Briefing

Employment

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FCA confirms that bonus cap will not apply to smaller firms

In welcome news for Level 3 financial services firms, the PRA and FCA have confirmed in a joint statement issued on 29 February 2016 that they will not require these smaller firms to apply the notorious 'bonus cap'.

This places UK regulators at odds with the European regulator, the European Banking Authority (EBA), who had previously stated in a set of guidelines published in March 2015 that all firms caught by the Capital Requirements Directive (CRD) are required to comply with the cap, irrespective of their size.

One of the more controversial requirements of CRD, the bonus cap requires firms to limit bonuses of certain staff to no more than 100% of their fixed pay, or 200% with shareholder approval. The PRA and FCA have historically applied the proportionality principle to this requirement and as a result only larger financial firms and institutions have been required to comply. Smaller firms have always been required to have regard to the general ratio between fixed and variable pay as part of their obligations to put in place remuneration structures which are consistent with effective risk management. However, they have not been required to apply a cap.

The EBA guidelines were published in March 2015 and reflected the prevailing view at a European level that the principle of proportionality could not be used to allow firms caught by CRD to avoid compliance with its key provisions, including the bonus cap.

The UK regulators have taken a contrary position, disagreeing with the EBA's legal interpretation of the underlying Directive. The UK regulators state that they consider that the principle of proportionality permits Level 3 firms to disapply remuneration principles in their entirety. They also state that the proportionality principle applies to all numerical requirements within CRD, including the bonus cap, the amount and length of deferral of variable pay, the amount of bonus that must be paid in non-cash form and the requirement for performance adjustments.

The UK regulators' position is, in part, an attempt to counteract the trend within the financial services sector of increasing levels of fixed pay as a means of complying with the bonus cap provisions. The regulators view this trend as inconsistent with the objectives of the rules, which are to enable firms to adjust pay in meaningful way to reflect multi-year financial performance, attitude to risk and other factors.

UK firms should monitor any further announcements from the EBA closely as there is some suggestion that further rule changes may be made at a European level. These may limit the UK regulators' ability to disapply these rules in this way. However, it is unlikely that further changes will be made at European level for some time, and until such time as such changes are made, Level 3 firms can continue to apply the UK regime as it currently stands. Further consultation on rule changes may be issued by the PRA and FCA in due course.

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