



HM TREASURY

# Bank Executive Remuneration Disclosure

Consultation on Draft Regulations

December 2011





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<b>Subject of this consultation</b>	A requirement for the largest banks operating in the UK to disclose the remuneration of their eight highest paid senior executive officers from 2012.
<b>Scope of this consultation</b>	The design characteristics of the proposed disclosure requirement and its implementing regulations.
<b>Who should read this</b>	Banks, institutional investors, professional advisers and other stakeholders with an interest in the disclosure of bank executive remuneration.
<b>Duration</b>	The consultation will run from 5 December 2011 to 14 February 2012.
<b>Enquiries</b>	For general enquiries, contact the Treasury Correspondence and Enquiry Unit on 020 7270 4558 or by e-mail to <a href="mailto:public.enquiries@hm-treasury.gov.uk">public.enquiries@hm-treasury.gov.uk</a> .
<b>How to respond</b>	Responses to this consultation should be sent by 14 February 2012 either by email to:  <a href="mailto:ExecutiveRemunerationDisclosure@hmtreasury.gsi.gov.uk">ExecutiveRemunerationDisclosure@hmtreasury.gsi.gov.uk</a>  or by post to:  Executive Remuneration Disclosure Consultation Institutional Investment HM Treasury Room 3/20 1 Horse Guards Road London SW1A 2HQ
<b>After the consultation</b>	Following consideration of responses, the Government will decide on what steps, if any, to take in relation to the draft regulations, before publishing a summary of responses and, if appropriate, laying final regulations before Parliament in the 2011/12 Parliamentary Session.



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# 1

## Introduction

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**1.1** Alongside the Project Merlin announcements in February 2011, the Government announced that it would consult on a mandatory requirement, from 2012, for large UK banks to publish pay details of their highest paid senior executive officers. This consultation sets out the Government's proposals in more detail.

**1.2** These commitments are part of a comprehensive range of measures being taken by the Government to address problems regarding inappropriate remuneration structures which have incentivised excessive risk taking in the financial services sector.

**1.3** The rest of this consultation is structured as follows:

- **Chapter 2** considers the rationale behind executive remuneration disclosure, including the international context;
- **Chapter 3** looks at the definition of 'relevant banking institutions' to ensure that appropriate firms are within scope;
- **Chapter 4** considers the definition of those executives in respect of whom disclosures should be made;
- **Chapter 5** considers what should be disclosed in the content of executive remuneration reports;
- **Chapter 6** considers other issues, including the timing of reports, the requirements for publication, board approval, and enforcement.

**1.4** Draft legislation is at **Annex A**, and an impact assessment, including the anticipated compliance costs of this legislation, at **Annex B**.



# 2

## The Government proposal

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**2.1** In February 2011 the Government announced an accord between the UK Government and the major UK banks – specifically Barclays, HSBC, LBG and RBS, and, in the context of lending, Santander – under Project Merlin.

**2.2** As part of the Project Merlin announcements, the Government indicated that it would consult on a mandatory requirement, from 2012, for all large UK banks to publish the pay of their eight highest paid senior executive officers. This follows on from this year's commitment by the four major banks to make detailed remuneration disclosures with respect to the five highest paid non-board executives within their organisations.

### Rationale

**2.3** There is widespread agreement that poorly designed remuneration structures incentivised excessive risk taking in the lead up to the financial crisis. Firms that operate in the major wholesale, retail and investment banking markets are typically large and complex organisations. Risks are managed within distinct business units and the senior managers with operational control of these units can have a significant impact on the firm's wider risk tolerance.

**2.4** The Government therefore proposes greater transparency of the reward structures for the eight most senior executives in an organisation, to permit greater scrutiny of the incentives for these individuals, and facilitate better oversight of the relationship between the capacity of senior executives to make decisions that impact on their firm's risk profile, and their remuneration.

**2.5** Such disclosure can help curb unsound compensation practices by:

- providing information to assist shareholders in holding boards to account;
- improving the quality of board oversight of remuneration policy and its link to risk management; and
- enhancing public scrutiny of board oversight of risks to financial stability from remuneration decisions.

**2.6** The Government proposals will apply to large banks operating in the UK. Firms will be required to issue an executive remuneration report, detailing the awards made to those executives with the highest levels of managerial control outside the board room. The Government's proposals complement the existing disclosure framework by requiring different levels of disclosures according to the seniority and risk profile of those disclosing; taken as a whole this provides a comprehensive disclosure regime.

**2.7** The Government is committed to balancing the need for better scrutiny and oversight of remuneration in the most significant firms with practical considerations, including issues of fairness and privacy. The additional disclosures will therefore be required on an individual but unnamed basis, minimising the impact on competitiveness and privacy for those in scope.

**2.8** It is also important to ensure that the Government's disclosure proposals do not disproportionately affect the international competitiveness of the UK. Many major jurisdictions

have some form of senior executive disclosure requirement. For example, the US requires the disclosure of the pay of five named senior executive officers, whilst France and Germany require disclosure of the pay of members of the Executive Management Board in listed companies. Australia requires the disclosure of pay details for key directors and company executives, including at least the five highest-paid company executives. These UK proposals have been crafted with reference to the international context to protect privacy to the extent that is possible, and also whilst providing more comprehensive information on incentivisation at large UK-based financial institutions than other comparable jurisdictions.

## **Wider disclosure context**

**2.9** Large UK listed banks are already required to adhere to the disclosure provisions contained in the Listing and Disclosure Rules, the Companies Act 2006, and Regulations made under that Act. These include the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008, and particularly Regulation 11 of those Regulations which requires quoted companies to prepare a directors' remuneration report (DRR) providing detailed disclosure, on a named basis, of the board's remuneration. Each director's remuneration, split into its various components, is reported on annually, and the report is put to an advisory shareholder vote.

**2.10** Remuneration disclosure has also been considered as part of an international drive to improve remuneration practices in the financial sector.

**2.11** The Financial Stability Board (FSB) Principles for Sound Compensation Practices and Implementation Standards require significant financial institutions to make public disclosures in respect of remuneration governance and decision-making as well as quantitative information on the remuneration paid to senior executive officers and employees whose actions have a material impact on the risk exposure of the firm. They allow for high-level disclosure relating to material risk takers within a firm, providing information on the policy of the organisation regarding risk incentivisation. In April 2009, the G20 Leaders' Summit endorsed the FSB Principles for Sound Compensation Practices, and the Implementation Standards were endorsed at the Pittsburgh G20 Leaders' Summit in September 2009.

**2.12** The revised Capital Requirements Directive (CRD3) includes provisions on remuneration disclosure modelled on the FSB's Implementation Standards. The Financial Services Authority (FSA) consulted on rules to implement the provisions of the Directive during 2010 and the revised FSA Remuneration Code came into force on 1 January 2011. These rules apply across the financial services sector and are applied to firms on a proportionate basis, commensurate with their size, the nature and scope of their operations, and the risks they pose. Banks subject to the FSA Code are required to include a remuneration report as part of their wider Basel Pillar 3 reporting pack. This must be published annually, and must show both qualitative and quantitative information on remuneration paid to Code staff.

**2.13** The Government's proposals would require more comprehensive disclosure of information relating to the eight most senior executives than is required in relation to Code staff by the FSA's remuneration disclosure rules, but less detailed disclosures than are required for executive directors of quoted companies in a directors' remuneration report. The comprehensive nature of the disclosure regime that results from the addition of these different obligations is explored further in chapter 4, and the impact assessment.

## Questions

1. Do you agree with the Government's approach to remuneration disclosure, as set out in this chapter, and does the draft legislation, set out in Annex A, achieve this aim?



# 3

## Relevant banking institutions

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**3.1** The proposal is intended to enhance the transparency of the relationship between risk and reward for the highest paid senior executives in the largest banking institutions. By virtue of their size, the largest firms are disproportionately exposed to systemic risks. As such, the relevance of a firm in these proposals is determined with reference to (a) the activities that it undertakes; and (b) its size.

### Relevant activities

**3.2** The proposed rules are intended to secure disclosures in relation to the employees of large UK banks, and in relation to those employed in the UK operations of large foreign non-EEA banks. Banking activities are defined in the draft legislation with reference to existing regulatory definitions which determine relevant banking institutions for disclosure purposes.

**3.3** It is proposed that the classes of firms in scope will include:

- UK banks, as defined in the glossary to the Handbook of Rules and Guidance made by the FSA (the FSA Handbook);
- BIPRU 730k firms, as defined in the glossary to the FSA Handbook; and
- Third country BIPRU firms, again as defined in the glossary to the FSA Handbook.

### Minimum assets threshold

**3.4** The purpose of the Regulations is to ensure that a banking institution discloses when its assets exceed £50 billion, or when it is part of a group in which any single banking institution in the UK has assets in excess of £50 billion. A UK bank or BIPRU 730k firm will be a relevant banking institution if (i) the total assets shown on its balance sheet are greater than or equal to £50 billion; or (ii) if it is a member of a group which contains a UK bank or BIPRU 730k firm with assets greater than or equal to £50 billion. A third country BIPRU firm will be a relevant banking institution (as will any of its subsidiaries which are UK banks or BIPRU 730k firms) if any of its subsidiaries which are UK banks or BIPRU 730k firms has assets greater than or equal to £50 billion.

**3.5** The financial services sector tends to be polarised with a large number of firms clustered below an assets threshold of £50 billion, and a small number of larger firms, whose assets can exceed £1 trillion. A £50 billion threshold is therefore a practical means of capturing the most significant firms, whilst excluding a long tail of smaller firms which present a less significant risk.

### UK firms and firms incorporated overseas

**3.6** Banking groups based in the UK can present risks to the wider economy by virtue of their domestic and overseas operations. For these firms senior executives may have global responsibilities, and the directors of the parent undertaking will therefore be expected to make disclosures covering the most senior executives with management responsibility for relevant banking institutions in their group.

**3.7** By comparison, the wider economy has a lower exposure to the risks presented by banking groups headquartered overseas. Whilst these firms' UK operations have a bearing on the UK market, their foreign operations are of less relevance. The obligation to make a disclosure will only apply to their UK operations.

**3.8** Under EEA passporting arrangements, the UK operations of EEA firms will not be subject to disclosure obligations under these proposals. These activities are subject to home state regulation, which is harmonised at the EU level, and the UK does not have the power to impose further disclosure requirements for these purposes.

## **Treatment of groups**

**3.9** The purpose of the regime is to require disclosure in relation to the most senior executives of a UK firm or group, or the most senior executives of the UK operations of a foreign group. However, the legislation requires disclosures in respect of relevant banking institutions. A single banking group may include a number of such firms. In order to avoid multiple disclosures by firms within a group, a provision has been made to allow firms which are part of the same group to elect to make a single collective disclosure, covering the eight most highly paid senior executives with management responsibility for relevant banking institutions within their group.

### **Questions**

2. Do you have any comments on the Government approach to defining relevant banking institutions?

# 4

## Relevant executives

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**4.1** By virtue of their managerial influence, senior executives can impact on the risk profile of the firm. Improved transparency of the incentives of the most senior executives will facilitate better oversight of their decisions and actions.

**4.2** The proposed draft Regulations require all relevant banking institutions to issue an executive remuneration report that discloses the remuneration awarded to the eight most highly paid relevant executives at the firm. As stated earlier, the parent firm of a group is permitted to issue a collective executive remuneration report that discloses the remuneration awarded to the eight most highly paid relevant executives responsible for managing the relevant banking institutions in the group, in lieu of individual disclosures.

**4.3** Relevant executives will consist of the eight most highly remunerated individuals who have either direct or indirect authority and responsibility for planning, directing and controlling the activities of a relevant banking institution, whether or not they are an employee of the institution.

**4.4** Relevant executives are likely to satisfy some or all of the criteria listed below:

- they will have significant managerial responsibility;
- they will likely have the highest level of operational decision-making responsibility outside the board room;
- they will have significant budgetary control;
- they will likely be business unit heads or otherwise be at the highest level of seniority in the corporate management hierarchy; and
- they will likely report directly to the CEO.

**4.5** Disclosures will not be required in relation to executive directors in respect of whom disclosures have been made on a named basis in the firm's directors' remuneration report under the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008. This means that UK quoted companies which make disclosures in respect of named executive directors will additionally be required under these Regulations to disclose details in respect of a further eight relevant executives.

**4.6** Disclosure of the remuneration of the highest paid relevant executives, alongside disclosures made in respect of directors and the aggregate Code staff remuneration disclosures required under the FSA remuneration disclosure rules, will provide information on the incentives that influence decision-making at different levels in a firm. Table 4.A illustrates the differences in responsibility and disclosure requirements at different levels in the structure of a firm.

**Table 4.A: Levels of responsibility and disclosure**

	<b>Impact on risk</b>	<b>Accountability</b>	<b>Named remuneration disclosure required?</b>	<b>Level of disclosure</b>	<b>Disclosure of composition of remuneration?</b>
Directors	Set risk appetite	To shareholders	Yes	Individual	Yes
Relevant executives	Develop strategy	To CEO	No	Individual	Yes
Code staff	Implement strategy	To senior management	No	Aggregated	Yes

**4.7** Disclosure on a named basis of the remuneration of directors of quoted companies in the UK is required by way of the directors’ remuneration report. The level of disclosure required for relevant executives by the proposed Regulations is less than that in the directors’ remuneration report reflecting in part the fact that relevant executives are not directly accountable to shareholders as are directors. The pay of less senior risk-taking staff also has implications for the incentivisation of risk management. This is indicated by the aggregated disclosures required in relation to this group under the FSA’s remuneration disclosure rules.

**Questions**

- Do you have any comments on the approach the Government has taken in defining relevant executives?

# 5

## Content of remuneration reports

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**5.1** The Government proposals require disclosure of the composition of remuneration in order to help demonstrate patterns of incentivisation. The approach taken is similar to those required under FSA remuneration disclosure rules and company law. It is anticipated that this will minimise duplication and costs and facilitate comparability. The proposed disclosure requirements draw on elements of both financial services and company law approaches, reflecting the similarity in structure between director and senior executive pay, and the design of financial services disclosure requirements to reflect sectoral pay structures. The proposed content of the disclosures in respect of each relevant executive is set out below.

### Fixed remuneration

**5.2** Fixed remuneration should include all awards or payments made under contractual salary arrangements within the relevant financial period.

### Variable remuneration

**5.3** Variable remuneration should include all awards made during the year whose size or structure is not contractually agreed in advance. Variable remuneration, or bonuses, can include: cash elements; shares or other equity linked instruments; and debt instruments or other contingent capital awards. In addition, variable remuneration typically comprises upfront components, where the remuneration is paid on or soon after the date which it is awarded, and deferred components, where payment is deferred into future periods.

**5.4** Under the proposed rules, the structural make up of a variable remuneration award must be disclosed, illustrating the disaggregation into three constituent components; cash components, shares and equity linked instruments, and all other variable awards. In addition, for each component the split between upfront and deferred payments must also be shown.

### Long term incentive scheme awards

**5.5** The total value of any interest in a long term incentive scheme which has vested in a relevant executive in the financial year must also be disclosed. In this context, a long term incentive scheme is any agreement or arrangement under which a relevant executive is entitled to receive remuneration of any kind conditional upon multi-year performance targets being met.

**5.6** When a relevant executive participates in any such arrangements or agreements, they are said to have a 'scheme interest'. In addition, once the applicable performance conditions have been met and the executive is entitled to receive remuneration, the scheme interest is said to have vested.

**5.7** Vested scheme interests need not be claimed immediately on vesting. However, once an interest has vested it represents an obligation on the part of the firm to pay remuneration or other assets to the executive. Under the proposed rules, the executive remuneration report must show the total value of all scheme interests that have vested for an individual in a given year.

## Pensions

**5.8** The proposed rules also require disclosure of pension awards and accrued benefits. Where relevant executives participate in a defined contribution or money purchase scheme, the report must show the amounts contributed or payable to the scheme by the relevant institution for the year in question.

**5.9** Where the relevant executives participate in a defined benefit scheme the report must show any increase or decrease in the executives' accrued benefits in the year, and the total accrued benefits as of year-end.

## Sign-on awards and severance payments

**5.10** The proposed rules require the disclosure of the amounts of any sign-on awards and the amounts of any severance awards made to relevant executives in the financial year, including the value of vested assets awarded as part of any sign-on or severance package.

**5.11** As guidance, an illustrative disclosure table could look like the following:

	Individual 1	Individual 2	Individual 3	Individual 4 etc
<b>Fixed Remuneration</b>	<b>x</b>	<b>x</b>	<b>x</b>	<b>x</b>
Upfront Variable Remuneration - Cash	x	x	x	x
Upfront Variable Remuneration - Equity	x	x	x	x
Upfront Variable Remuneration - Other	x	x	x	x
Deferred Variable Remuneration - Cash	x	x	x	x
Deferred Variable Remuneration - Equity	x	x	x	x
Deferred Variable Remuneration - Other	x	x	x	x
<b>Total Variable Remuneration</b>	<b>x</b>	<b>x</b>	<b>x</b>	<b>x</b>
<b>Long Term Incentive Plan Awards</b>	<b>x</b>	<b>x</b>	<b>x</b>	<b>x</b>
<b>Pension Awards</b>	<b>x</b>	<b>x</b>	<b>x</b>	<b>x</b>
<b>Total Remuneration</b>	<b>x</b>	<b>x</b>	<b>x</b>	<b>x</b>
Sign-on Award	x	x	x	x
Severance Award	x	x	x	x

## Questions

- Do you have any comments on the approach the Government has taken in determining the content of executive remuneration reports?

# 6

## Other issues

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### Frequency and timing

**6.1** An executive remuneration report will need to be prepared in relation to each financial year of a relevant banking institution or if made collectively on behalf of a group of relevant banking institutions, in relation to each financial year of the parent. The report must be filed with Companies House within the same period as the annual accounts and reports required under the Companies Act 2006 (or Overseas Companies Regulations 2009 for overseas companies).

**6.2** Transitional provisions will apply to the executive remuneration report produced for the 2011 financial year. The obligation to produce this executive remuneration report will only apply after these regulations come into force, and as this may not fit in with the timing for preparation of the 2011 annual reports and accounts of relevant banking institutions, they will be allowed a longer period within which to prepare and file the executive remuneration report for that year.

### Approval and publication

**6.3** The executive remuneration report must be approved by the board of directors prior to publication, and signed on behalf of the board by a director or the secretary of the responsible institution.

**6.4** Disclosing firms should publish the information in a practical way that facilitates its availability and use in enhancing market discipline as part of a comprehensive bank remuneration disclosure regime. Accordingly, the disclosing firm will be required to publish the executive remuneration report on the firm's website, and disseminate it further by means of a regulated information service. At the discretion of the disclosing entity, the executive remuneration report may be included in the annual report.

**6.5** The Regulations apply those provisions in the Companies Act 2006 which create offences for failure to comply with the requirements for directors' remuneration reports, to failures to comply with the requirements in these Regulations in relation to the executive remuneration report (see for example the offences provided for in sections 420, 422, 430, 433, and 451 of the Act). These are criminal offences, punishable by a fine.

### Costs

**6.6** As outlined in the impact assessment at Annex B, the costs arising from this proposal are expected to be incremental to the existing cost of implementing the CRD3 remuneration disclosure requirements which also apply to the group of firms expected to be subject to the proposed Regulations. Implementation costs are expected to average approximately £2,250 per firm.

## Questions

5. Do you have any comments on the Government approach to these issues?
6. Do you have any comments on the costs and benefits attached to these proposals, as set out in the impact assessment at Annex B?



# Draft Regulations

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**A.1** The following pages contain the draft regulations for The Financial Services Act 2010 (Executives' Remuneration Report) Regulations 2011.



“financial instrument” has the meaning given in Article 4.1(17) of Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments<sup>(a)</sup>;

“long-term incentive scheme” has the meaning set out in paragraph 3 of the Schedule to these Regulations;

“manager” means a person who has authority and responsibility for planning, directing and controlling the activities of a relevant banking institution, directly or indirectly, whether or not that person is an employee of the institution;

“overseas company” has the meaning set out in section 1044 of the Act;

“period for filing the executives’ remuneration report” means—

- (a) for the financial year beginning on or after 1st January 2011 but before 1st January 2012, the period starting from the date on which these Regulations come into force, and ending on the date stated in regulation 11(2);
- (b) for financial years beginning on or after 1st January 2012—
  - (i) in relation to a company, the period within which the directors of the company are required to deliver accounts and reports for a financial year to the registrar under section 442 of the Act (including in relation to relevant banking institutions which are overseas companies subject to Chapter 3 of Part 6 of the Overseas Companies Regulations 2009<sup>(b)</sup>, that section as modified by regulation 55 of those Regulations), and
  - (ii) in relation to a relevant banking institution which is an overseas company required to prepare accounts under its parent law, the period allowed for delivery in regulation 46 of the Overseas Companies Regulations 2009,

“qualifying services” in relation to any person, includes that person’s services as a relevant executive of the relevant banking institution, and any other services given by that person to the relevant banking institution or to an undertaking which is a subsidiary undertaking of that banking institution;

“registrar” has the same meaning as in section 1060 of the Act.

“regulated information service” means an information service which has been approved by the Financial Services Authority as meeting the criteria for regulated information services published by the Financial Services Authority in May 2010, and which is on the list of regulated information services maintained by the Financial Services Authority;

“remuneration” includes any cash or non-cash benefit received or receivable by a relevant executive which falls into one of the categories set out in paragraph 3 of the Schedule to these Regulations;

“responsible institution” means—

- (a) in relation to an executives’ remuneration report prepared by the directors of a relevant banking institution in accordance with regulation 5, the relevant banking institution, and
- (b) in relation to an executives’ remuneration report prepared for the group by the directors of the parent undertaking of the group in accordance with regulation 7, the parent undertaking of the group;

“secretary” includes any person occupying the position of secretary, by whatever name called;

“share-linked financial instrument” means—

- (a) share options, warrants and other instruments entitling the holder to subscribe for shares in an incorporated company,
- (b) other derivative instruments whose value is determined by reference to the value of shares in an incorporated company.

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(a) O.J. L145, 30.4.2004, p.1.

(b) S.I. 2009/1801.

“shares” means shares (whether allotted or not) in the relevant banking institution, or any undertaking which is a group undertaking in relation to the relevant banking institution, and includes a share warrant as defined by section 779(1) of the 2006 Act;

(2) References in these Regulations to a group undertaking, a parent undertaking, or a subsidiary undertaking of a banking institution are to be construed, unless the context otherwise requires, in accordance with sections 1161 and 1162 of and Schedule 7 to the Act.

(3) The following expressions have the meaning given in the Handbook of Rules and Guidance made by the Financial Services Authority (as that Handbook has effect on [date Regulations come into force])—

“BIPRU 730k firm”;

“third country BIPRU firm”;

“UK bank”.

### **Relevant banking institution**

3.—(1) For the purpose of these Regulations, a “relevant banking institution” is—

- (a) a company which satisfies condition 1 or condition 2 and is—
  - (i) a UK bank; or
  - (ii) a BIPRU 730k firm; or
- (b) an overseas company which—
  - (i) is a third country BIPRU firm established in the UK, and
  - (ii) satisfies condition 3.

(2) Condition 1 is that the aggregate of the amounts shown as assets on the institution’s balance sheet for the financial year was equal to or exceeded £50 billion.

(3) Condition 2 is that, where the institution is a member of a group, the aggregate of the amounts shown as assets on the balance sheet of any UK bank or BIPRU 730k firm which is—

- (a) a member of that group, and
- (b) incorporated in the United Kingdom,

at the end of the financial year was equal to or exceeded £50 billion.

(4) Condition 3 is that the aggregate of the amounts shown as assets on the balance sheet of any UK bank or BIPRU 730k firm which is a subsidiary undertaking of the third country BIPRU firm incorporated in the United Kingdom at the end of the financial year was equal to or exceeded £50 billion.

### **Relevant executives**

4.—(1) For the purposes of section 4(3)(b) of the Financial Services Act 2010 (relevant executives), an employee who satisfies the conditions in paragraph (3) is a relevant executive of a relevant banking institution.

(2) For the purposes of section 4(3)(c) of the Financial Services Act 2010, an individual who satisfies the conditions in paragraph (3) is a relevant executive of a relevant banking institution.

(3) A person satisfies the conditions in this paragraph if that person—

- (a) is a manager; and
- (b) is—
  - (i) one of the eight most highly remunerated managers working for the institution; or
  - (ii) in the case of a third country BIPRU firm, one of the eight most highly remunerated managers working for any branch of the firm established in the United Kingdom, or any subsidiary undertaking of the firm incorporated in the United Kingdom, and

- (c) that person is not one of the directors information about whose remuneration is published in a directors' remuneration report under regulation 11 of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008(a).

#### **Duty to prepare executives' remuneration report**

5.—(1) Subject to paragraph (2), the directors of a relevant banking institution must prepare an executives' remuneration report for each financial year of the institution.

(2) The directors of a relevant banking institution are exempt from the requirement to prepare an executives' remuneration report under paragraph (1) where—

- (a) the relevant banking institution is a subsidiary undertaking, and an executives' remuneration report is prepared by the directors of the parent undertaking for the group in accordance with regulation 7, or
- (b) the information required by these Regulations to be published in the executive remuneration report has already been published in response to requirements contained in the Act or subordinate legislation made under the Act.

(3) Section 420(2) and (3) of the Act (failure to prepare directors' remuneration report) applies in the case of failure to prepare an executives' remuneration report as it applies in the case of failure to prepare a directors' remuneration report, with the following modifications in section 420(2)(a)—

- (a) for "director of the company" substitute "director of the relevant banking institution";
- (b) the reference to "accounts and reports" shall include a reference to "the executives' remuneration report"; and
- (c) the "period for filing accounts and reports" shall include a reference to the "period for filing the executives' remuneration report".

#### **Contents of an executives' remuneration report**

6.—(1) The executives' remuneration report prepared by the directors of a relevant banking institution must contain the information specified in the Schedule to these Regulations in relation to the eight most highly remunerated relevant executives working for the banking institution, unless paragraph (2) applies.

(2) It is not necessary for any information relating to executives' remuneration which has been set out in accounts or reports prepared by the parent undertaking of the relevant banking institution which have been published to be repeated in the executives' remuneration report, and for the purposes of this regulation, "published" has the same meaning as in section 436(2) of the Act.

#### **Duty to prepare group executives' remuneration report**

7.—(1) The directors of a parent undertaking of a group which contains two or more relevant banking institutions may prepare an executives' remuneration report for the group in relation to each financial year of the parent undertaking, and that report must contain the information specified in the Schedule to these Regulations in relation to—

- (a) the eight most highly remunerated relevant executives working for relevant banking institutions in the group, or
- (b) in the case of a third country BIPRU firm established in the United Kingdom, the eight most highly remunerated relevant executives working for any branch or subsidiary undertaking in the United Kingdom,

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(a) S.I. 2008/410.

who are not directors information about whose remuneration is published in a directors' remuneration report under regulation 11 of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008.

(2) It is not necessary for any information relating to executives' remuneration which has been set out in notes to the accounts of a relevant banking institution, or in the consolidated accounts of a group including the relevant banking institution, to be repeated in the relevant executives' remuneration report prepared for the group.

### **Approval and signing of executives' remuneration report**

**8.**—(1) The executives' remuneration report must be approved by the board of directors and signed on behalf of the board by a director or the secretary of the responsible institution.

(2) Section 422(2) and (3) of the Act (approval of non-compliant directors' remuneration report) applies to an executives' remuneration report as it applies to a directors' remuneration report, with the modifications in paragraph (3).

(3) In section 422(2) of the Act—

- (a) for “director of the company” substitute “director of the responsible institution”;
- (b) for “requirements of this Act”, substitute “requirements of these Regulations”.

### **Executives' remuneration report to be made available on website and published by means of a regulated information service**

**9.**—(1) A responsible institution must ensure that its executives' remuneration report—

- (a) is made available on a website, and
- (b) remains so available until the executives' remuneration report for the responsible institution's next financial year is made available in accordance with this regulation.

(2) The executives' remuneration report must be made available on a website that—

- (a) is maintained by or on behalf of the responsible institution, and
- (b) identifies the responsible institution in question.

(3) Access to the executives' remuneration report on the website, and the ability to obtain a hard copy of the executives' remuneration report from the website, must not be—

- (a) conditional on the payment of a fee, or
- (b) otherwise restricted, except so far as necessary to comply with any enactment or regulatory requirement (in the United Kingdom or elsewhere).

(4) The executives' remuneration report—

- (a) must be made available as soon as reasonably practicable, and
- (b) must be kept available throughout the period specified in paragraph (1)(b).

(5) A failure to keep the executives' remuneration report available on the website throughout that period may be disregarded if—

- (a) the executives' remuneration report is made available on the website for part of that period, and
- (b) the failure is wholly attributable to circumstances that it would not be reasonable to have expected the responsible institution to prevent or avoid.

(6) A responsible institution must ensure that its executives' remuneration report is published by means of a regulated information service as soon as reasonably practicable.

(7) Section 430(6) and (7) of the Act (failure to make annual accounts and reports available on website) applies in the event of a failure to comply with this regulation as it applies to a failure to comply with section 430 with the modification in paragraph (8).

(8) In section 430(6) of the Act, for “company”, substitute “responsible institution”.

### **Name of signatory to be stated in published copies of the executives' remuneration report**

**10.**—(1) Every copy of an executives' remuneration report that is published by or on behalf of a responsible institution must state the name of the person who signed it on behalf of the board.

(2) For the purpose of this regulation, a responsible institution is regarded as publishing the executive' remuneration report if it publishes, issues or circulates it or otherwise makes it available for public inspection in a manner calculated to invite members of the public generally, or any class of members of the public, to read it.

(3) Section 433(4) and (5) of the Act (publication without statement of signatory's name) apply to an executives' remuneration report as it applies to a directors' remuneration report, with the modification in paragraph (4).

(4) In section 433(4), for "company", each time it appears, substitute "responsible institution".

### **Filing of executives' remuneration report**

**11.**—(1) The directors of a responsible institution which is a UK bank or a BIPRU 730k firm must deliver to the registrar for each financial year a copy of the executives' remuneration report—

- (a) for the financial year beginning on or after 1st January 2011, but before 1st January 2012, by 31 December 2012,
- (b) for financial years beginning on or after 1st January 2012, within the period for filing the executives' remuneration report.

(2) Where the responsible institution is a third country BIPRU firm, or the parent undertaking of a third country BIPRU firm, the directors of the largest subsidiary undertaking of that firm incorporated in the United Kingdom must deliver the executives' remuneration report prepared in relation to the third country BIPRU firm for each financial year to the registrar—

- (a) for the financial year beginning on or after 1st January 2011, but before 1st January 2012, by 31st December 2012,
- (b) for financial years beginning on or after 1st January 2012, within the period for filing the executives' remuneration report.

(3) The copy of the executives' remuneration report delivered to the registrar under this regulation must state the name of the person who signed it on behalf of the board.

(4) Section 451 and 452 of the Act (default in filing accounts and reports: offences and court order) apply to an executives' remuneration report as they apply to a directors' remuneration report, with the following modifications—

- (a) for "company", each time it appears, substitute "responsible institution";
- (b) references to "accounts and reports" include a reference to "the executives' remuneration report";
- (c) the "period for filing accounts and reports" shall include a reference to the "period for filing the executives' remuneration report"; and
- (d) in section 451, for "this Part", substitute "these Regulations".

### **Voluntary revision of report**

**12.**—(1) Section 454(1) of the Act (voluntary revision of accounts) applies to an executives' remuneration report as it applies to a directors' remuneration report, with the modifications in paragraph (2).

(2) In section 454(1)—

- (a) for "directors of a company", substitute "directors of a responsible institution";
- (b) for "the requirements of this Act", substitute "the requirements of the Financial Services Act 2010 (Executives' Remuneration Report) Regulations 2011".

(3) The provisions of these Regulations as to the matters to be included in an executives' remuneration report apply to a revised report as if the revised report was prepared and approved by the directors of the responsible institution as at the date of the original executives' remuneration report.

(4) Regulation 8 applies to a revised executives' remuneration report, save that, in the case of revision by supplementary note, it applies as if it required the signature to be on the supplementary note.

(5) Upon the directors of the responsible institution approving a revised executives' remuneration report under this regulation, the provisions of these Regulations have effect as if the revised report was, as from the date of its approval, the executives' remuneration report in place of the original executives' remuneration report.

(6) In particular, the revised report shall as from that date be the executives' remuneration report for the relevant financial year for the purposes of regulations 9 and 11 (if the requirements of regulation 11 have not been complied with prior to the date of revision).

(7) Where the directors of the responsible institution have prepared a revised executives' remuneration report, and a copy of the original remuneration report has been delivered to the registrar under regulation 11, the directors of the responsible institution must, within 28 days of the date of revision, deliver to the registrar—

- (a) in the case of a revision by replacement, a copy of the revised executives' remuneration report, or
- (b) in the case of a revision by supplementary note, a copy of that note.

(8) Regulation 11(5) applies with respect to a failure to comply with the requirements of this regulation as it applies to a failure to comply with regulation 11 but as if the reference in regulation 11(5) to the period for filing the executives' remuneration report was a reference to the period of 28 days referred to in paragraph (7).

(9) In this Regulation—

“date of the original executives' remuneration report” means the date on which the original executives' remuneration report was approved by the board of directors under regulation 8;

“date of revision” means the date on which the revised executives' remuneration report is approved by the board of directors under paragraph (5);

“original executives' remuneration report” means the executives' remuneration report which are the subject of revision by the revised report;

“revised report” means an executives' remuneration report prepared by the directors under section 454 of the Act as applied by this regulation;

“revision by replacement” means revision by the preparation of a replacement executives' remuneration report in substitution for the original executives' remuneration report;

“revision by supplementary note” means revision by the preparation of a note indicating corrections to be made to the original executives' remuneration report.

### **Offences under these Regulations**

**13.—**(1) Section 463 of the Act (liability for false or misleading statements in reports) applies to an executives' remuneration report as it applies to a directors' remuneration report, with the modification that, for “company” each time it appears, substitute “responsible institution”.

(2) The following sections of the Act apply in relation to an offence under these Regulations as they apply to an offence under the Companies Acts—

- (a) section 1121 (liability of officer in default);
- (b) section 1122 (liability of company as officer in default);
- (c) section 1123 (application to bodies other than companies);
- (d) section 1125 (meaning of “daily default fine”);
- (e) sections 1127 and 1128 (summary proceedings: venue and time limit for proceedings);

(f) section 1129 (legal professional privilege);

(3) Section 1132 of the Act (production and inspection of documents where offence suspected) applies to an offence under these Regulations as it applies to an offence under the Companies Acts, with the modification that, for “company” each time it appears, substitute “responsible institution”.

## **Review**

**14.**—(1) Before the end of the review period, the Treasury must—

- (a) carry out a review of these Regulations,
- (b) set out the conclusions of the review in a report, and
- (c) publish the report.

(2) The report must in particular—

- (a) set out the objectives intended to be achieved by the regulatory system established by these Regulations,
- (b) assess the extent to which those objectives are achieved, and
- (c) assess whether those objectives remain appropriate and, if so, the extent to which they could be achieved with a system that imposes less regulation.

(3) “Review period” means the period of five years beginning with the day on which these Regulations come into force.

	<i>Name</i>
	<i>Name</i>
Date	Two of the Lords Commissioners of Her Majesty’s Treasury

## **SCHEDULE**

Regulation 6

### **EXECUTIVES’ REMUNERATION REPORT: CONTENTS**

**1.** The executives’ remuneration report for a financial year (“the relevant financial year”) must show the information specified in paragraphs 3 to 7, in tabular form.

**2.** In an executives’ remuneration report which has been prepared by the directors of a parent undertaking of a group under regulation 7, there must be disclosed the names of each of the relevant banking institutions to which the report relates.

#### **Details of remuneration**

**3.** For each relevant executive there shall be stated—

- (a) the total amount of fixed remuneration paid to or receivable by that executive in respect of qualifying services,
- (b) the total amount of variable remuneration awarded to that executive in respect of qualifying services, divided between—
  - (i) remuneration paid to the relevant executive when it is awarded (“non-deferred variable remuneration”);
  - (ii) remuneration the payment of which is deferred for some period after it is awarded (“deferred variable remuneration”);
- (c) the total amounts of non-deferred variable remuneration awarded to that executive which fall into each of the following categories—
  - (i) money;

- (ii) shares or other share-linked financial instruments;
- (iii) other forms of remuneration;
- (d) the total amounts of deferred variable remuneration awarded to that executive which fall into each of the following categories—
  - (i) money;
  - (ii) shares, or other share-linked financial instruments;
  - (iii) other forms of remuneration.

### **Long term incentive schemes**

**4.**—(1) For each relevant executive, there shall be stated the total value of any scheme interest in a long-term incentive scheme which has vested in the relevant executive in that financial year.

(2) In this paragraph, “long-term incentive scheme” means an agreement or arrangement—

- (a) under which money or other assets may become receivable by a relevant executive, and
- (b) which includes one or more qualifying conditions with respect to service or performance which cannot be fulfilled within a single financial year.

(3) For this purpose the following must be disregarded—

- (a) bonuses the amount of which falls to be determined by reference to service or performance within a single financial year,
- (b) compensation for loss of position, payments for breach of contract and other termination payments, and
- (c) benefits payable under a pension scheme.

(4) For the purposes of this paragraph—

- (a) “scheme interest”, in relation to a person, means an interest under a long term incentive scheme that is an interest in respect of which assets may become receivable under the scheme in respect of qualifying services by that person,
- (b) such an interest “vests” at the earliest time when—
  - (i) it has been ascertained that the qualifying conditions have been fulfilled; and
  - (ii) the nature and quantity of the assets receivable under the scheme in respect of the interest have been ascertained.

### **Pensions**

**5.**—(1) For each relevant executive, there shall be stated the information in respect of pensions which is specified in sub-paragraphs (2) and (3).

(2) Where—

- (a) the relevant executive has rights under a pension scheme that is a defined benefit scheme in relation to that executive, and
- (b) any of those rights are rights to which the executive became entitled in respect of qualifying services,

details of any changes during the relevant financial year in the value of the relevant executive’s accrued benefits under the scheme.

(3) Where—

- (a) the relevant executive has rights under a pension scheme which is a money purchase scheme in relation to that executive, and
- (b) any of those rights are rights to which the relevant executive has become entitled in respect of qualifying services,

the total amount of any contribution to the scheme in respect of that executive that is paid or payable by the relevant banking institution for the relevant financial year or paid by the relevant banking institution in that year for another financial year.

### **Joining benefits**

6.—(1) For each relevant executive, there shall be stated the amount of any benefit paid to or receivable by to that executive in respect of accepting a position as an executive with the relevant banking institution.

(2) In this paragraph—

- (a) references to a benefit include benefits otherwise than in cash, and
- (b) in relation to such benefits references to its amount are to the estimated money value of the benefit.

### **Severance payments**

7.—(1) For each relevant executive, there shall be stated the amount of any compensation paid to a relevant executive or former relevant executive in respect of loss of their position with the relevant banking institution.

(2) In this paragraph references to compensation for loss of position include—

- (a) compensation in consideration for, or in connection with, a person's retirement from their position, and
- (b) where the loss of position is occasioned by a breach of the relevant executive's contract with the relevant banking institution or with a subsidiary undertaking of the relevant banking institution—
  - (i) payments made by way of damages for the breach; or
  - (ii) payments made by way of settlement or compromise of any claim in respect of the breach.

(3) In this paragraph—

- (a) references to compensation include benefits otherwise than in cash, and
- (b) in relation to such compensation references to its amount are to the estimated money value of the benefit.

### **General nature of obligations**

8.—(1) This Schedule requires information to be given only so far as it is contained in the relevant banking institution's books and papers or the relevant banking institution has the right to obtain it from the persons concerned.

(2) For the purposes of this Schedule any information is treated as shown if it is capable of being readily ascertained from other information which is shown.

### **Provisions as to amounts to be shown**

9.—(1) The following provisions apply with respect to the amounts to be shown under this Schedule.

(2) The amount in each case includes all relevant sums, whether paid by or receivable from the relevant banking institution, any of the relevant banking institution's subsidiary undertakings or any other person.

(3) References to amounts paid to or receivable by a person include amounts paid to or receivable by a person connected with him or a body corporate controlled by him (but not so as to require an amount to be counted twice).

(4) Except as otherwise provided, the amounts to be shown for any relevant financial year are—

- (a) the sums receivable in respect of that year (whenever paid), or
- (b) in the case of sums not receivable in respect of a period, the sums paid during that year.

(5) References in this paragraph to a person being “connected” with a relevant executive, and to an executive “controlling” a body corporate, are to be construed in accordance with sections 252 to 255 of the Act.

### **Meaning of “pension scheme” and related expressions**

**10.**—(1) In this Schedule, “pension scheme” means a pension scheme within the meaning of section 150(1) of the Finance Act 2004(a) which is—

- (a) operated by or on behalf of the relevant banking institution, or
- (b) one to which the relevant banking institution paid a contribution during the period of account.

(2) In this Schedule, in relation to a relevant executive—

“defined benefits” means benefits payable under a pension scheme that are not money purchase benefits;

“defined benefit scheme” means a pension scheme that is not a money purchase scheme;

“money purchase benefits” means benefits payable under a pension scheme the rate or amount of which is calculated by reference to payments made, or treated as made, by the executive or by any other person in respect of the relevant executive and which are not average salary benefits; and

“money purchase scheme” means a pension scheme under which all of the benefits that may become payable to or in respect of the executive are money purchase benefits.

(3) Where a pension scheme provides for any benefits that may become payable to or in respect of any relevant executive to be whichever are the greater of—

- (a) money purchase benefits as determined by or under the scheme; and
- (b) defined benefits as so determined,

the banking institution may assume for the purposes of this paragraph that those benefits will be money purchase benefits, or defined benefits, according to whichever appears more likely at the end of the relevant financial year.

(4) For the purpose of determining whether a pension scheme is a money purchase or defined benefit scheme, any death in service benefits provided for by the scheme are to be disregarded.

### **References to subsidiary undertakings**

**11.** Any reference in this Schedule to a subsidiary undertaking of the relevant banking institution, in relation to a person who is or was, while a relevant executive of the institution, a relevant executive also, by virtue of the banking institution’s nomination (direct or indirect) of any other undertaking, includes that undertaking, whether or not it is or was in fact a subsidiary undertaking of the banking institution.

### **EXPLANATORY NOTE**

*(This note is not part of the Regulations)*

These Regulations make provision for the preparation, approval and disclosure of executives’ remuneration reports under sections 4 and 5 of the Financial Services Act 2010. They require certain banking institutions to prepare executive remuneration reports disclosing the remuneration of their eight most highly remunerated executives.

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(a) 2004 c. 12.

Regulation 1(3) provides that these Regulations are to cease to have effect seven years after they come into force.

Regulation 2 contains interpretation provisions for the Regulations.

Regulation 3 defines “relevant banking institution” for the purpose of the Regulations. Regulation 4 defines two further categories of “relevant executives” (in addition to officers of relevant banking institutions, who are relevant executive under section 4(3)(a) of the Financial Services Act 2010).

Regulation 5 imposes a duty to prepare the executives’ remuneration report on the directors of the relevant banking institution.

Regulation 6 and the Schedule to the Regulations set out the information which must be contained in the executives’ remuneration report.

Regulation 7 imposes a duty to prepare a group executives’ remuneration report on the directors of the parent undertaking of group which contain two or more relevant banking institutions.

Regulation 8 provides for the approval and signing of an executives’ remuneration report.

Regulation 9 requires the publication of the executives’ remuneration report on a website maintained by or on behalf of the institution concerned, and its publication on a regulatory information service.

Regulation 10 requires the name of the signatory to be stated in every copy of the executives’ remuneration report which are published.

Regulation 11 requires the executives’ remuneration report to be delivered to the registrar.

Regulation 12 provides for the voluntary revision of the executives’ remuneration report.

Regulation 13 applies a number of provisions of the Act to executives’ remuneration reports, and to offences under these Regulations.

Regulation 14 requires the Treasury to review the operation and effect of these Regulations and publish a report within five years after the Regulations come into force. Following the review it will fall to the Treasury to consider whether the Regulations should be allowed to expire as regulation 1(3) provides, be revoked early, or continue in force with or without amendment. A further instrument would be needed to continue the Regulations in force with or without amendments or to revoke them early.



# B

## Impact Assessment

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**B.1** The following pages contain the Government's consultation stage impact assessment for the proposals contained in this consultation document.

Title:

# Remuneration Disclosure

Lead department or agency:

HM Treasury

Other departments or agencies:

BIS

## Impact Assessment (IA)

IA No:

Date: 05/12/2011

Stage: Consultation

Source of intervention: Domestic

Type of measure: Primary legislation

Contact for enquiries:

ExecutiveRemunerationDisclosure@  
hmtreasury.gsi.gov.uk

### Summary: Intervention and Options

#### What is the problem under consideration? Why is government intervention necessary?

Remuneration practices in the financial services sector incentivised excessive risk-taking in some cases, contributing to the onset and severity of the financial crisis. Remuneration policies that incentivise behaviour leading to short term rewards without taking account of longer term risks can expose shareholders, and in some cases ultimately the taxpayer, to loss. Improved transparency can lead to better alignment of risk and remuneration, reducing these risks. However, pay data can be commercially sensitive. Without a regulatory framework, firms are unlikely to provide consistent and comparable information voluntarily.

#### What are the policy objectives and the intended effects?

The objective is to address a gap in pay disclosure at the largest UK-based financial institutions. More detailed disclosures for non-board senior executives will provide information on high-level incentivisation, This will encourage better shareholder governance (through oversight of the incentives that influence behaviour and the relationship between remuneration and risk), which in turn will facilitate better decision making by boards; and it will enhance public scrutiny, increasing public confidence. The proposal aims to minimise potential costs and externalities, including privacy concerns.

#### What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

The options considered were: do nothing (0); or require large banks operating in the UK to disclose details of the remuneration of the 8 highest paid senior executives, on an individual un-named basis (1). The preferred option (1) would, when coupled with existing requirements, provide a comprehensive and graduated pay disclosure framework for large banks. It would fill a gap in the current framework by providing information on the incentivisation of senior executives below board level with substantive decision-making power. Whilst theoretically transparency can enhance governance, this can be very difficult to estimate, as the main benefits of this proposal are non-monetised. However, implementation and operating costs are low (circa £0 - £2,250 per firm p.a.), and the potential for negative externalities is low. Voluntary alternatives to regulation are unlikely to provide consistent and comparable information.

Will the policy be reviewed? It will be reviewed. If applicable, set review date: 5/2017

What is the basis for this review? Sunset clause. If applicable, set sunset clause date: 5/2019

Are there arrangements in place that will allow a systematic collection of monitoring information for future policy review?

Yes

**SELECT SIGNATORY Sign-off** For consultation stage Impact Assessments:

*I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.*

Signed by the responsible SELECT SIGNATORY:

Date:

5.12.11

# Summary: Analysis and Evidence

Policy Option 1

Description:

Price Base Year 2010	PV Base Year 2010	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: £0	High: £0	Best Estimate: £0

COSTS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	£0	£0	£0
High	£0	£0.04	£0.338
Best Estimate	£0	£0.04	£0.338

### Description and scale of key monetised costs by 'main affected groups'

The key monetised costs flowing from the policy comprise the incremental administrative costs faced by firms in complying with the regulations. These include: changes in the firms' systems and controls; additional data collection and reporting costs; additional record keeping costs; publishing costs; and other sundry clerical costs. These costs will mostly be incorporated in the upfront setup costs and ongoing annual costs of parallel policy changes.

### Other key non-monetised costs by 'main affected groups'

Firms may face indirect non-monetised costs in the form of staff retention and recruitment costs ('ratchet effects') arising from employees having more information on colleagues' pay, and competing firms having more information on the firm's remuneration practices. Employees may also suffer loss of privacy.

BENEFITS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	n/a	n/a	n/a
High	n/a	n/a	n/a
Best Estimate	n/a	n/a	n/a

### Description and scale of key monetised benefits by 'main affected groups'

There are no key monetised benefits flowing from the proposed policy.

### Other key non-monetised benefits by 'main affected groups'

Improved transparency and governance of the incentive structures that influence decision making and risk taking in large banking organisations contributes to financial stability. It will enhance shareholder oversight of pay and risk taking; improve risk budgeting and remuneration decision making by boards; and increase public confidence in oversight and decision making.

### Key assumptions/sensitivities/risks

Discount rate (%) 3.5

The key assumption made regarding costs is that compliance costs are low because firms under scope are significantly revising remuneration reporting to comply with new FSA remuneration disclosure provisions. It has also been assumed that disclosure will not have a material impact on pay in the financial services sector.

On benefits, it has been assumed that the disclosures will be used by stakeholders to improve governance and oversight of remuneration and risk.

Direct impact on business (Equivalent Annual) £m): Costs: 0	Benefits: 0	Net: 0	In scope of OIOO? No	Measure qualifies as NA
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# Enforcement, Implementation and Wider Impacts

What is the geographic coverage of the policy/option?		United Kingdom			
From what date will the policy be implemented?		01/08/2012			
Which organisation(s) will enforce the policy?		BIS / Companies House			
What is the annual change in enforcement cost (£m)?		£neg			
Does enforcement comply with Hampton principles?		Yes			
Does implementation go beyond minimum EU requirements?		N/A			
What is the CO <sub>2</sub> equivalent change in greenhouse gas emissions? (Million tonnes CO <sub>2</sub> equivalent)		Traded: n/a		Non-traded: n/a	
Does the proposal have an impact on competition?		No			
What proportion (%) of Total PV costs/benefits is directly attributable to primary legislation, if applicable?		Costs: n/a		Benefits: n/a	
Distribution of annual cost (%) by organisation size (excl. Transition) (Constant Price)	Micro 0	< 20 0	Small 0	Medium 0	Large 100
Are any of these organisations exempt?	Yes	Yes	Yes	Yes	No

## Specific Impact Tests: Checklist

Set out in the table below where information on any SITs undertaken as part of the analysis of the policy options can be found in the evidence base. For guidance on how to complete each test, double-click on the link for the guidance provided by the relevant department.

Please note this checklist is not intended to list each and every statutory consideration that departments should take into account when deciding which policy option to follow. It is the responsibility of departments to make sure that their duties are complied with.

Does your policy option/proposal have an impact on...?	Impact	Page ref within IA
<b>Statutory equality duties<sup>1</sup></b> <a href="#">Statutory Equality Duties Impact Test guidance</a>	No	
<b>Economic impacts</b>		
Competition <a href="#">Competition Assessment Impact Test guidance</a>	No	
Small firms <a href="#">Small Firms Impact Test guidance</a>	No	
<b>Environmental impacts</b>		
Greenhouse gas assessment <a href="#">Greenhouse Gas Assessment Impact Test guidance</a>	No	
Wider environmental issues <a href="#">Wider Environmental Issues Impact Test guidance</a>	No	
<b>Social impacts</b>		
Health and well-being <a href="#">Health and Well-being Impact Test guidance</a>	No	
Human rights <a href="#">Human Rights Impact Test guidance</a>	No	
Justice system <a href="#">Justice Impact Test guidance</a>	No	
Rural proofing <a href="#">Rural Proofing Impact Test guidance</a>	No	
<b>Sustainable development</b> <a href="#">Sustainable Development Impact Test guidance</a>	No	

<sup>1</sup> Public bodies including Whitehall departments are required to consider the impact of their policies and measures on race, disability and gender. It is intended to extend this consideration requirement under the Equality Act 2010 to cover age, sexual orientation, religion or belief and gender reassignment from April 2011 (to Great Britain only). The Toolkit provides advice on statutory equality duties for public authorities with a remit in Northern Ireland.

## Evidence Base (for summary sheets) – Notes

Use this space to set out the relevant references, evidence, analysis and detailed narrative from which you have generated your policy options or proposal. Please fill in **References** section.

### References

Include the links to relevant legislation and publications, such as public impact assessments of earlier stages (e.g. Consultation, Final, Enactment) and those of the matching IN or OUTs measures.

DN No.	Legislation or publication
1	<a href="#">Financial Services Act 2010</a>
2	<a href="#">Financial Stability Board Principles for Sound Compensation Practices (FSB, 2009)</a>
3	<a href="#">Capital Requirements Directive (European Commission, 2010)</a>
4	<a href="#">FSA Remuneration Code (FSA, 2010)</a>
5	<a href="#">Walker Review of Corporate Governance in Banks and other Financial Industry Entities (HMT, 2009)</a>
6	<a href="#">Deloitte UK Tax: Directors Remuneration Report 2004 (Deloitte, 2004)</a>
7	<a href="#">Project Merlin – Banks' Statement (HMT, 2011)</a>
8	<a href="#">FSA CP10/19: Revising the Remuneration Code (FSA, 2010)</a>
9	<a href="#">FSA CP10/27: Implementing CRD3 requirements on the disclosure of remuneration (FSA, 2010)</a>
10	<a href="#">UBS Issues Shareholder Report on Write-downs (UBS, 2008)</a>

+ Add another row

### Evidence Base

Ensure that the information in this section provides clear evidence of the information provided in the summary pages of this form (recommended maximum of 30 pages). Complete the **Annual profile of monetised costs and benefits** (transition and recurring) below over the life of the preferred policy (use the spreadsheet attached if the period is longer than 10 years).

The spreadsheet also contains an emission changes table that you will need to fill in if your measure has an impact on greenhouse gas emissions.

#### Annual profile of monetised costs and benefits\* - (£m) constant prices

	Y <sub>0</sub>	Y <sub>1</sub>	Y <sub>2</sub>	Y <sub>3</sub>	Y <sub>4</sub>	Y <sub>5</sub>	Y <sub>6</sub>	Y <sub>7</sub>	Y <sub>8</sub>	Y <sub>9</sub>
<b>Transition costs</b>		0	0	0	0	0	0	0	0	0
<b>Annual recurring cost</b>	0.04	0.04	0.04	0.04	0.04	0.04	0.04	0.04	0.04	0.04
<b>Total annual costs</b>	0.04	0.04	0.04	0.04	0.04	0.04	0.04	0.04	0.04	0.04
<b>Transition benefits</b>										
<b>Annual recurring benefits</b>										
<b>Total annual benefits</b>										

\* For non-monetised benefits please see summary pages and main evidence base section



Microsoft Office  
Excel Worksheet

# Evidence Base (for summary sheets)

## Introduction

This section sets out the assumptions supporting this consultation stage impact assessment and outlines information sought from consultees.

As part of Project Merlin in February 2011, the four Merlin banks disclosed pay details on an anonymous basis for the five highest paid executives not on the board for the 2010 financial year. The Government made a commitment to consult on a mandatory requirement for large UK banks to publish the pay of the eight highest paid executives (in addition to executive director pay already disclosed).

## Problem under consideration

A firm's remuneration policy shapes incentives that influence employees' behaviour. An appropriately structured remuneration policy should align the employee's rewards with the profile of the risks they manage on behalf of the firm, and indirectly on behalf of shareholders and other stakeholders. Inappropriately structured policies have been shown to reward employees in the short term whilst leaving shareholders, and ultimately taxpayers, exposed to significant long term risks (Shareholder Report on UBS's Write Downs, 2008). In such cases, remuneration policy is a source of risk that can have an impact on the stability of the firm, and if the firm is systemic, an impact on wider economic and financial stability.

Effective oversight is necessary to ensure remuneration policy aligns the interests of employees with that of shareholders. The principal responsibility for this lies with the board of directors, and it can be reinforced by the actions of shareholders, supervisors and other stakeholders. Shareholders and other stakeholders can influence board oversight through market operations (and the impact of these on the share price) and through their dialogue with board and management. Supervisors can influence board oversight through their supervisory activities.

The framework in place before the financial crisis was inadequate at some firms. Below board director level, there was little visibility of the incentive structures influencing senior managers and other significant risk takers. Boards themselves often had limited information on the scale and prevalence of inappropriately structured remuneration awarded in their companies (Walker, 2009).

## Objective and rationale for intervention

Significant progress has been made in improving remuneration practices. In September 2009, G20 member states endorsed the Financial Stability Board (FSB) Principles for Sound Compensation Practices and associated Implementation Standards (the Standards). These provide for aggregated qualitative and quantitative disclosures on the policies and awards made to material risk takers. In the European Union, the Standards have been implemented through the revised Capital Requirements Directive (CRD3), agreed in June 2010. The UK has transposed these through the Financial Services Authority (FSA) remuneration disclosure rules which came into force on 1 January 2011.

Existing disclosure requirements are in respect of two areas. First, director disclosure requirements provide a detailed breakdown of the incentivisation of the most senior decision makers. Secondly, the FSA disclosure rules require aggregate disclosures of pay levels, structures and policies for larger groups of material risk takers. This proposal would insert an intermediate level of disclosure between the two existing requirements, by requiring firms in scope to provide more detailed disclosures on the pay of senior non-board executives. Firms that operate in major investment, wholesale and retail banking markets are large and complex organisations. Risks are managed within business units and the senior managers with operational control of these units have a significant impact on the firm's risk tolerance and management.

Filling this gap in the current disclosure requirements will enhance shareholder oversight of pay and risk taking; improve risk budgeting and remuneration decision making by boards; and increase public confidence in oversight and decision making.

## Policy proposal

The proposed policy will require large banks with operations in the UK to disclose annually and on an unnamed basis the level and composition of the pay of the eight highest paid executives (excluding those already subject to UK director disclosure requirements) responsible for planning, directing and controlling the firm's operations and. These executives are likely to have the highest level of decision making responsibility and budgetary control outside the board. Their actions will disproportionately influence the risk profile of the firm. More transparency of the incentives that influence their decisions will facilitate better governance of risk.

The proposal is intended to improve scrutiny and oversight of remuneration on a targeted basis in the largest firms, providing more comprehensive information than comparable jurisdictions, whilst minimising potential impacts on privacy and competitiveness. The proposal to require disclosure in respect of the largest banks based in the UK is consistent with the greater potential impact of these firms on financial stability than smaller firms.

The proposed level of disclosure is consistent with that agreed between banks and Government during the Merlin discussions. It is less detailed than that currently required in respect of executive directors, reflecting the lower level of responsibility of non-board executives. It is on an unnamed basis, reflecting the fact that senior executives do not share directors' personal accountability to shareholders for their stewardship, and the more limited benefit of named disclosure in these cases.

The proposal to require disclosure in respect of eight executives strikes a balance between breadth of coverage and capturing only those with the greatest responsibilities for risk management. In a corporate structure these executives are likely to be heads of business units and/or reporting directly to the CEO. The proposed scope also balances the objective of a highly transparent UK regime in international terms, without diverging in a way that materially impacts on UK competitiveness. For example, listed firms in the US must disclose pay details for the five highest paid senior executives on a named basis and in France and Germany, these details must be disclosed for members of the executive management board. In Australia, disclosure is required in respect of directors and key management personnel. Further details on those captured by the definition of 'relevant executive' can be found in the accompanying consultation document. An alternative might be to define senior executives in terms of their responsibilities or position in the corporate hierarchy, but it is not clear that this would be practical or secure against manipulation.

The proposed content of the disclosures is set out in the table below. It draws on both the FSA's aggregate remuneration disclosure requirements for risk takers, and remuneration disclosure requirements for directors of quoted companies.

	Individual 1	Individual 2	Individual 3	Individual 4 etc
<b>Fixed Remuneration</b>	x	x	x	x
Upfront Variable Remuneration - Cash	x	x	x	x
Upfront Variable Remuneration - Equity	x	x	x	x
Upfront Variable Remuneration - Other	x	x	x	x
Deferred Variable Remuneration - Cash	x	x	x	x
Deferred Variable Remuneration - Equity	x	x	x	x
Deferred Variable Remuneration - Other	x	x	x	x
<b>Total Variable Remuneration</b>	x	x	x	x
<b>Long Term Incentive Plan Awards</b>	x	x	x	x
<b>Pension Awards</b>	x	x	x	x
<b>Total Remuneration</b>	x	x	x	x
Sign-on Award	x	x	x	x
Severance Award	x	x	x	x

## Alternatives to legislation

The main alternatives would be a voluntary arrangement similar to that made under Project Merlin or a voluntary code of practice. These could potentially provide the desired transparency without legislative

compulsion. However, there are several issues with such voluntary codes. The first is the uncertainty associated with reaching and maintaining a durable ongoing agreement with a diverse group of banks, membership of which may change over time. The second is the potential difficulty in maintaining consistent disclosure across the group, when disclosure is on a voluntary basis. It is not clear that either alternative could provide a sufficiently robust assurance of reliable and consistent disclosures over time. The Government welcomes views on whether a non-legislative approach would be a more effective way of achieving the Government's policy objectives.

## Costs

The costs flowing from the policy comprise direct monetised costs incurred by firms and potential indirect non-monetised costs arising from the impact on firm competitiveness and the privacy of covered employees. These are discussed in turn.

### *Direct monetised cost*

This assessment draws on the cost-benefit analysis undertaken by the FSA for its implementation of disclosure rules implemented in January 2011. Given the similarities between the proposed disclosures and the current disclosure requirements, associated compliance procedures and costs are likely to be similar. We have diverged from the FSA's conclusions where necessary to reflect differences in the policies. The FSA cost-benefit analysis is published in the consultation paper FSA CP 10/27 (November 2010).

The FSA rules require, inter-alia, the disclosure of aggregate quantitative data on the remuneration awarded to significant risk takers in an estimated 239 large banks and credit institutions with operations in the UK. The proposed policy will require individualised quantitative disclosures in respect of the eight highest paid senior executives at large banking organisations situated in the UK. The organisation will be subject to disclosure requirements if it has, or has a UK subsidiary with, assets of more than £50 billion. We estimate that approximately 15 groups are likely to be captured. This group is a subset of the firms subject to the FSA rules. The number of firms is unlikely to grow significantly over the lifecycle of the policy.

The individuals in respect of whom disclosure is required under the proposed policy are likely to be Code Staff under the definition in the FSA Remuneration Code, and therefore included in the aggregate disclosures required under FSA rules. Much of the information required under the proposed policy will already be collected in order to provide the FSA disclosures. The incremental costs of making the proposed disclosures are correspondingly reduced.

The FSA cost-benefit analysis breaks down costs into upfront setup costs and ongoing annual costs. The table below shows firms' estimates of the costs they would incur implementing the FSA's remuneration disclosure rules.

### FSA disclosure rules estimated costs:

Costs , £	Upfront Setup Costs		Ongoing Annual Costs	
	Lowest	Highest	Lowest	Highest
	Estimate	Estimate	Estimate	Estimate
Changes in systems and controls	0	35,000	0	2,000
Additional data collection and reporting	0	25,000	0	60,000
Additional record keeping	0	5,000	0	5,000
Other clerical costs	0	650	0	0
Publishing costs	0	10,000	0	10,000
<b>Total (for 239 firms)</b>	<b>0</b>	<b>650,000</b>	<b>0</b>	<b>320,000</b>
Median total cost per firm		0		0
Average of total cost per firm	-	2,650	-	1,300

This data is from a sample of 17 credit institutions within the population of 239 firms covered by the FSA regulations. While it does not show the distribution of cost estimates within each range, the median of the total costs is zero, suggesting the high estimates are likely to be outliers. The following analysis does not correct for this potential bias and estimates are therefore more likely to overstate the costs incurred.

Changes in systems and controls: necessary changes to a covered firm's controls infrastructure will have been made to implement the FSA disclosure rules. Further changes are not necessary, upfront or on an ongoing basis, and we expect this cost to be zero.

Additional data collection and reporting: most of data required under the proposed policy will already be collected under the FSA disclosure rules. Firms will be required to select and report on the eight highest paid qualifying executives most likely from the pool of Code Staff. They will also need to recalculate some elements of the disclosure on a different basis. We estimate that the additional time required to collect, modify and compile this data will be small and additional ongoing costs are likely to lie in the range of £0 - £1,000 p.a. per firm, with no additional upfront costs.

Additional record keeping: the incremental record keeping costs over those already incurred under the FSA rules will be negligible. We anticipate this cost to be zero.

Other clerical costs: no additional clerical costs are associated with the proposed policy.

Publishing costs: under the proposed policy, firms will be required to publish disclosures online and through a regulated information service, and file them with Companies House, within the timeframe for filing the annual reports and accounts. Firms may choose to publish the disclosures in conjunction with the annual report, in conjunction with the remuneration disclosures under FSA rules, or independently. The last option is likely to be the most costly, with ongoing incremental costs likely to fall in the range £0 - £1,250 p.a.

*Proposed policy estimated direct compliance costs:*

Costs , £	Upfront Setup Costs (upper estimate)	Ongoing Annual Costs (upper estimate)
Changes in systems and controls	0	0
Additional data collection and reporting	0	1,000
Additional record keeping	0	0
Other clerical costs	0	0
Publishing costs	0	1,250
Total cost per firm	0	2,250

Enforcement costs: The Registrar would follow up where timely disclosures are not received from firms expected to comply. Credible information suggesting misleading disclosures would be investigated, for example by seeking an explanation from the firm.

Given the small number of firms covered by the regulations and the high profile nature of remuneration disclosure, high levels of compliance with the policy or in remedying any inadvertent breach are likely. Directors are subject to criminal penalties for non-compliance. The reputational cost of non-compliance or inaccurate compliance would be significant.

Accordingly, the incremental cost for an established enforcement agency in enforcing compliance with the proposed regulations would be negligible, with an annual upper bound estimated at £2,500.

On the basis that there will initially be 15 firms in scope, the likely upper bound of the direct costs of the proposed policy would initially be less than £40,000 p.a. and this has been used as the estimate of the total annual cost.

### *Indirect non-monetised costs*

Indirect costs could be imposed on either individuals or firms.

Individuals value privacy in relation to their income and loss of privacy could impose costs (and potentially lead firms to compensate affected staff). Any loss of privacy will, however, be limited by the anonymous nature of the disclosures. While it will be possible to use the disclosures and other public data to speculate about the identity of the relevant executives, it will not be officially confirmed.

The extent and impact of any consequential loss of privacy is difficult to estimate. However, the fact that the Merlin banks were prepared to make similar disclosures on a voluntary basis indicates that privacy concerns were not sufficient to override disclosure. In addition, several other jurisdictions (eg, US, Germany, Hong Kong, France) require remuneration disclosure in respect of groups of executives, and privacy concerns have not led to reconsideration of these policies.

Costs to firms could arise from higher recruitment and retention costs (so called 'ratchet effects') arising from employees having more information on colleagues' pay, and competing firms having more information on a firm's remuneration practices. This effect could be stronger in a mobile and global industry such as investment banking. However, such costs are hard to assess. There is also a question of whether a change in cost resulting from better informed negotiations actually represents an economic cost (or merely a more accurate market price). While there is anecdotal evidence from the industry and practitioners that cost increases may occur, there is little concrete evidence. For example, a study of the impact of the introduction of the Directors Remuneration Report Regulations 2002 suggested that the level of pay did not increase as a result of that increase in disclosure (Deloitte, 2004).

There are two principal reasons for expecting the proposed policy would have little impact on recruitment and retention costs, particularly in the international market place. First, the proposed disclosures do not substantially depart from existing international practice in a number of other major financial centres. Secondly, the fact that the Merlin banks have made similar disclosures on a voluntary basis provides some comfort that costs are acceptable.

### **Benefits**

Despite agreement that poorly designed remuneration structures incentivised excessive risk taking in the lead up to the financial crisis, it is difficult to evidence and calculate the value of the benefits of greater transparency in curbing unsound compensation practices by disincentivising short-termism and risky behaviour, and thus promoting financial stability

There are estimates by the Basel Committee on Banking Supervision of the annual economic benefits and costs of tighter regulatory standards affecting the probability of systemic banking crisis. However, these take into account a wider range of interventions, many of which would have a greater impact than changes to remuneration disclosure, and do not provide a useful basis for assessing disclosure benefits.

There is evidence that boards had insufficient oversight of the incentivisation of material risk takers and shareholders had insufficient information to challenge board performance in this area (Walker 2009). The information to be disclosed under this proposal will improve shareholders' ability to engage with boards on the subject of incentivisation and risk management, and has the potential to improve dialogue. Public disclosure may reinforce this by generating further analysis and a more informed public debate on these topics. These in turn are likely to support the efforts made by boards to exercise more robust and informed oversight of the incentivisation of the management level just below the board.

Potential benefits are likely to be enhanced by realisation of a comprehensive bank remuneration disclosure framework. Disclosure of remuneration of senior managers below board level fills a gap in the current model, between the more detailed disclosures in relation to executive directors and the aggregate disclosures in respect of material risk takers, and would provide a more rounded picture of a firm's approach to incentivisation and risk management.

## **Implementation Plan**

The regulations will be implemented through secondary legislation, under the powers granted to the Government in the Financial Services Act 2010. The powers, granted under sections 4 and 5 of the Act, enable the Government to make provision by regulations about the preparation, approval and disclosure of executives' remuneration reports. Draft secondary legislation has been prepared and issued for consultation alongside the attached consultation document. These draft regulations have already been subjected to legal and government scrutiny. In line with the Government's requirements, the draft regulations have been through an internal challenge review at HM Treasury and a two stage legal peer review. In addition, they will be reviewed by the Reducing Regulation Committee.

These regulations will undergo consultation and the Government is inviting comments on them from a broad group of individuals and organisations. This consultation period is scheduled to end on 14 February 2012, after which the Government will issue a report on the consultation and will prepare the final regulations, taking into account the comments received during consultation.

## **Specific Impact Tests**

### *Statutory Equalities Duties*

The Government has considered the proposed policy in relation to its public sector equality duties under the Sex Discrimination Act 1975, the Race Relations Act 1976, the Disability Discrimination Act 1995, section 75 of the Northern Ireland Act 1998 and the Equality Act 2010. It has concluded that no relevant issues arise. All relevant executives would be affected equally by the proposed policy.

### *Economic Impacts*

There will be no competition effects associated with this policy, on the basis that the proposed policy will not:

- a) directly limit the number or range of employers or employees;
- b) indirectly limit the number or range of employers or employees;
- c) limit the ability of employers or employees to compete; or
- d) reduce employers' or employees' incentives to compete vigorously.

It was considered whether the increased disclosures might, by requiring the disclosure of information on prices / costs of labour, encourage price fixing by either firms or employees. It has been reasoned that this would not be possible on the basis that international aspects of this labour market will minimise (to zero) competition impacts between firms, and similarly that given the global labour market for such staff, employees would be unable to enter into collective bargaining agreements.

The proposed changes are not expected to have any impact on small businesses because of the £50 billion assets threshold and focus on large financial services firms.

### *Environmental Impacts*

The proposed changes are not expected to have any significant impact. There may be a negligible effect due to an increased amount of paper.

### *Social Impacts*

The proposed changes will not have any impact.

### *Sustainable Development*

The proposed changes are not expected to have any impact.

### *Micro Businesses*

The proposed changes are not expected to have any impact on micro-businesses because of the £50 billion assets threshold and focus on large financial services firms.

# Annexes

Annex 1 should be used to set out the Post Implementation Review Plan as detailed below. Further annexes may be added where the Specific Impact Tests yield information relevant to an overall understanding of policy options.

## Annex 1: Post Implementation Review (PIR) Plan

A PIR should be undertaken, usually three to five years after implementation of the policy, but exceptionally a longer period may be more appropriate. If the policy is subject to a sunset clause, the review should be carried out sufficiently early that any renewal or amendment to legislation can be enacted before the expiry date. A PIR should examine the extent to which the implemented regulations have achieved their objectives, assess their costs and benefits and identify whether they are having any unintended consequences. Please set out the PIR Plan as detailed below. If there is no plan to do a PIR please provide reasons below.

<p><b>Basis of the review:</b> Sunset clause In line with best practice, the Government will review the policy within five years.</p>
<p><b>Review objective:</b> It is intended as a proportionate check that the regulation is operating as expected in line with the policy objectives</p>
<p><b>Review approach and rationale:</b> The review approach will be to evaluate data released under the regulations.</p>
<p><b>Baseline:</b></p>
<p><b>Success criteria:</b> Regulations ensure that information is disclosed on a consistent and comparable basis by the relevant firms.</p>
<p><b>Monitoring information arrangements:</b> As part of these proposals, the relevant enforcement agency will be notified when new data is released.</p>
<p><b>Reasons for not planning a review:</b> n/a</p>





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This document can be found in full on our website: <http://www.hm-treasury.gov.uk>

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