Consultation Paper on Guidelines on Remuneration Policies and Practices (CP42)

Introduction

The Association of British Insurers ('ABI') is the voice of the UK's insurance, investment and long-term savings industry. It has over 300 members, which together account for around 90% of premiums in the UK domestic market.

The UK insurance industry is the third largest in the world and the largest in Europe, helping individuals and businesses protect themselves against the everyday risks they face. It pays out over £230 million per day in pension and life insurance benefits and over £50 million per day in general insurance claims. The industry is also an important institutional investor, it manages investments of £1.5 trillion, over 20% of the UK's total net worth, and is the single largest investor group in Europe.

Response

We welcome the opportunity to respond to this important consultation. Our response is divided into general comments on the guidelines, and further comments on two of the main pillars of the guidance.

General Comments

The ABI and its members agree with the fundamental principle that remuneration policies and practices should be consistent with and promote sound and effective risk management. However, we consider that this principle must be applied in a proportionate, credible, effective and fair manner (as recognised in 1.2.1).

Proportionality is of particular importance where there is not the same level of systemic risk and/or the interests of clients are protected by other regulation, such as Conduct of Business. The Investment Management industry is a good example of this, and we would urge CEBS to carefully consider how the principles are applied in such cases. We would also urge CEBS to consider how more of the provisions could be applied with proportionality or even neutralised.

Although, we understand the motivation around applying the principles on a Group-wide basis, we have considerable concerns that the extra-territorial nature of the guidance will undermine the competitiveness of European businesses operating outside the EEA. The guidance goes well beyond what is being implemented in other jurisdictions, and as a consequence European

institutions will be at a severe disadvantage when operating in such places. We therefore believe that consideration should be given to how the requirements could be applied proportionally or even neutralised in some cases. This may include taking into account or harmonising requirements for local staff with local regulation.

We consider that the proposed implementation date of the 1st January 2011, combined with the retrospective nature of requirements, does not provide institutions with adequate time to implement the proposals. A hasty implementation timetable risks the guidance being inappropriately applied by both companies and supervisors, and could have serious adverse consequences.

We continue to believe that the guidance (and the CRD3 requirements) are primarily designed for proprietary trading activity. There has not been adequate recognition of the different activities undertaken within financial services or within individual institutions. Given this, we do not consider that this guidance should be seen as best practice or a blue-print for further remuneration regulation in other areas of financial services, for example insurance. There needs to be recognition that the level and nature of systemic risk is varied, that business models are very different across the sectors, and that existing remuneration practices are not the same in every segment of financial services.

We consider that there is an underlying belief that quantum naturally equals risk, or excessive risk taking. We do not agree with this and would point to the case of Jerome Kevial, whose remuneration was well under the level considered to be highly remunerated, as an example of this. We believe therefore that when considering how to apply the overarching principle, the primary consideration should be the nature of the activity generating the reward, rather than the size of the remuneration accrued.

The guidance states that variable remuneration awards should not adversely affect the capital adequacy of the institution. We agree that this is a sound principle. However, we note that the effect of regulatory intrusion into variable pay has been a substantial increase in base salary. The substantial rise in these fixed costs also may affect the capital base of the company and of course cannot be lowered in the case of poor business performance. We would further note that in section 3.2.2. the guidance states that "Golden Parachutes' arrangements for staff members who are leaving the institution and which generate large payouts without any performance and risk adjustments are prudentially unsound', the guidance continues with "such arrangement create a 'heads I win, tails I still win' approach to risk'. We would agree that "Golden Parachutes" are not acceptable, but would point out that the substantial rise in fixed remuneration has created the ultimate case of "heads I win, tails I still win" in both cases of continuing employment and severance.

We welcome the recognition of the problems that partnerships may pose in terms of what element of the value accruing to partners should be covered by the requirements. We consider that, given the wide variety of partnership structures that exist and their different liability arrangements, the best way to approach this is by not considering legal structure to be a defining characteristic, but to firstly consider the business activity and level of systemic risk posed.

Governance

We agree that the requirement for a Remuneration Committee should be applied in a proportionate manner, dependent institutions. However, we have concerns regarding the guidance on the composition of committees. We are unsure of what the nature and background of a person would be who would have 'sufficient expertise and professional experience concerning risk management and control activities, namely with regard to the mechanism for aligning the remuneration structures to institutions' risk and capital profiles.' This we believe is overly prescriptive and that many companies would struggle to recruit such candidates with so restricted a background. We consider that the committee members should be competent and have sound judgement, as should be expected of any director, and that they should be able to draw on independent advice either externally or internally as they see fit. This competence should be assured through the normal fit and proper tests ('FSA's approved persons regime' in the UK context) rather than through some additional requirement.

Risk Alignment

As noted earlier, we agree with the fundamental principle of the guidance on risk alignment, but we have some concerns with how it will work in practice.

Remuneration should be aligned with sound risk management that is in the interests of the regulatory and ultimately public good. However, we also believe that the remuneration structures must also be aligned with the interests' of investors who provide the capital that allows the institution to trade and ultimately provide socially useful function such as lending money for investment that creates jobs `and wealth. This requires that institutions engage in a degree of reasonable risk taking, in accordance with the strategy and risk appetite agreed by the board, in order to generate a return to shareholders. Without risk there is ultimately no reward. We note that the guidance recognises the value of variable remuneration in section 4.1.2, but we consider that there needs to be a greater appreciation of interests of investors and that this should be taken into account when applying the guidance.

In relation to section 4.3.2 on ex ante risk adjustment and 4.2.1 on the risk alignment, we are unclear how this should work in cases where there is no

on-going risk to capital and/or tail risk. We consider that in sectors such as investment management these requirements are not always necessary and therefore should be capable of being neutralised or at least applied in a proportionate manner.

In relation to 4.4.1 on Non-deferred and deferred remuneration, we have concerns that the inclusion of vesting schedules of 3-5 years minimal and proportions deferred of between 40 and 60 per cent, will result in a competitive race to the bottom approach rather than one aligned with the strategy and risks of the business. Our experience as institutional investors has shown that in the case of executive remuneration this has been the case. We therefore consider that the guidance should set out principles, and individual institutions should be required to demonstrate how they implement these in line with their business model and risk profile. The role of the supervisors is then to test these structures for adherence to the principles. This will ultimately in our view lead to a better outcome than the prescriptive one-size fits all model currently envisaged.