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The UK and EU Bank Remuneration Regimes Begin To Diverge

In the aftermath of the 2007-09 global financial crisis, the G20 nations committed to reforming bank remuneration frameworks in response to criticism that excessive risk-taking at banks incentivised by poorly structured pay practices played a role in the crisis.

The Financial Stability Board (FSB) issued principles[1] and standards,[2] which were subsequently implemented into EU law through the Capital Requirements Directive (CRD).[3] The UK — a member of the EU at the time — adopted these rules, integrating them primarily into the Financial Conduct Authority (FCA) and Prudential Regulation Authority (PRA) rules.

There have since been several rounds of amendments and refinements to the EU rules, most recently through CRD VI in 2024.[4]

Following Brexit, the UK regime started to diverge from the EU framework in several areas, in line with domestic priorities such as ensuring the UK remains a competitive financial hub — exemplified by the removal of the bonus cap in 2023. More recently, the PRA and FCA jointly consulted on changes to the bank remuneration regime, aimed at making it more effective, simple and proportionate.

In this article, we examine the recent and proposed changes in the UK and EU and provide a comparison of the two frameworks.

UK Regime: Overview of the Core Remuneration Principles and Requirements

UK banks are subject to remuneration rules issued by both the FCA and PRA. This is because they are dual-regulated, with the FCA responsible for conduct matters and the PRA responsible for prudential matters. The FCA's rules largely fall under its Remuneration Code (the FCA Remuneration Code),[5] whilst the PRA's remuneration rules are set out in the Remuneration Part of the PRA Rulebook (the PRA Remuneration Rules).[6]

Under the combined regime, banks are required to establish, implement and maintain remuneration policies, procedures and practices that are consistent with, and promote, sound and effective risk management. The regime is intended to cover all aspects of remuneration that could have a bearing on effective risk management, including salaries, bonuses, long-term incentive plans, options, hiring bonuses, severance packages and pension arrangements.

[1] See the FSF Principles for Sound Compensation Practices.

[2] See the Implementation Standards for the FSB Principles for Sound Compensation Practices.

[3] Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC.

[4] Directive (EU) 2024/1619 of the European Parliament and of the Council of 20 May 2019 amending Directive 2013/36/EU as regards supervisory power; sanctions; third-country branches; and environmental, social and governance (ESG) risks.

[5] For banks, this is contained in SYSC 19D in the FCA Handbook.

[6] See the PRA Remuneration Rules.

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UK banks are subject to several core remuneration principles and requirements, designed to promote sound risk management and prevent excessive risk-taking, including:

1. **Risk management and risk tolerance:** Remuneration policies must promote effective risk management and align with the bank's risk appetite, ensuring that compensation does not incentivise excessive risk-taking.
2. **Supporting business strategy:** Compensation structures should align with the bank's business strategy, objectives and long-term interests to support sustainable performance.
3. **Governance and oversight:** Banks must establish a robust governance framework for remuneration, with a dedicated remuneration committee that ensures policies comply with regulatory requirements.
4. **Avoidance of guaranteed variable remuneration:** Guaranteed bonuses are discouraged, except in exceptional circumstances (*e.g.*, to hire new staff), and must be limited to the first year of service.
5. **Deferral of variable pay:** A significant portion of variable remuneration must be deferred over a minimum period of up to seven years to align incentives with long-term outcomes, rising to 60% for senior management and material risk-takers (MRTs) in significant roles.
6. **Risk adjustment of awards:** Remuneration must be subject to *ex ante* (before payment) and *ex post* (after payment) risk adjustments, including malus and clawback provisions to recoup or adjust pay where necessary.
7. **Proportionality:** The application of remuneration rules should reflect the size, complexity and risk profile of the bank, to ensure that smaller institutions are not disproportionately burdened.
8. **Long-term instruments:** Variable remuneration must include a substantial portion paid in shares, share-linked instruments or other equivalent noncash instruments, to align employee interests with the bank's long-term performance.
9. **Public disclosure:** Banks are required to publicly disclose information about their remuneration policies and practices, including aggregate figures for senior executives and risk-takers.
10. **Gender neutrality:** Remuneration policies must be gender-neutral, ensuring equal pay for equal work and avoiding discriminatory practices.
11. **ESG integration:** Banks are required to integrate ESG factors into remuneration frameworks, to promote sustainability and manage long-term risks.

Banks are required to apply these principles and requirements at the level of their group, parent undertaking and subsidiary undertakings.

Overview of the EU Regime

As outlined above, EU banks are subject to the remuneration rules set out by CRD VI as implemented by each EU member state (leaving room for national gold-plating). These remuneration rules are complemented by the European Banking Authority's Guidelines on Sound Remuneration Policies.[7]

Because both the UK and the EU rules on remuneration derive from the same source and were first introduced by CRD, the general remuneration requirements for banks in the UK and the EU are mostly aligned. As in the UK, European banks are required to establish, implement and maintain remuneration policies, procedures and practices that are consistent with, and promote, sound and effective risk management.

The EU regime likewise covers all aspects of remuneration that could have a bearing on effective risk management, including salaries, bonuses, long-term incentive plans, options, hiring bonuses, severance packages and pension arrangements. EU banks are also subject to very similar core remuneration principles with minimal deviations, such as a minimum deferral period of up to five years.

Material Risk-Takers

Under both the UK and the EU regimes, banks are required to identify their MRTs and apply stricter remuneration terms to them. MRTs generally include:

- Senior management.
- Employees engaged in control functions.
- Employees responsible for key strategic decisions, significant revenue, material assets under management or approving transactions.
- Employees whose total remuneration places them among the top earners of the bank.

Banks are required to use qualitative and quantitative criteria to identify MRTs, including assessing the individual's role, responsibilities and potential to impact the bank's risk profile. The identification and management of MRTs must be overseen by the remuneration committee (where one has been established), ensuring alignment with regulatory expectations and internal risk management policies.

MRTs are subject to stricter remuneration rules, including higher deferral thresholds, increased use of noncash instruments and enhanced risk adjustment mechanisms. For example, currently at least 60% of variable remuneration for MRTs must be deferred over three to five years, although this is subject to change in the UK under recent proposals from the regulators (discussed further below).

[7] See the Guidelines on Sound Remuneration Policies under Directive 2013/36/EU.

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Banks are required to disclose detailed information about MRTs in their public remuneration reports, including the number of MRTs, their aggregate remuneration and how risk alignment has been achieved.

Removal of the Bonus Cap

In October 2023, the UK's PRA and FCA announced that they would remove the cap on bankers' bonuses,[8] which was a key element of the EU remuneration regime that the UK inherited whilst it was a member, with almost immediate effect. The cap limited variable remuneration to 100% of fixed pay (or 200% with shareholder approval).

Removing the cap was the UK's first major departure from the existing EU-inherited rules and was implemented as part of the UK's broader strategy to enhance the competitiveness of its financial services sector post-Brexit.

One of the other main drivers behind the decision was the observed increase in the proportion of the fixed component of total remuneration (such as via the use of role-based fixed allowances) at UK banks since the introduction of the bonus cap, which was seen as reducing the ability of banks to adjust their costs to absorb losses in a downturn. The regulators viewed flexibility to restructure remuneration faster as being an important asset for managing costs in such circumstances.

As such, despite the removal of the cap, banks are still required to set an appropriate and balanced ratio between the fixed and variable components of total remuneration. They must continue to ensure that the level of the fixed component of total remuneration represents a sufficiently high proportion of the total remuneration to allow the operation of a fully flexible policy on variable remuneration components, including the possibility of not paying any variable remuneration component.

Nonetheless, banks are now afforded flexibility by being permitted to set their own remuneration ratios for MRTs that align more closely with their business model. As a result, MRTs face greater upside and downside remuneration risk.

There is currently no comparable initiative in the EU to remove the bonus cap for banks. This may change over time, as the UK's initiative is likely to give European critics of the bonus cap a new argument to start up the debate again.

Flexibility for Smaller Banks

The other notable post-Brexit amendment to the UK regime is the measure aimed at increasing flexibility for smaller and less complex banks, to enhance proportionality and more appropriately calibrate regulatory burdens. In December 2023, the PRA and FCA released joint policy statements[9] outlining revisions to the remuneration framework that allowed these institutions to disapply certain requirements, such as malus, deferral, clawback and bonus buy-out provisions, where appropriate.

These changes reflect an acknowledgment that smaller banks often lack the scale and resources to comply with the full suite of remuneration rules, and that many of such rules are primarily calibrated to the business models of larger banks.

Banks qualify as "small" if they have average total assets of (i) £4 billion or less, or (ii) £20 billion or less and have business models that meet certain criteria that make them less risky. The tests need to be met by both the bank and its consolidated group, to the extent it belongs to one.

The aim of these proportionality measures is to balance regulatory oversight with operational feasibility, ensuring smaller banks remain competitive whilst still adhering to sound risk management practices. Small banks are still subject to a revised disclosure regime that requires them to proactively inform their regulators of certain material changes to remuneration structures.

The EU follows a similar approach, disapplying certain remuneration requirements such as malus, deferral and clawback with regard to banks whose assets did not exceed €5 billion during the last four financial years, provided these banks do not qualify as large.[10] Member states may derogate from this threshold (increasing or decreasing it) if certain requirements are fulfilled.

Future UK Reforms

In November 2024, the PRA and FCA jointly consulted on reforms to the UK's bank remuneration framework.[11] The reforms are intended to make the remuneration regime more effective, simple and proportionate while still ensuring accountability for risk-taking and appropriate outcomes for consumers and markets, and facilitating the international competitiveness of the UK economy and its growth in the medium to long term.

Broadly, the changes proposed are as follows:

1. **Alignment of PRA and FCA rules:** To simplify the framework of remuneration rules applying to banks, and to eliminate the existing repetition and overlap between the FCA Remuneration Code and PRA Remuneration Rules, the FCA Remuneration Code would be amended to cross-refer to the PRA Remuneration Rules where relevant and appropriate. A few FCA-specific rules would then remain. The FCA would also align its rules relating to buyout awards to exempt small banks, which the PRA has already done.

[8] See PRA PS9/23 and FCA PS23/15.

[9] See PRA PS16/23 and FCA PS23/17.

[10] See Art. 4 para. 1 no. 146 of Regulation (EU) 575/2013 for the definition of a large bank.

[11] See PRA CP16/24 and FCA CP24/23.

2. **Simplification of MRT rules:** A single quantitative threshold would be introduced to identify MRTs: those in the top 0.30% of earners at a bank. This threshold would exist alongside the existing qualitative assessments. The requirement for banks to seek regulatory approval to exclude those who would otherwise qualify as MRTs based on quantitative criteria would be removed. In addition, the proportionality threshold at which the disapplication of certain remuneration rules is possible (such as deferral or payment in instruments) would also be increased, from a ceiling of £500,000 to £660,000 of total annual compensation for an employee, where their variable pay does not exceed 33% of their total pay.
3. **Remuneration and individual accountability:** Banks would be required to consider adjusting the variable remuneration of MRTs up the management chain who are accountable in the event of adverse outcomes. This change would hold individuals in management positions more responsible for risk events involving one or more members of their team. Banks would also be required to consider the performance of senior managers against the supervisory priorities of the regulators when making pay decisions.
4. **Deferral and retention periods:** The minimum deferral period for senior managers at banks would be reduced from seven years to five years, whilst all other MRTs would be subject to a minimum deferral period of four years. In addition, deferred awards for senior managers would be allowed to vest on a *pro rata* basis from the date of the award. Currently, they can only begin to vest three years after the date of the award. Banks would now also be able to pay interest or dividends on deferred awards, and they would have discretion as to whether to set retention periods on vested awards.

In general, the banking industry has welcomed the proposed changes to the regime. They would generally reduce the regulatory burden on banks and give them much more discretion to set remuneration models that work for their own particular business. However, by placing the onus back on the banks, the regulators would clearly expect them to have detailed and considered rationale for any changes to remuneration structures they implement, with a view to continuing to ensure accountability for risk-taking. Banks would also need to ensure they have clear processes for identifying MRTs and adjusting their compensation on a continuous basis.

The consultation closes in March 2025, with final rules to be published in the second half of the year. The regulators expect the new rules to apply to performance years commencing 1 January 2026.

Developments in the EU

For the time being, there is no initiative in the EU to simplify the MRT rules or to reduce deferral and retention periods.

Moreover, CRD VI establishes sanctions requirements for banks that have not implemented a gender-neutral remuneration system or that do not comply with the applicable remuneration requirements. These requirements will be applicable once CRD VI has been transposed into national law in the EU member states, at the latest by January 2026. In the past, regulators would have had to use the angle of an "improper business organisation" if they intended to sanction a bank for a noncompliant remuneration system.

Analysis

The remuneration requirements for banks in the UK and the EU remain similar, but the process of divergence has started with the removal of the bonus cap in the UK and will progress with the planned future reforms.

It remains to be seen whether the EU will take steps to follow the UK's example. At the moment, it seems unlikely that this will be the case, especially against the background that the newest reforms strengthen the EU regulatory bodies in the enforcement of the remuneration requirements for banks.