Please note that the comments expressed herein are solely my personal views

CEBS Secretariat
Tower 42 (level 18)
25 Old Broad Street
London EC2N 1HQ
United Kingdom

Chris Barnard
Germany

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Your Ref: Comment letter on Consultation Paper CP 42
Guidelines on Remuneration Policies and Practices

Dear Sir.

Thank you for giving us the opportunity to comment on your consultation paper on Guidelines on Remuneration Policies and Practices. I will first make some general comments, and then discuss some more detailed points.

Transparency, communication and governance

It is absolutely necessary that institutions have clear and transparent remuneration policies. These should be communicated and disclosed to all stakeholders, including investors and shareholders, regulators and internally within the institutions. It is also necessary to have strong, independent governance structures and processes to ensure that the institutions' remuneration policies are appropriate and are being followed. Some arguments in favour and against these principles are as follows:

In favour

- Oversight of remuneration practices in institutions has been sorely lacking. It is appropriate that more regulatory oversight be brought to bear here.
- We hold executive management accountable for the performance of institutions, but not for the proper functioning and control of remuneration policies and practices.

Against

- To make rules on remuneration, which are required in institutions anyway, it to take the view implicitly that regulators have more expertise in managing institutions than the institutions' management themselves do. One also mistakenly assumes that institutions will adopt sound remuneration policies and practices only if required to do so by regulators.

- The very existence of such rules will increase the frequency of regulatory action against institutions, which implies that existing supervisory management and shareholders are incapable, or unwilling, to supervise institutions themselves. This itself undermines the integrity and confidence in supervisory management and shareholder actions.

I strongly support the principles. Importantly, it does not matter whether an institution is already complying with such principles; it is more critical that they are seen to be complying. I do not believe that this would be an onerous procedure, or be costly to implement. Either institutions are already implementing the principles – which is good, or they are not – in which case they should.

Risk adjustments

It is clearly appropriate that variable remuneration should take account of the risks being taken on by personnel. If personnel meet performance targets by taking on excess risk, then this endangers the institution, and effectively rewards luck, which is unacceptable. I would recommend that the risk adjustment to variable remuneration should be done through a cost of capital type adjustment, for example by linking performance to a risk adjusted measure such as economic value added or RORAC.

Deferral of variable remuneration

Variable remuneration should be paid out in instalments over a minimum period of 5 years after award. The important remuneration principle to uphold here is that personnel receive a salary for doing their job, and should only receive bonuses for outperformance, and one can only reasonably measure outperformance over a medium-term period. It is also important that personnel who have outperformed actually receive their bonuses, i.e. that bonuses represent earnings, and the deferral of payment is exactly that.

Unintended consequences

Unfortunately the proposed remuneration policies and practices will probably lead to a greater weighting towards fixed components of remuneration, i.e. salary, and a consequent reduction in variable components. This may have the adverse effect of making the remuneration system more rigid, and even less flexible than before.

More comments on the consultation paper CP 42

Para 1. I disagree that "excessive" remuneration was the problem, rather "inappropriate remuneration structures". If excessive remuneration is really the problem, then CP 42 will do nothing to prevent future problems, as it does not deal with amounts, rather than with forms of remuneration.

Para 8. There would only be a level playing field amongst EEA regulated institutions, not with all global institutions.

Para 11. I agree that all forms of remuneration should be covered by CP 42.

1.2. Proportionality. I agree with the proportionality principle. The consequence of this is also that institutions such as investment managers, platform providers and agency brokers will look to take a proportionate approach to compliance.

Para 33. The management body, in its supervisory function, should also be held personally accountable for breaches of remuneration requirements.

1.4.2. Capital base. I'm not sure that I understand the purpose of this section. The aim is to ensure a sound capital base is maintained / not eroded by variable remuneration practices. However, institutions have to comply with minimum capital standards, and usually seek target capital ratios well in excess of these for ratings, marketing and other reasons. No institution would threaten capital ratios, at least not minimum ratios, by paying out bonuses to staff, as this would trigger supervisory and legal interventions anyway. Also, what do you mean by "sound" capital base? If an institution has an (excessive) capital ratio of 400% of minimum capital, and this reduces to 300% because of variable remuneration payments, is the institution "unsound"? Most would argue that such an institution is far stronger than one which pays out minimal variable remuneration, but maintains a steady capital ratio of 120% of minimum capital. I find the rationale and practicability of this whole section unconvincing.

1.4.3. State support and remuneration. This is clearly appropriate.

3. General requirements on risk alignment. I agree with this in principle.

Para 69. Guaranteed variable remuneration is a contradiction in terms. This should be prohibited, with punitive fines for misuse.

Para 70. Severance pay should be limited to redundancy and payment for the duration of a notice period.

4. Specific requirements on risk alignment. I would be interested to see how this develops in the future. In principle, the amount of variable remuneration should be linked to a risk adjusted measure of performance, such as economic value added, and suitably deferred, i.e. paid out over a minimum period of 5 years. This should apply regardless of the form of the variable remuneration. Such variable remuneration should not have a floor, i.e. it could be zero.

Para 89. I agree. For all staff, part of any variable remuneration should be linked to the performance of the institution.

5. Disclosure. I fully agree here.

Yours faithfully

C-R-B.

Chris Barnard