

Investment Firm Prudential Regime New remuneration rules in force

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The UK's new Investment Firm Prudential Regime (the **IFPR**) for MiFID investment firms and Collective Portfolio Management investment firms (together **MiFID Firms**) took effect from 1 January 2022, with new remuneration rules for performance periods starting on or after 1 January 2022. Implementation planning is well underway for some firms, but for those grappling with the impact of the changes there is still time to plan and to adapt remuneration strategies to ensure compliance.

This briefing gives an overview of the new remuneration rules and of some of the tricky issues that firms will need to navigate. For further insights on the IFPR, please consult our Allen & Overy [IFPR webpage](#) where you can also access our [webinar recording](#) on the remuneration regime "*Show me the (IFPR) money*".

The new rules at a glance

The IFPR remuneration rules are contained in a [new SYSC 19G in the FCA Handbook](#) (the **MIFIDPRU Remuneration Code**). MiFID Firms fall into one of three categories according to their size and complexity: "small and non-interconnected firms" (**SNI firms**); in-scope firms that are not SNI firms (**non-SNI firms**); and large non-SNI firms that meet certain additional criteria (**largest non-SNI firms**). Different rules (basic requirements, standard requirements and extended requirements) apply to each.

Basic Requirements

All SNI and non-SNI firms

Standard Requirements

All non-SNI firms

Extended Requirements

Largest non-SNI firms

Basic requirements

The “basic requirements” (the minimum standards) apply to all MiFID Firms that are subject to the MIFIDPRU Remuneration Code, regardless of their category. These are broadly aligned with previous IFPRU and BIPRU rules. They include:

- **Remuneration policies and practices** Firms must implement and operate gender-neutral and non-discriminatory remuneration policies and practices for all staff that are in line with the firm’s business strategy, objectives and long-term interests, and account for its risk strategy (including ESG factors), culture and values and the long-term effects of investment decisions.
- **Remuneration governance** A firm’s management body must adopt and periodically review the remuneration policy and have responsibility for overseeing its implementation. Staff engaged in control functions must remain independent from the business units they oversee and be remunerated in a way that supports this independence, using objectives linked to their functions.
- **Fixed and variable remuneration** Fixed and variable remuneration must be clearly distinguished and appropriately balanced, with both financial and non-financial criteria being used to assess individual performance. New guidance is also given on the treatment of payments under LLP, carried interest and co-investment arrangements.

Standard requirements

Non-SNI firms must apply the “standard requirements” to their Material Risk Takers (MRTs) as well as the basic requirements, but may choose to apply these more widely. Key requirements include:

- **Identification of MRTs** Non-SNI Firms must identify MRTs (individuals whose professional activities can have a material impact on the risk profile of the firm or the assets it manages) annually. Some staff will be designated as MRTs based on fixed qualitative criteria (e.g. directors). However, criteria linked to the firm’s activities and risk profile will identify other staff as MRTs; guidance on key indicators is available to assist in this process. Unlike under CRD IV and CRD V, there is no purely quantitative threshold that can confer MRT status.
- **Remuneration** Firms must set an appropriate ratio for fixed to variable pay in their remuneration policy, or different ratios for different categories of staff, which can change in new performance periods. Performance-related variable remuneration must be based on the performance of the individual, relevant business unit and firm, and be assessed over a multi-year framework.

- **Non-standard variable remuneration** Guaranteed, buy-out and retention awards must be used in limited and particular circumstances and must be aligned with the long-term interests of the firm. They must also be subject to terms on the fixed to variable pay ratio, malus and clawback as well as, where applicable, payment in instruments, deferral and retention (for buy-outs, with deferral and retention periods no shorter than those applied by the previous employer). The remuneration policy must specify whether severance can be paid and any maximum amount or criteria for determining severance.
- **Malus and clawback** All forms of variable remuneration must be subject to in-year adjustments, malus (where deferral applies) and clawback arrangements. Firms must set specific criteria for the application of malus and clawback, which must include, as a minimum, situations where the MRT 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.

Extended requirements

The largest non-SNI firms (those meeting certain size thresholds) must comply with extended requirements in relation to their MRTs, as well as with the basic and standard requirements. Just over 100 out of around 3,600 UK MiFID Firms are likely to fall within this category. Key requirements (the first three below are known as the pay-out process rules) include:

- **Deferral** At least 40% of variable remuneration awarded to MRTs must be deferred for at least three years (or 60% where the variable remuneration is particularly high and in any case where it is over GBP500,000). Vesting of deferred remuneration must be no faster than on a pro rata basis annually, with interest and dividends on deferred shares permitted to accrue during the deferral period.
- **Payment in shares or other instruments** At least 50% of variable remuneration must be paid out in shares, share-linked instruments or other prescribed forms of non-cash instruments and must be subject to an appropriate retention policy. Firms that cannot issue these instruments may apply to the FCA to use alternative arrangements.
- **Discretionary pension benefits** Discretionary pension benefits for MRTs who leave a firm before retirement age, or who reach retirement age, are subject to certain minimum five-year retention requirements.
- **Remuneration committee** A remuneration committee must be established in which, where a firm’s legal structure permits, the Chair and 50% of its members (which can include the Chair) are non-executive members of the firm’s management body. Firms may apply to the FCA for a waiver or meet the requirements to rely on a remuneration committee at corporate (rather than just consolidated) group level.

Tricky issues

Firms may need to conduct more detailed analysis and implementation planning in the following areas:

- **Introducing appropriate non-financial performance metrics** Unlike investment banks, which are now well-acquainted with non-financial performance metrics, some investment firms are not used to adjusting pay based on non-financial metrics. For firms without a developed non-financial performance methodology, it will be important to spend time identifying relevant and appropriate non-financial metrics that can be used as performance criteria under the IFPR. What is important here is that personal conduct needs to form part of the non-financial performance criteria and that non-financial performance must be capable of overriding financial performance.
- **Interaction of the IFPR with other remuneration rules** Firms will need to confirm whether prudential consolidation rules apply in order to determine which remuneration requirements are in play. Investment firms will be subject to more than one remuneration regime, e.g. where they are part of a wider corporate group subject to other financial services remuneration rules (e.g. the AIFM remuneration rules or the Dual-regulated firms Remuneration Code). In such circumstances, the FCA expects that firms will need to level up to the most onerous requirements and must not arbitrage the rules. The FCA has also said that it does not expect firms to encounter conflicting provisions when applying multiple sets of rules, but the practical reality of such interplay may be less straightforward than the FCA has billed.
- **Remuneration committee composition waivers** Firms subject to extended requirements will need to establish a remuneration committee, though many will have an existing governance structure at corporate or consolidated group level. Firms may wish to consider applying to the FCA for a waiver of the remuneration committee composition requirements where meeting these would require substantial restructuring; however, the FCA has provided no guidance or template forms of amendment(s) to set expectations on acceptable alternative committee memberships.
- **Selecting appropriate fixed/variable ratio(s)** Non-SNI firms must navigate decisions about the most appropriate ratio(s) for their business, against a backdrop of limited guidance from the FCA on this point. Whilst it is helpful that the IFPR allows firms to change the ratio each year and to implement different ratios for different groups of staff, firms nevertheless need to decide whether to implement one, two or several ratios within their business and what the appropriate ratio ought to be. There is no correct answer here and the approach taken by one firm may not work for others. Unlike the Dual-regulated firms Remuneration Code (where the ratio may not exceed 1:2, subject to obtaining shareholders' approval), the FCA has not prescribed the ratio, though this must be the highest amount that can be paid in any given performance period based on the "most positive scenario" and even accounting for a broad range of severance payments. Firms are not required to publish the ratio for the public or their investors/workforce to see.



- **Implementing malus and clawback** Remuneration structures used by non-SNI firms not otherwise subject to malus or clawback will require adjustment to incorporate these rules into relevant documentation. Such structures will need to be carefully drawn in order to maximise the firm's prospects of enforcing such provisions in the future and to minimise litigation risk. Firms will need to determine whether to include any additional malus/clawback criteria over and above the FCA's criteria and how long malus/clawback ought to be capable of operating for. The FCA has published guidance setting out further details of its expectations on malus and clawback (see link below). When setting minimum clawback periods where no deferral is used, the FCA reminds firms to carefully consider all types of risks, including conduct risks, and how long they may take to crystallise. Non-SNI firms will need to apply malus and clawback to variable remuneration going forward. Firms should ensure that the clawback period spans at least the combined length of any deferral period and retention period. Where clawback applies to awards where there is no deferral, a minimum of three years from grant is deemed appropriate.
- **Identification of MRTs** Some of the MIFIDPRU Remuneration Code requirements only apply to MRTs, for example, those relating to guaranteed awards, buy-out awards, retention awards, severance pay, and the pay-out process rules. MRTs are identified on the basis of qualitative criteria and there is no requirement to identify MRTs on the basis of remuneration alone. MRTs include staff who have a material impact on the risk profile of the firm or the assets that the firm manages, and must be identified at the solo and consolidated level (though limits apply in respect of staff in third country subsidiaries). There is a de minimis carve-out for individuals whose total annual variable remuneration is GBP167,000 or less and is not more than one-third of their total annual remuneration which makes them exempt from the pay-out process rules.
- **Treatment of carried interest** This will constitute variable remuneration under the IFPR and so it will be important that any fixed to variable pay ratios adequately allow for the vesting of carried interest structures. Carried interest must be valued at the time of its award and the requirements on deferral, pay-out in instruments, retention and ex-post adjustment do not apply if certain criteria are met.
- **Partner pay structures** The MIFIDPRU Remuneration Code includes guidance for LLP and partnership structures to help determine what types of payments should be treated as remuneration and what types should be treated as return on equity, and therefore outside the rules. Broadly, residual profits are not considered to be remuneration, whereas monthly drawings and discretionary payments are considered to be remuneration. For non-SNI firms, these provisions will need to be carefully considered when devising fixed to variable ratios and implementing ex-post risk adjustment.
- **Structuring deferral instruments** As under other remuneration codes, the requirements for pay-outs in instruments can create a headache for firms that do not typically remunerate in shares or other instruments. The drafting of remuneration plans for private firms, and particularly non-stock corporations, will need careful planning.



Next steps

The IFPR and its remuneration regime will entail major changes for FCA investment firms. Although the categorisation of firms means that some firms will have lighter remuneration requirements than others, the majority of firms will need to adjust remuneration structures to some degree in order to comply with the regime. In order to prepare, firms should take the following steps, if they have not already done so:

- Assess their categorisation and the remuneration rules that apply to them as soon as possible. Firms will also need to monitor any changes to their business that may affect their categorisation and lead to the application of different (more onerous) remuneration rules.
- Review remuneration structures to confirm any required changes. It will be good practice to communicate any amendments to affected staff. If amendments are required to contractual documents, consent needs to be sought from the relevant staff.
- Identify MRTs and communicate with them appropriately, if applicable.
- Complete the FCA's remuneration policy statement (**RPS**) template (see link to FCA webpage below). Whilst this is not obligatory, it is a good starting point to record how remuneration policies and practices comply with the MIFIDPRU Remuneration Code and to identify changes that need to be addressed. Firms may elect to revise an existing remuneration policy.
- Complete the FCA's MRT table template (see link to FCA webpage below). Again, this is not mandatory, but may be useful in order to confirm that the MRT assessment has been carried out appropriately and that the applicable rules have been followed, where relevant. Keeping this and the RPS template up-to-date ought to provide a useful record of compliance, should the FCA request details.

Useful links

[FCA webpage on MIFIDPRU Remuneration Code \(includes links to RPS and MRT templates\)](#)

[CP21/7: A new UK prudential regime for MiFID investment firms](#)

[PS21/9: Implementation of Investment Firms Prudential Regime](#)

[CP21/26: A new UK prudential regime for MiFID investment firms](#)

[PS21/17: Implementation of Investment Firms Prudential Regime](#)

[FG21/5: General guidance on the application of ex-post risk adjustment to variable remuneration](#)

Key contacts

Bob Penn
Partner, Banking
Tel +44 20 3088 2582
bob.penn@allenoverly.com

Kate Sumpter
Partner, Banking
Tel +44 20 3088 2054
kate.sumpter@allenoverly.com

Kate Pumfrey
Counsel, Litigation Employment
Tel +44 20 3088 1329
kate.pumfrey@allenoverly.com

Jack Prettejohn
Senior Associate, Banking
Tel +44 20 3088 1276
jack.prettejohn@allenoverly.com

Felicity Gemson
Senior PSL, Litigation Employment
Tel +44 20 3088 3628
felicity.gemson@allenoverly.com

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