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Further relaxation of UK bankers' remuneration rules: deferral periods for bonuses to be shortened and other changes

The Prudential Regulation Authority ("**PRA**"), together with the Financial Conduct Authority ("**FCA**") has published a consultation paper proposing shortening the deferral periods that currently apply to risk-takers' variable remuneration in large banks, along with other changes to the remuneration rules. This alert considers those proposals and their implications for banks and relevant employees.

Although it will only be pay for 2026 calendar year onwards that is likely to benefit from these proposals, all banks should start considering next year what changes they may make in response to these generally very welcome proposals.

Background

In response to arguments that excessive risk-taking was a key contributor to the 2008 banking crisis, the UK along with other countries introduced remuneration rules designed to curb short-term incentives rewarding such behaviour amongst risk-takers working in banks.

A key part of the overall remuneration framework is that a percentage of variable remuneration for certain risk-takers in larger banks is required to be deferred both in shares and cash. These rules have since evolved under both UK and EU legislation, but in its development of deferral rules the UK regime has gone further than EU rules or international norms.

This has led to criticisms that the rules are clipping UK competitiveness and make working for a large UK bank in the UK or overseas unappealing.

As a reminder, the rules apply to material risk takers ("**MRTs**) in banks, but do not apply to a bank director/employee's variable remuneration if one of 2 proportionality tests is met:

1. The employee works for a small bank. The vast majority of banks or bank branches operating in the UK are in this category.

   More were moved to be treated as small banks by reforms introduced last year – see the second part of our client alert under "PRA Proposal". PRA proposes smaller banks will no longer have to operate clawback on key staff bonuses; or

2. The employee works for a larger bank as a MRT, but their remuneration is below certain limits (the "**proportionality exclusion**").

DEFERRAL/RETENTION PERIODS, AND THE PAYMENT OF DIVIDENDS ON SHARES DURING A DEFERRAL PERIOD

Current deferral rules

Currently, the level of responsibility of MRTs in large banks broadly determines the deferral rules as follows:

Category of MRT	**Minimum Deferral Period**	**When can vesting of deferred remuneration start?**
Those holding Senior Management Functions ("**SMFs**"), who are responsible for implementing the overall business strategy and risk management of the bank.	7 years	3 years after the year in which remuneration is earned
MRTs who take on a risk-managing element	5 years	1 year after remuneration is earned
Other MRTs	4 years	1 year after remuneration is earned

Receipt of shares etc is further delayed by the operation of retention periods (see below) and no dividends or interest can currently be paid on shares or instruments during the deferral period.

Proposed changes to deferral rules

A two-tier rather than three-tier deferral framework is proposed.

Category of MRT	**Minimum Deferral Period**	**When can vesting of deferred remuneration start?**
SMFs	5 years	1 year after the year in which remuneration is earned
Other MRTs	4 years	As above

This will align the UK with other regimes. For example, in the EU, bankers' bonuses are typically deferred for three to five years, which causes the UK's current seven year period to be a significant outlier.

Subsequent retention periods (see below) will also no longer be required.

The concept of significant firm and higher paid earner will also be removed from the rulebook though this is more relevant to other areas of the remuneration rules.

Deferral periods are also closely related to recovery provisions, and the proposed changes also include proposals to:

- introduce a rule for firms to consider adjusting remuneration of accountable individuals up the management chain in the event of failures in risk management;
- introduce a requirement to ensure that senior management are accountable for their performance against PRA supervisory priorities; and
- clarify expectations for remuneration committees for determining accountability for adverse risk events.

Allowing Dividends and Interest to be paid

In addition, the proposals allow MRTs to receive dividends or interest on shares or other instruments in the deferral period as and when they would normally be paid, which is currently prohibited. In support of the change, the consultation paper notes that paying interest and dividends (or dividend equivalents) is common practice among listed companies generally, does not significantly impact on the effect of deferral and not paying dividends or interest (in a time of inflation) has a major and unintended effect on the value of the instruments being deferred.

Removing the need for Retention Periods

Finally, when deferred shares (or other instruments) vest, there is currently a requirement that MRTs subject to the remuneration rules retain those shares for up to a further 12 months, in effect prolonging the effect of the deferral even longer.

It is now proposed that banks will be free to not set a retention period at all. This will mean that shares can be sold as soon they vest.

MRTS AND PROPORTIONALITY

Current identification of MRTs and the proportionality exclusion

Deferral periods are required for variable remuneration – principally bonuses, although share options and LTIPs are also included in this category of pay – payable to MRTs in larger banks unless the proportionality exclusion applies.

Currently, a MRT is an employee or director whose professional activities have a material impact on the firm's risk profile. These are the so-called "qualitative" factors. In addition, there are also "quantitative" factors: s/he is automatically deemed a MRT if they earn £660,000 or more or they are within the top 0.3% of the firm's highest earners, although banks can apply to the PRA for dispensations from the results produced by the quantitative factors.

However, just because an employee is an MRT does not mean that their bonuses have to be deferred or other remuneration rules apply if they work for a larger banks (MRTs at smaller banks are not subject to these rules).

Under the so-called "proportionality exclusion", which was significantly reduced in scope in 2021, the remuneration deferral rules do not apply to a MRT in a larger bank if the MRT has variable pay of less than £44,000 and their variable remuneration is less than 33% of their fixed pay, which means that many MRTs are not able to take advantage of the proportionality exception.

Proposed changes to identification of MRTs and the proportionality exclusion

Changes are being made both to the identification of MRTs and the scope of the proportionality exclusion.

The proposed changes to the identification of a MRT (which affects large and small banks) all but remove the quantitative elements of the categorisation so that MRTs will in practice not simply be caught as MRTs because of their pay. Under the new proposals, the £660,000 automatic threshold will be removed, and firms will no longer have to include those in the top 0.3% as MRTs. While including the top 0.3% will still be an expectation, a bank will be able to form its own view on whether individuals in that group should be included as MRTs without specifically contacting the PRA for a dispensation. The specific rules that capture MRTs who are high earners in specific business units will also be removed. The PRA estimates that c. 20% of MRTs are currently identified as MRTs solely because of their pay and so the changes could lead to a sizeable fall in the number of MRTs.

However, at the same time the PRA has tightened up the processes which firms must follow to identify their MRTs, including providing non-exhaustive examples of roles that can materially affect the risk profile of a firm and specifically providing for greater involvement of specific individuals in the firm (e.g. chief risk officers). Firms should look closely at the new proposals which stand out in setting new requirements in what is generally a consultation reducing burdens on firms.

As to whether a MRT is able to take advantage of the proportionality exclusion, the variable pay limit of £44,000 has been changed to a total remuneration limit of £660,000 (to return to the pre-2021 position as adjusted for inflation). In addition, to take advantage of the proportionality exclusion, variable remuneration must remain not more than 33% of fixed pay as under the existing regime. The current and proposed proportionality exclusions for deferral are set out next to each other below:

Remuneration below which an MRT is currently not subject to deferral	**Proposed position**
Variable remuneration of £44,000 or less AND variable remuneration of 33% or less of total remuneration	Total remuneration of £660,000 or less AND variable remuneration of 33% or less of total remuneration (*same as previously*)

On a related point, the level at which variable remuneration is required to be 60% deferred rather than subject to the standard 40% deferral is also proposed to rise to £660,000 (currently it is set at £500,000).

The consultation paper estimates from the PRA's own sampling that the number of MRTs who will be able to benefit from the proportionality exclusion should rise to c. 30% from the current c. 20%.

IMPLEMENTATION

The regulators are currently inviting feedback on the proposals. The consultation closes on 13 March 2025. It is anticipated that the proposed changes will come into force some time in 2025 H2. They will apply to firms' performance years starting after that date, meaning that variable remuneration for years ending 31 December 2025 is not going to be affected by these proposals. Pay for calendar year 2026 will be the first year able to take advantage of these proposals. Also, the proposals will not take effect retrospectively. All remuneration for earlier years will remain subject to the current deferral rules until payment.

As part of the changes, there will also be greater alignment between PRA and FCA rules. Currently, the PRA and the FCA each have a set of remuneration rules with which dual-regulated firms must comply. As part of the proposals, the FCA intends to simplify its rules by in large part simply cross-referring to the remuneration part of the PRA rules, removing the need for it to maintain its own set of parallel remuneration rules. This should remove duplicative and inconsistent rules, achieving greater alignment.

CONCLUSION

The proposed changes to deferral periods and the identification of MRTs complement the recent removal of the bankers' bonus cap and the changes enhancing the number of firms able to treated as smaller firms. These were both changes to the remuneration rules implemented last year.

They form part of a trend, which had already started with the previous Government, of loosening some rules (e.g. the Listing Rules) which are now perceived to be losing the UK business, a reaction to issues which are no longer current problems or which can be addressed in other ways.

It is likely that the current proposals will be implemented. There will be very little pushback on them as they are generally welcome. There may be some pressure to introduce the proposals earlier. This would allow remuneration currently subject to existing rules to be subject to the new rules, if a firm wishes, as soon as they are implemented. The bonus cap removal was, after all, implemented very quickly after first being proposed: if a regime is perceived to be harmful to UK interests, it should sensibly be dismantled as quickly as possible. However, the regulators' practice over the years has not been to affect pay from current or earlier years with its proposals. This has normally worked to employees' benefit, as pay rules have become tougher, though it would not do so here where they are becoming easier.

Link to proposal: [CP16/24 – Remuneration reform | Bank of England]

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