

ASSET MANAGEMENT AND INVESTORS COUNCIL

Lindsey Dawkes
Remuneration Team
Financial Services Authority
25 The North Colonnade
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London E14 5HS

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Sent by email

Dear Ms Dawkes,

FSA Consultation Paper – CP 10/19 – Revising the Remuneration Code

The ICMA Asset Management and Investors Council (AMIC) was established in March 2008 to represent the buy-side members of the ICMA membership. ICMA is one of the few trade associations with a European focus having both buy-side and sell-side representation.

Taking into consideration the changes that have occurred in the industry, the AMIC composition embraces the diversification and the current dynamics of the industry – taking the asset management representation to a broader and global level. The AMIC is concerned by issues affecting investors-led organisations rather than issues related to fund distribution.

The AMIC welcomes the opportunity to respond to the FSA Consultation Paper on Revising the Remuneration Code. The AMIC has been very interested and engaged in the issue of the industry remuneration system. In particular the AMIC has argued on different occasions that asset managers are not banks and should not be subject to rules originally designed for the banking sector. The CRD III provides that investment firms and credit institutions could apply the measures in “*different ways according to their size, internal organisation and the nature, scope and complexity of their organisation*”. And in fact, the directive adds that it may not be “*proportionate*” for certain types of investment companies to “*comply with all the principles*”.

In the UK application of the CRD III provisions related to remuneration, two specific aspects of the proposals are of significant importance: (a) the proportionate application of the remuneration provisions; and (b) the super-equivalence being introduced by the FSA. The AMIC will provide general comments on these two aspects. AMIC members broadly agree with the IMA conclusions presented in their response to this consultation.

GENERAL REMARKS

The AMIC understands that the scope of this consultation paper reflects the changes in the CRD III, and the wider scope of the Directive. However it is worth noting that global standards, as set by the G20 roadmap and the FSB Principles for Sound Compensation Practices, did not have investment management firms in focus, but were seeking to address systemic risks related to significant financial institutions activities. Therefore different risk profiles and impacts on markets that fiduciary agents have compared to principals need to be adequately reflected in the national implementation of remuneration provisions. The investment management industry is not at the heart of the financial crisis and the regulatory changes related to remuneration provisions are a spillover effect from banking.

In the context of remuneration policies, taking a broad approach to financial services can prove problematic. The industry represented by the AMIC has a fiduciary duty towards its clients. The investment management industry should therefore be differentiated from the banking industry. Asset managers are responsible for their clients' assets and have a fiduciary duty as agents. Whilst banks are able to put their own capital at risk, asset managers act as agents on behalf of their clients rather than principals. The way asset managers are compensated therefore is aligned with clients' interests and their longer-term time-horizons: asset management is a multi-year business rather than a transactional business and remuneration arrangements already reflect this, with variable pay being based on a multi-year performance rather than a one-year record of transaction-driven profits. As a result, the time period on which an asset manager's performance is based is more likely to be of 2 - 3 years.

The aim for asset managers is to achieve repeat business and this is done by achieving good performance over longer time. The AMIC therefore calls for proportionate approach to remuneration policies targeted at asset managers to ensure adequate flexibility. Many asset managers' response to recent market events has entailed variable pay that varied downward, in some cases quite sharply, to protect core staff resources over the years of lower revenues: this ensured that the long-term structure of asset managers (necessary to align asset managers with clients' long term performance requirements) was not put at risk by short-term revenue dips. Remuneration policies are therefore consistent with the promotion of sound risk management and do not encourage risk-taking that exceeds the level of tolerated risk of a firm, and in line with the business strategy, objectives and long-term interest of that firm.

Proportionality

The FSB Principles for Sound Compensation Practices that were released in April 2009

were intended to apply to significant financial institutions, and were especially critical for large, systemically important firms. They should not therefore be applied to all firms. The Capital Requirements Directive applies to a much broader range of firms than just those which are large or systemically important and do not fully capture the multitude of different ways in which financial institutions are structured or organised. However the text of the amended CRD III did provide for a flexible application of the remuneration policies for investment firms. The AMIC agrees that a proportionate national application of the CRD III provisions on remuneration policies should recognise the specific characteristics of the investment industry.

Remuneration structure of an asset manager does not result in the same risks to the financial system as that of a trading entity. Whilst accepting the general principle of promoting effective risk management, the AMIC believes investment managers, because of their existing remuneration structures, should comply or explain with specific rules, and should not be subject to many of the detailed requirements that were drafted for institutions with a different risk-taking profile.

Remuneration and risk management

As mentioned previously, asset management firms do not trade on their balance sheets. Remuneration is not therefore linked to such risk taking behaviour. Client assets are held in segregated accounts and not placed at risk by virtue of the actions of the firm's senior management. The risks taken by a portfolio manager with a client's assets are in line with the stated investment objectives of the fund. The firm will monitor the portfolio to ensure that the risks within it are consistent with the stated investment objectives. This provides effective risk management controls which amendments to remuneration structures are unlikely to enhance.

Remuneration and performance

Some of the points made by the IMA are highlighted below.

The reference point against which variable remuneration is assessed is a much more certain figure with asset managers than with trading entities such as investment banks. Where bonuses that are paid by an asset manager are based upon performance, this will invariably reflect real value captured for the clients and not as with some business models merely turnover or the totality of sales where the ultimate profitability is yet to be ascertained.

Remuneration cannot be addressed in isolation to overall risk management. A particular facet of this principle is that the imposition of the qualitative references at face value would produce perverse impacts due to the likely response of increasing the fixed component of salaries. These impacts include:

- an increase in regulatory capital at a marginal rate of at least 25% of the increase, not least as the CRD's capital requirements are essentially the fixed overheads requirement of an asset manager. This will increase the costs to investors;

- a reduction in management tools as employees will be provided with a downside stop-loss option (since fixed is the same as guaranteed in this regard); and
- a greater risk that employees might see their deferred bonus pools as less critical and if these are invested in own managed funds then this misaligns their incentives with their clients' interests.

The AMIC agrees with the CRD III intention of promoting effective risk management. However Council members believe that the more detailed obligations, such as remuneration, are supposed to be aimed at those firms which have the greatest impact on the financial system. The investment management industry has embedded in remuneration structures such risk management considerations.

For example, one of our members' appraisal system is based on a base salary that typically reflects the scope, responsibilities and experience required in a particular role, be it on the investment side or any other function in the company, and a bonus compensation. Base compensation is regularly reviewed against peers with the help compensation survey data as well as special competitor analysis.

Bonus compensation is designed to primarily reflect the achievements of an individual against set goals and over a certain time period. For an investment professional these goals will be typically 70% quantitative and 30% qualitative. The quantitative element reflects a three-year rolling-time period, calculated as one-year and three year results at 25% and 75% weighting. Performance is measured by external measurers. The qualitative component encompasses everything from marketing success to adherence to compliance guidelines. Company profits and appraisal result play a role.

Pay is composed of the base salary and a variable component, which consists of the cash element and Long-Term Incentive Plans (LTIP), which can range from 0% (graduate level) to 40% (MD level). The value LTIP is based on financial performance of the firm and the mother company and cliff vests after 3 years. This component allows strengthening further the alignment between clients, senior professionals, and the corporate of the firm.

Super-equivalence

The success of these remuneration principles will be dependent upon a consistent application. If applied consistently across boundaries, firms will be placed on a level playing field, with none able to apply remuneration policies which fail to promote effective risk management. Recital 4 of CRD III highlights the importance of implementation in a consistent manner, whereas the FSB implementation standards (September 2009) noted the commitment to ensure a level playing field, and stated that the standards 'must be rigorously and consistently implemented. This should assist in reducing risk within the overall financial system. Importantly, a consistent application will also ensure that firms are able to compete for staff. Any variance in approach could place that jurisdiction at a competitive disadvantage when its firms attempt to recruit and retain staff. We consider therefore that a consistent application by the FSA of the requirements with the other European and international jurisdictions to be one of the key outcomes of this consultation process. Additional requirements proposed by the FSA

will further place UK asset managers at a competitive disadvantage, highlighting the imperative nature of both a proportionate approach and the absence of any super-equivalent

The Committee of European Banking Supervisors (CEBS) has been tasked with issuing interpretative guidance (including on the proportionate application), with a formal consultation paper planned for later this year. Final guidance is not therefore likely to be available until early 2011. The AMIC is looking forward to reading the proposals made by CEBS.

Moreover additional remuneration proposals arising within both the Alternative Investment Fund Managers Directive and UCITS IV are also to take into account. Remuneration policies are very fragmented, and other provisions are scattered in the aforementioned Directives which are not yet agreed upon at European level. To date there is no coherent approach on how policies will affect the investment management industry. The original requirements stem from the Financial Stability Board principles and should dictate how much proportionality is permitted. The investment management industry is expecting harmonisation and coherence as well as clarity as regards European and national remuneration provisions, to ensure competitiveness of the industry on a global basis.

The AMIC would be happy to discuss further with you the points made in this letter. The Secretary of the AMIC, Nathalie Aubry-Stacey, can be reached at Nathalie.aubry-stacey@icmagroup.org should you need further information.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Robert Parker', with a horizontal line underneath the name.

Robert Parker
AMIC Chairman

Cc: Dan Waters (FSA), Michael Collins (FSA), Ivo Jarofke (CEBS)