A&O SHEARMAN

UK bankers' remuneration reform: MRT proposals in focus

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PRA and FCA proposals to revamp bankers' remuneration rules would reduce the number of in-scope material risk takers (MRTs), while enabling more MRTs to benefit from proportionality exclusions. Banks would have greater autonomy when identifying MRTs but would need to tighten governance guardrails.

Here's our deep dive on the MRT rule changes and their impact, as well as action areas for banks. For further background on the reforms and on the "banks" within the scope of the rule changes, please see our earlier blog UK bankers' remuneration: significant reform proposals.

WHY THE CHANGES?

The current rules in the Remuneration Part of the PRA Rulebook and FCA SYSC 19D: Dual-regulated firms Remuneration Code apply principally to MRTs whose activities have a material impact on a bank's risk profile. Banks must identify MRTs using minimum qualitative (role-based) and quantitative (remuneration-based) criteria. Aligned with the broader aims of their reform package, the regulators want to simplify MRT rules to tailor them more for the UK while reducing costs and increasing flexibility for banks.

WHAT ARE THE CHANGES?

Simplified quantitative thresholds

A single quantitative threshold would apply whereby banks would be expected to consider identifying employees within the 0.3% of highest earners (based on their total remuneration in the previous performance year) as MRTs. This would be an expectation in the PRA's Supervisory Statement SS2/17 (SS2/17), rather a rule, so banks could still decide not to identify those individuals as MRTs, assuming that they aren't otherwise captured by qualitative criteria. SS2/17 would include some additional qualitative criteria for banks to consider that would point to a determination of MRT status. Other quantitative thresholds (for those earning GBP660,000 or more and for high-earning key decision makers within material business units) would be removed.

Simplified exclusions process

Firms would no longer have to seek PRA approval to exclude someone as an MRT on account of the quantitative threshold, nor to conduct the associated regulatory reporting.

Tighter governance expectations

There would be enhanced governance expectations around MRT identification processes and decisions. A bank's management body would be ultimately responsible for a bank's MRT methodology and for overseeing its implementation. Those in overall charge of a bank's risk controls (usually the Chief Risk Function, SMF4) would have a specific role: to review and approve MRT identification each year and to ensure that the relevant staff, including those from control functions, legal, HR, and risk, are involved in identifying MRTs. Thorough record-keeping would be required, and although there would be no PRA approval process, banks would need to be ready to provide the PRA, upon request, with documentary evidence in support of any determination that someone isn't an MRT.

Higher proportionality threshold

The MRT remuneration threshold at which certain remuneration rules (such as deferral or payment in instruments) can be disapplied would be increased to cover those with total annual pay not exceeding GBP660,000 (up from GBP500,000) and with variable pay not exceeding 33% of their total pay. (The GBP660,000 threshold is the pre-2021 and pre-CRD V threshold of GBP500,000, adjusted for inflation.) This would also help simplify how some other rules that link to proportionality status are applied.

HOW WOULD THESE CHANGES IMPACT BANKS?

Banks will welcome the possibility of the reduced compliance costs that would result from having fewer MRTs overall, as well as the prospect of reducing the number of staff who are subject to the full set of remuneration rules. The PRA estimates that around 20% of MRTs are identified as MRTs solely because of their pay, so the proposed simplification of quantitative thresholds should reduce MRT numbers (although the result will vary by firm). Moreover, it estimates that around 900 more MRTs could benefit from proportionality, leaving increased scope to disapply the rules in more cases. The changes could additionally help banks to recruit and retain key staff, including from other parts of the sector.

The prospect of banks having greater ownership over identifying MRTs, and being able to tailor this by size and business model, is also likely to be welcomed. However, considerable work may be needed to tighten governance and record-keeping systems, to show that adequate and effective controls are in place to identify MRTs. Getting this right will be key, and the PRA and FCA are clear it ties in with risk management and their separate proposals that would require banks to assess individual accountability robustly and make pay adjustments in the event of misconduct, risk management failings, or downturns in financial performance.

HOW CAN BANKS GET AHEAD?

Although the changes are still under consultation, to get ahead, banks may wish to review and monitor their MRT lists to identify staff whose status or pay restrictions might change, and whose arrangements might need to change (we'll discuss the issue of amendment in a future blog). This will include reassessing their status and obligations under the SMCR if they might cease to be MRTs.

Banks could also get ahead by benchmarking their current MRT identification and record-keeping processes against the proposals and identifying where these need to be bolstered. This will include reviewing the criteria taken into account, as well as who is involved in MRT assessments. Managers with overall responsibility for risk controls, management body members and control functions, among others, would need to have significant involvement going forward (if they don't already). Finally, banks may wish to start considering the impact of staff ceasing to be MRTs on employment and remuneration arrangements, such as fixed pay allowances.

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