

# PRA and FCA Announce Their Decision Not to Apply CRD IV Bonus Cap to Smaller Firms

March 2, 2016

Financial Services and Regulation

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To the great relief of those firms effected, on February 29, 2016, the Prudential Regulation Authority (“PRA”) and the Financial Conduct Authority (“FCA”) announced in a [statement](#) that they will continue to allow a large number of Level 3 smaller banks and investment firms in the United Kingdom (“UK”) to not apply the bonus cap.

## The “proportionality principle”

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Article 92(2) of the Capital Requirements Directive IV (the “CRD IV Directive”) (2013/36/EU) requires firms to comply with the CRD IV Directives remuneration requirements “in a manner and to the extent that is appropriate to their size, internal organisation and the nature, scope and complexity of their activities”. This is often referred to as the “proportionality principle”. In its final guidelines, published on December 21, 2015, the European Banking Authority (“EBA”) published its opinion on the application of the proportionality principle to the CRD IV Directive remuneration provisions. In this, the EBA confirmed its approach that the CRD IV Directive remuneration requirements should apply to all firms subject to the CRD IV Directive (that is, credit institutions and investment firms) and that the proportionality principle does not have the effect of disapplying these requirements for certain firms.

The remuneration guidelines published in December 2015 (which updated the previous guidelines published in 2010), together with other documentation released at the same time had the effect of extending the bonus capping rules to all firms caught by the CRD IV Directive. In addition, the remuneration guidelines had the effect of making a number of other changes to banking remuneration practices (although it was mostly only larger firms in Levels 1 and 2 in the UK that were affected by these other changes).

At the time, the EBA said that this position was required in order to comply with European Union (“EU”) legislation.

In the statement published on February 29, 2016, the PRA and the FCA disagreed with the EBA on its interpretation of the proportionality principle in relation to the bonus cap set by Article 94(1)(g) of the CRD IV Directive (that is, the limit on awarding variable remuneration to 100 percent of fixed remuneration, or 200 percent with shareholder approval). The PRA and the FCA have decided to retain their current approach of requiring smaller firms to determine an appropriate ratio between fixed and variable remuneration for their business, whilst not applying the bonus cap. The bonus cap will continue to apply to all large and systemically important CRD IV Directive firms in the UK.

The view of the PRA and the FCA is that the “extent” of application in a proportionate manner may include not applying a remuneration principle in its entirety, based on a firm’s size, internal organisation and the nature, scope and complexity of its activities. They also consider that the CRD IV Directive proportionality principle applies equally “to all numerical

requirements,” including the bonus cap, deferral, payment in instruments and ex-post risk adjustment.

The PRA and the FCA believe that the extension of the bonus cap to all firms would exacerbate the problems caused by increasing fixed pay as a percentage of total pay.

Andrew Bailey, Deputy Governor, Prudential Regulation, Bank of England and the CEO of the PRA said “the PRA attaches a great deal of importance to the principle of applying policies in a proportionate manner consistent with the legal provisions. We have followed the principle of proportionality, which in practice means that smaller firms which pose less risk to the safety and soundness of the financial system face lower regulatory requirements. This is a sensible outcome”.

All large and systemically important CRD-regulated firms must continue to apply the bonus cap.

The PRA and the FCA are considering whether any rule changes are required in order to implement the guidelines and, if necessary, will consult with the industry on these changes.

Given a statement given by the PRA in December 2015, the announcement by the PRA and the FCA did not come as any particular surprise. However, it is possible that the EBA may ask the UK to justify its departure from the EU position and potentially, could take action against the UK in respect of this. The European Commission has said that it is likely to propose changes to the underlying law in this area and if passed, this would have serious consequences for the position of the UK in this area. This said, these changes may not occur, or if they do, it will be some time in the future, allowing the disapplication of the bonus cap for Level 3 firms for quite some time yet.

If you have any questions concerning the material discussed in this client alert, please contact the following members of our Financial Services and Regulation practice group:

Charlotte Hill  
William Maycock

+44 20 7067 2190  
+44 20 7067 2191

[chill@cov.com](mailto:chill@cov.com)  
[wmaycock@cov.com](mailto:wmaycock@cov.com)

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