criteria if subject to managerial oversight.

IFPRU firms are able to retain the three to five year deferral period for all material risk-takers who are not senior managers. Senior managers will be subject to the same minimum seven-year deferral rule as set out above.

For material risk-takers who do not satisfy the De Minimis Concession in a level one or level two firm, 50% of the variable pay should be paid on a net of tax basis in the form of shares, equivalent ownership interests or, where possible, capital instruments which adequately reflect the credit quality of the firm as a going concern and are appropriate for use as variable pay. The Delegated Regulation sets out the type of instruments which are appropriate for these purposes.

It is not necessary to ensure that the upfront and deferred components of variable pay have the same split of cash and instruments and the FCA have indicated that it is good practice for the deferred portion of variable pay to contain a higher proportion of instruments, that is, more than 50% of the deferred portion of variable pay should be in instruments.

Any shares, ownership instruments or other non cash instruments should also be subject to a retention policy, generally of twelve months, to ensure that the incentives are aligned with the longer-term interests of the firm. If the individual's variable pay is subject to a deferral period of five years, a six-month retention period may be acceptable, unless the individual is a member of the management body or senior management team.

Guaranteed variable pay

Firms must not award, pay or provide an incentive guaranteed variable pay to any member of staff unless:

> it is exceptional;

> it occurs in the context of hiring new staff;

> the firm has a strong and sound capital base; and

> it is limited to the first year of service.

To demonstrate that guaranteed variable pay is exceptional, the firm must consider whether the variable pay is exceptional both on commercial grounds and prudential grounds. Firms should also consider the number of staff to whom they offer guarantees – it is difficult to demonstrate that a bonus is exceptional where a high number of new hires are awarded a guarantee. For PRA–regulated firms guaranteed bonuses should not be the "norm" but rather should be "rare and infrequent".

Buy-out awards

A buy-out award, that is, an award buying-out rights that will be reduced or forfeited on the staff member leaving their former firm, is guaranteed remuneration. However, in contrast to an incentive sign on bonus, traditionally there has been no need to demonstrate that a buy-out award is exceptional (although, in its Guidelines, the EBA seems to suggest otherwise).

The buy-out award should not be more generous (either in terms of amount or vesting) than the awards that the staff member will forfeit. The UK Regulators apply this requirement strictly - an award of a lower amount but with a shorter vesting schedule will breach this requirement. The buy-out award should also align with the long-term interests of the employer and should be subject to appropriate retention, deferral and performance adjustment provisions.

PRA-regulated firms in proportionality level one and two must ensure that buy-outs for individuals who were material risk-takers in their previous firms (even if they met the De Minimis Concession) are subject to terms that give the new firm a contractual right to reduce buy-outs if it received a reduction notice from the previous firm. The amount by which the new firm must reduce the buy-out is the amount specified in the reduction notice. The previous firm will only be able to issue a reduction notice if it has determined, acting fairly and reasonably, that the individual has committed misconduct or made a material error or there have been risk management failings. The new firm is expected to act solely as the executor of the previous firm's decision without any exercise of discretion. However, in practice, the new firm should, as a minimum, check that the staff member is at least aware of the reduction notice.

Retention awards

Retention awards are not guaranteed variable pay. However, as with guaranteed variable pay, retention awards should not be common practice and should be limited to rare and infrequent occurrences.

In accordance with the Guidelines, retention awards should be subject to the requirements relating to deferral, payment in instruments and performance adjustment. In addition, such awards form part of variable pay for the purposes of the bonus cap. Retention awards should not be granted to compensate for the lack of performance-related pay due to insufficient performance or the firm's financial situation. Where a firm intends to grant retention awards to material risk-takers, it must notify the appropriate UK Regulator and explain why the award is justified.

Non-executive directors and variable pay

Firms are prohibited from awarding or paying variable pay to non-executive directors in respect of activity carried out in their roles as non-executives.

Performance adjustment

Performance adjustment refers to the downward adjustment of variable remuneration. This may be in accordance with a **malus** arrangement (under which unvested, deferred variable remuneration is reduced) or a **clawback** arrangement (under which the staff member is required to repay amounts he has received).

Where financial performance is subdued or negative, firms must ensure that variable pay is "considerably contracted", including reducing payouts of amounts previously earned.

Firms must ensure that any variable pay (including both the non-deferred and deferred element) awarded to material risk-takers who do not satisfy the De Minimis Concession is only paid or vested if it is sustainable according to the financial situation of the firm and justified on the basis of the performance of the firm, business unit and individual. In addition, variable pay should be subject to performance adjustment where the staff member participated in, or was responsible for, conduct which resulted in significant losses to the firm and/or failed to meet appropriate standards of fitness and propriety.

Under the Codes, firms are required to apply malus to deferred variable pay (including any element to be paid in non-cash instruments in the event of poor performance) including:

> staff member misbehaviour or material error;

> the firm and/or relevant business unit suffering a material downturn in its financial performance; and/or

> the firm and/or relevant business unit suffering a material failure of risk management.

The PRA has indicated that performance adjustment should not be limited to the staff directly culpable for misfeasance. It should also apply to those staff who could reasonably have been expected to be aware of the failure or misconduct at the time, but failed to take adequate steps to promptly address it and those staff who, by virtue of their role or seniority, could be deemed indirectly responsible or accountable for the failure or misconduct.

Level one and level two proportionality firms regulated by the PRA have been required to ensure that deferred and undeferred variable pay awarded to material risk-takers is subject to clawback arrangements for a minimum period of seven years from the date of award where either:

> there is reasonable evidence of the material risk-taker's misbehaviour or material error; and/or

> the firm or relevant business unit suffers a material failure of risk management.

Firms in proportionality levels one and two are required to extend the clawback period from seven years to ten years for senior managers where at the end of the seven-year period there is an outstanding internal or regulatory investigation which may lead to the application of clawback, but for the expiration of the seven-year period.

The PRA has confirmed that, in implementing these requirements, the principle of proportionality will apply. In particular, where there has been a material failure of risk management, firms should take into account the seniority of the employee and their proximity to the failure.

Firms solely regulated by the FCA are required to consider both malus and clawback as means of performance adjustments.

There are a number of legal and practical difficulties with implementing performance adjustment mechanisms, particularly for existing awards, so firms must take particular care in this regard.

Pension policy

A firm's pension policy must be in line with its business strategy, objectives, values and long term interests. Pension contributions which are discretionary (i.e. in the nature of a bonus) should be held for five years in the form of shares/equivalent ownership interests.

Termination payments

Payments on termination of employment should not reward failure or misconduct, but should reflect the performance achieved over time. Severance pay should not be awarded where either of the following applies:

> a staff member voluntarily resigns to take up a position in a different legal entity (unless required by national law); or

> there is an obvious failure that allows the employer to summarily dismiss the staff member.

In addition, where a firm awards severance pay, the firm must be able to demonstrate the reasons for the settlement, the appropriateness of the amount of severance pay and the criteria used to determine the amount. When determining the amount of severance payment, the firm should take into account performance achieved over time and assess (where relevant) the severity of any firm or individual failure.

In accordance with the Guidelines, termination payments are variable pay. However, there is no need to take certain termination payments into account for the purposes of the bonus cap, the application of deferral and pay-out instruments, including:

> termination payments that are mandatory under national labour law or following a decision of a court;

> termination payments that are subject to a contractual non-competition clause and paid out in future periods up to the amount of the fixed pay which would have been paid for the non-competition period, if staff were still employed; and

> termination payments where the firm has demonstrated the reasons and the appropriateness of the amount of the severance payment where either (i) the firm and staff member agree on a settlement in the case of a potential or actual employment law dispute to avoid litigation; or (ii) in broad terms, the staff member is being made redundant.

It is best practice not to accelerate the vesting of any outstanding bonus payments or long-term incentive awards.

Hedging strategies

Material risk-takers should undertake that they will not engage in personal investment strategies that undermine risk strategies, such as hedging or remuneration-related insurance strategies. The Guidelines suggest that firms should implement arrangements to ensure material risk-takers are complying with this provision, including conducting spot checks.

Confirmation of compliance

Firms operating a website must explain on their website how they comply with the Codes.

Approach to proportionality

The effect of the proportionality principle is that not all firms have to give effect to the remuneration requirements in the same way and to the same extent. Proportionality operates both ways. Some firms will need to apply more sophisticated policies or practices in fulfilling the requirements whilst other firms will be able to meet the requirements in a simpler or less burdensome way.

As stated above, firms are categorised into three levels as a starting point to help firms understand the general expectations of the UK Regulators. Firms that are part of a group containing one or more entities caught by the Codes will generally fall into the highest proportionality level of those entities, although a firm can apply for individual guidance from the UK Regulators to vary its proportionality level.

The table at the end of this Inbrief shows for each level how the UK Regulators generally expect the Codes to be applied to the firm and individuals. Note however, that there is a degree of flexibility in how the UK Regulators apply the boundaries between the levels having regard to a firm's specific risk characteristics. In addition, each firm remains responsible for assessing its own characteristics to develop and implement remuneration policies and practices which appropriately minimise risk-taking and incentivise staff.

The PRA has confirmed that all firms in proportionality level one or level two are required to implement the cap on variable pay. However, generally firms in level three (including banks and building societies) are currently able to disapply the cap. However, those firms should record their rationale for doing so. The UK Regulators may ask a firm to justify their decision and, if they considers it appropriate, issue individual guidance requiring that firm to apply the cap.

The position is likely to change. Under the Guidelines and opinion on proportionality, the EBA has indicated that the principle of proportionality does not apply to the cap. The EBA considers the cap should be applied to all material risk-takers in firms subject to CRD4 and their subsidiaries, even if those subsidiaries are not themselves subject to CRD4.

In addition, the EBA considers that the proportionality principle does not allow a firm to disapply any of the CRD4 requirements in their entirety. The EBA (supported by the European Commission) consider that CRD4 sets out the *minimum* thresholds with which *all* firms caught by CRD4 should comply. That said, the EBA has proposed that CRD4 is amended (under CRD5) to introduce two specific exemptions:

> First, a "small and non-complex" firm whose asset value over the four-year period immediately preceding the current financial year is on average equal to or less than EUR 5 billion which is not a subsidiary of a significant firm should be exempt from the requirements on deferral and payment in non-cash instruments.

> Second, staff members whose annual variable remuneration does not exceed EUR 50,000 and does not represent more than one fourth of the staff member's annual total remuneration.

Amendments have since been proposed to the draft CRD5 by the EU Council and European Parliament, with both bodies suggesting an increased asset threshold (or power for national regulators to increase the asset threshold) and that the variable pay of EUR 50,000 should not represent more than one third of the staff member's total remuneration. The timing of the implementation of these proposed charges is uncertain, but it is understood that the negotiations between the Commission, EU Council and European Parliament will conclude by the end of 2018. If the legislation is ready towards the end of 2018, the changes could potentially take effect from 1 January 2021.

Breaches of the Codes

Under the Financial Services Act 2010 the UK Regulators have power to:

> prohibit a firm from remunerating its staff in a specified way; and

> make rules to render a contractual term void if it contravenes such a prohibition.

Under the Codes, contractual terms for material risk-takers (who do not satisfy the De Minimis Concession) which breach the rules on guaranteed variable pay and deferral of discretionary variable pay and clawback of variable pay are void if the individual works for a proportionality level one firm, a credit institution or a PRA-designated investment firm which forms part of a group containing a proportionality level one firm.

Where a payment or other property is paid or transferred to an individual in pursuance of a void term, the firm is obliged to take reasonable steps to recover the payment or property from the individual. The firm is restricted from paying further variable pay to that individual in respect of the same performance year, unless it has a legal opinion stating that the award complies with the Codes. Any payment made in breach of this restriction is also void and should be recovered.

The Codes contain wide anti-avoidance provisions requiring all firms to ensure that variable remuneration is not paid through vehicles or using methods that facilitate avoidance of the Codes. For example, the practice of effectively awarding staff an immediate bonus by giving them non-recourse loans pledged against share/share equivalent awards which are still subject to retention or deferral is viewed as a breach of the Codes.

Sanctions which are available to the UK Regulators for breach of the Codes include private warnings (which may include restricting how a firm structures its variable remuneration in the future), fines and public censure or, ultimately, variation or cancellation of a firm's authorisation.

Future developments

In December 2017, the EU Commission adopted a number of legislative proposals which, if implemented, will simplify the prudential classification of investment firms and establish a single, harmonised approach to their prudential requirements.

The effect of the Commission's proposals will be to divide investment firms into the following three categories:

> Systematically important firms (Class 1 firms). These are "bank-like" firms with total assets in excess of EUR 30 billion that deal on their own account or underwrite financial instruments and/or place financial instruments on a firm commitment basis (or both). These firms will be subject to all the requirements set out in CRD4, including the bonus cap.

> Investment firms (Class 2 firms). These are non-systemic investment firms that do not fall within the definition of a small and non-interconnected investment firm. These firms will not be required to apply the bonus cap. However, subject to the De Minimis exemptions, such firms will be required to apply the rules on deferral, payment in instrument and malus or clawback to the variable pay of their senior managers and risk-takers.

> Small and non-interconnected investment firms (Class 3 firms). These are very small firms with "non-interconnected" services which will be subject to limited requirements.

The other issue to consider is the impact of the UK's decision to leave the EU. This could potentially have significant implications for the regulation of the financial services sector, depending on the relationship that the UK agrees with the EU going forward. In a press release issued on 24 June 2016, the day after the UK's referendum, the FCA confirmed that, in the interim, firms should continue to abide by their obligations under UK law, including those derived from EU law and continue implementation plans for legislation that is still to come into effect. Longer term, the Government may remove the bonus cap but it is likely that many of the other requirements (such as deferral and performance adjustment) will not change significantly.

Proportionality level	Type of firm	Relevant total assets of firm on relevant date *(see note below table)*	Application of relevant Code(s) to firm
One	• UK bank • Building society • Full scope IFPRU 730k investment firm	Exceeding £50bn	All of the rules must be applied
Two	• UK bank • Building society • Full scope IFPRU 730k investment firm	Exceeding £15bn but not exceeding £50bn	All of the rules must be applied
Three	• UK bank • Building society • Any full scope IFPRU investment firm • Limited license IFPRU firm or limited activity IFPRU firm	Less than £15bn	All of the rules must be applied, except it may be appropriate for a firm to disapply: • Buy-out awards • Retained shares and other instruments • Deferral, although all firms are encouraged to consider using deferral techniques to align remuneration practices with effective risk management • Performance adjustment In addition, it may also be appropriate for firms to disapply the bonus cap.

Note: For these purposes, "relevant total assets" means, generally:

- *The average of the firm's total assets on the firm's last three accounting reference dates.*
- *For non-EEA Codes firms, the average of the firm's total assets that covered the activities of the branch operation in the UK on the firm's last three relevant dates. Relevant dates for these purposes means 31 December.*

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How can we help?

We have a specialist team of employment and reward lawyers who are able to review and advise on your remuneration plans, policies and practices and contracts for individual staff members to ensure that they are compliant with the Codes and advise where necessary on amending those plans, policies and contracts.

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