Revising the Remuneration Code

Introduction

The FSA issued a consultation paper (CP10/9) in July 2010 proposing changes to the Remuneration Code. The current code is at SYSC 19 and was implemented in January 2010. It currently impacts primarily only on the largest banks and building societies.

As a result of the impending revision of the Capital Requirements Directive ('CRD 3'), and also to implement aspects of the Financial Services Act 2010, the FSA have proposed amendments to the Code. The amendments also reflect proposals arising from the Walker review on Corporate Governance,

One key aspect of the proposals is that the Code will now include all investment managers in scope. It will also act as guidance to non-scope firms e.g. advisers and arrangers and may be extended to include these types of firms formally in due course.

The Code is due to be implemented by 1 January 2011. Newly impacted firms need to ensure that they take reasonable steps to comply from that date and in any case must comply by 1 July 2011 at the latest.

The consultation paper closes on 8 October and a policy statement with final rules is due in mid November. However the EU is still debating the changes to the CRD and so the current proposals may be subject to change. Given the implementation date of 1 January 2011, this does not leave firms with much time to prepare. The Code may also be impacted in the future by similar provisions in the Solvency II Directive and the Alternative Investment Fund Managers Directive.

Summary of Proposals

The FSA consider that firms need to align remuneration policies with effective risk management. They have some discretion on how the changes can be implemented and are likely to allow firms to consider arrangements on a 'proportionate' basis.

The new Code at SYSC 19 will contain a number of updated Principles that all firms must comply with as a minimum. There will be additional Principles or requirements that certain firms must additionally comply with depending upon the nature of their business and organisation.

In addition to the increased scope for firms, there are also new proposals on the definition of "Code Staff' (see below).

The FSA will have the power to make arrangements void which they consider breach the provisions of the Code and/or new Financial Services Act. They will also have the power to recover such payments.

Code Staff

The definition of Code Staff will include:

- personnel who perform a significant influence role
- senior managers, including those in non-controlled function roles
- all staff whose remuneration takes them into the same brackets as above
- heads of significant business units

Firms are required to identify Code Staff and document them, and ensure that any such staff are aware they are Code Staff and what this means in practice. This should also include any secondees in the above roles. Firms will be required to confirm annually via Gabriel that all Code Staff have been identified. This list should be maintained and reviewed regularly, and may be requested by the FSA should it wish to review (and challenge) the list.

General Requirement

The general principle is that arrangements must be consistent with and promote effective risk management. The policies and procedures should promote equality and diversity and any policies and procedures should be clear and documented.

Code Principles

A summary of the principles is shown at the end of this Briefing Note. In accordance with Annex 5 Table 1 of the Consultation paper, all firms as a minimum must comply with the General Requirement, Code Staff and Principles 1, 2, 3, 4, 6, 8, 11 and 12.

Specifically at Principle 12, this details the elements that firm's must consider when reviewing their remuneration structure and arrangements. This includes:

- bonuses to be based principally on profits
- deferral of 40% (and in some cases 60%) for up to 3 years of bonus amounts
- an appropriate balance between fixed and variable remuneration
- payment of a proportion of variable remuneration in such instruments as shares
- restrictions on severance pay
- the ability to clawback deferred bonuses subject to performance

A de minimis provision will apply.

Ongoing Requirements

All inscope firms will be required to carry out a self assessment of their arrangements in relation to remuneration due after 1 January 2011 against the Code. A review of a firm's remuneration arrangements will also form part of a firm's normal FSA supervision process during an ARROW visit.

‘Higher impact’ firms which are subject to greater and more intrusive supervision will be required to consider the additional Principles and in some cases, consider a ‘comply or explain’ approach. This is also detailed in Annex 5 of the Consultation paper. They will also be required to submit their Remuneration Policy Statement annually to the FSA for review and may be required to carry out capital exercises to see the impact of their policy.

Next steps

There is still a great deal of uncertainty on the final requirements due to the ongoing debate by the EU on the CRD. In addition, future regulatory developments may impact on the current code although the FSA have aimed to take these developments into account in the current proposals.

The current proposals are largely silent on any specific impact on partnerships including LLP’s where remuneration will only be taken from profits. There may also be practical issues for LLP’s regarding taxation and any deferred remuneration.

As a first step, firms should identify whether they will be within scope of the new Code. If so, they should review their staff to identify who will be ‘Code Staff’, document this review formally and inform staff. Firms should then consider existing remuneration arrangements (for post 1 January 2011) for these staff in line with the Code and Principles and identify any changes that need to be made. This includes identifying whether any of the additional or ‘comply or explain’ requirements apply.

The link below refers to the current consultation paper:

http://www.fsa.gov.uk/pubs/cp/cp10_19.pdf

This briefing note is intended as a summary only and is not full or firm specific advice. For further information and assistance on how your firm should comply, please contact Gillian Gallacher.

Gem Briefing Note

September 2010

GEM Compliance Consulting

Remuneration Code (SYSC 19) – 1 January 2011
Summary of FSA Principles for a Firm's Remuneration Policy

1. The firm's policy must not encourage risk taking that exceeds the firm's tolerated level of risk.

2. The policy should be in line with its business strategy, objectives, values and the longer term interests of the firm.

3. The policy should include measures to avoid conflicts of interest.

4. The governing body should maintain and review the policy. Where there is a Remuneration Committee, this should exercise independent judgement and have the appropriate skills and expertise. Its judgement should be consistent and it should approve/review the firm's policy. It should be responsible for decisions on the policy and carry out an annual review. Larger firms **must** establish a remuneration committee and the chair and members should be non-executives.

5. Controls function staff should be independent from the business unit they oversee. Remuneration for staff in such control functions e.g. Risk and Compliance should be determined independently based on achieving that objective. The Risk function should also have input into the firm's Remuneration Policy.

6. A firm must ensure that its total variable remuneration does not limit its ability to strengthen its capital base

7. Principles for firms that benefit from exceptional government intervention.

8. The firm must take into account current and future risks when considering remuneration.

9. The firm must ensure that any enhanced discretionary pension benefits comply with these Principles.

10. Firms should ensure staff comply with principles on personal investment strategies and that Code Staff do not take measures to avoid the impact of these arrangements by transfer of downside risk i.e. by insurance or hedging against reduced variable remuneration.

11. Firm's should avoid remuneration structures which are intended to act as avoidance of the Code.

12. Remuneration structures should have an appropriate balance between variable and fixed pay, and should reflect the performance of the individual.

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