

## NEW REMUNERATION CODE FOR MIFID FIRMS: IMPACT ON PRIVATE EQUITY

### WHAT'S HAPPENING?

In July the FCA published its single remuneration code for FCA investment firms authorised under MiFID (the 'MiFIDPRU Code'). Aside from the largest investment firms that will be subject to CRD, all MiFID firms, including most PE firms, will be impacted. A copy of our full briefing can be found [here](#).

The changes apply to remuneration awarded for performance periods starting on or after 1 January 2022, so timings are tight. For firms that are not used to the remuneration regulatory landscape these changes will signify a significant shift in how they approach remuneration policy and practice, and this will include PE firms.

### WHO IS IMPACTED?

How the MiFIDPRU Code applies to you will depend on the classification of your group entities under the FCA's new classification regime. In particular, this will depend on whether a firm is classified as a Larger or interconnected firm ('non-SNIs') or a Smaller and non-interconnected firm ('SNIs'):

- For SNIs, 'basic' requirements apply, covering basic remuneration policy, governance and structural requirements.
- For non-SNIs not categorised as large, 'standard' rules will apply, i.e. all 'basic' rules as well as: malus and clawback, restrictions on retention awards, guarantees, severance payments and buyouts, a requirement to identify material risk takers (MRTs) and to have an appropriate ratio between variable and fixed pay.

- For the largest of non-SNIs<sup>1</sup>, 'extended' requirements apply which are similar to those introduced for banks under CRD: all of the above apply, plus minimum deferral of MRT variable pay (either 40% or 60%) with 50% delivered in shares or instruments, subject to a holding period and a requirement to establish a remuneration committee ('RemCo') either at group or entity level.

## CO-INVESTMENTS AND CARRIED INTEREST

The MiFIDPRU Code includes specific provisions on how carried interest and co-investment arrangements should be treated:

- Returns made by staff on co-investments do not typically constitute remuneration (where the investment is made from an individual's own funds and not a loan from the firm). These will therefore be outside of the MiFIDPRU Code.
- Carried interest, where payments are a share in the profits of a fund and not related to a co-investment arrangement, will be considered remuneration. There will however be the ability to disapply the MiFIDPRU Code requirements on pay-out in instruments, deferral, retention, and ex-post risk adjustment to carried interest arrangements if: (i) the value is determined by reference to the performance of the fund; (ii) the period between award and payment is at least 4 years; and (iii) there are provisions dealing with forfeiture for significant losses and failures of fitness and propriety).

## WHAT DO YOU NEED TO DO NOW?

- Firms will need to assess their classification to determine which requirements will apply to them.
- Remuneration policies and practices will need to be thoroughly reviewed and updated.
- All Non-SNIs will need to:
  - assess and identify MRTs on an annual basis;

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<sup>1</sup> Where the value of on-balance sheet assets and off-balance sheet items over 4 years is a rolling average of: (i) more than £300m; or (ii) more than £100m but less than £300m and if it has trading book business of over £150m and/or derivatives business of over £100m.

- review pay structures for those MRTs;
  - consider the extent to which contractual arrangements need to be amended;
  - consider whether policies/practices in relation to guaranteed bonuses, buy out awards, severance pay or pension arrangements need to be modified going forward; and
  - prepare appropriate comms to MRTs informing them of their status and what that means for them in practice.
- Firms will want to look carefully at their carried interest arrangements and consider updating future documentation to either fit within the exemption or ensure the arrangements comply with the rules.
  - Larger non-SNIs will also need to prepare for the requirements to:
    - deliver variable remuneration in line with the pay-out process rules; and
    - establish a RemCo (of which at least 50% of the members must be non-executive members of the management body). These firms will need to establish a RemCo at individual entity level unless they decide to apply to the FCA for a waiver or (if they are consolidated) choose to rely on a group level RemCo instead.
  - A new disclosure regime is also being introduced by the FCA which will need thought and early preparation. The disclosure rules that apply will broadly depend on the category of firm and will include new provisions on disclosure of remuneration and governance arrangements, directorships held by a management body and diversity policies.
  - Firms will want to consider amending or implementing a diversity policy, if not already in place.
  - Finally, careful analysis will be needed by investment firm groups, including looking at applicable group consolidation rules and any jurisdictional overlap.

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