Plus ça change

Alexandra Carn looks at whether Brexit will change how EU regulations on pay affect the UK. Could the bankers' bonus cap now be revoked, for example?

The introduction of the "bankers' bonus cap" in 2014 brought together an unholy trinity of British banks, their regulators and the government, all united in opposition to the regulation. Brexit should have brought them together once again. But as the dust begins to clear, it has become apparent that any immediate change to the UK's financial remuneration regulation is far from likely.

The bonus cap came into effect as part of CRD IV, the EU legislative package covering prudential rules for banks, building societies and investment firms. The label "bonus cap" is a misnomer as there is no absolute limit on the amount of bonus that can be paid. Instead the "cap" operates as a limit on the ratio between fixed (basic) pay and variable (bonus) pay such that variable pay cannot exceed two times basic pay. It was an unpopular measure. The banks disliked it for driving up fixed costs and reducing flexibility, and the regulators saw it as an attack on the City as a financial centre. After all, the City's main competitors in the US and Asia do not have the cap.

The UK government lodged its abortive legal challenge in September 2014. Given the government's willingness to do battle over the regulation – and whatever the repeated protestations by Anthony Browne, head of the British Bankers' Association, and others in banking that there will be "no bonfire of red tape" – the longevity of the bonus cap post the Brexit vote appears to be in jeopardy. Is it?

Despite the two years plus that it will take the UK to leave the EU, it is theoretically open to the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) to revoke immediately parts of the remuneration codes and see how the EU reacts. But such a unilateral step would appear unlikely. The consensus is that the cap is deeply embedded in the EU's prudential rules and that the UK must have at least equivalence with EU rules if it wants to retain access to the single market. In short, the UK must agree a trade deal and the bonus cap is likely to be a pre-condition of any such deal.

The bonus cap is not an isolated issue. There is further reform due in the City in the shape of the European Banking Association's (EBA) guidelines on sound remuneration policies and it appears this will still come into effect as expected in January 2017. If it does not, the City risks stoking further discord with Brussels at a sensitive time. There is also the force of public opinion. Much of the post credit crunch legislation arose from a need to be seen to be doing something to curb the perceived excesses of the banks. It would be a significant divergence if the UK were to back-track. The bonus cap has been an important part of being seen to prioritise financial stability and consumer protection.

But there is an argument that the UK regulations are strong enough to underpin stability and protect consumers without the need for the cap. "Equivalent" does not mean identical and, by definition, must allow for difference.

Despite common perception, most legislation on financial organisations in the City has not been at the insistence of the EU, but rather adopted as a matter of choice by UK regulators. The UK rules on bonus payment deferment are more punitive than in the EU, with the UK insisting on seven years to the EU's three to five years. There is also no EU requirement for clawback. The UK may be able to argue that these provisions are enough in themselves.

To some extent the PRA and FCA set out their stall in this regard pre-Brexit. In their statement of 29 February, 2016, they stated that when the EBA's guidelines come into effect, although they would retain their current approach of requiring smaller firms to determine an appropriate ratio between fixed and variable remuneration for their business, such smaller firms would continue not to be required to apply the bonus cap. This is contrary to the EBA's guidelines that are clear that it expects all remuneration requirements to apply to all firms subject to the CRD IV Directive (that is, credit institutions and investment firms) and not just the largest institutions as dictated by the PRA and FCA. Banking laws are currently under regulatory review in the US but there are no plans to introduce any bonus cap. In his speech on 1 July, 2016, John Griffith-Jones, FCA chairman, suggested that it was global, as opposed to European, international regulatory convergence that may define the post-Brexit era.

> UK regulators saw the bonus cap as an attack on the City

Before the vote, HSBC said that Brexit could see 20 per cent of its 5,000 London investment bankers moved out of London to Paris. Goldman Sachs also issued warnings that it would be likely to move some staff out of the City if the UK voted to quit. Since the vote, both banks have reiterated their commitment to the UK and said they would not make any immediate staffing changes.

In the midst of all this uncertainty, the FCA issued a statement on the referendum result stating: "Much financial regulation currently applicable in the UK derives from EU legislation. This regulation will remain applicable until any changes are made, which will be a matter for government and parliament." So, on all fronts it appears that everything will be the same until it is different. It was ever thus.

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