COMMITTEE OF EUROPEAN BANKING SUPERVISORS

CONSULTATION PAPER ON GUIDELINES ON REMUNERATION POLICIES AND PRACTICES (CP42)

RESPONSE BY THE ASSOCIATION OF PRIVATE CLIENT INVESTMENT MANAGERS AND STOCKBROKERS (APCIMS)

The Association of Private Client Investment Managers and Stockbrokers (APCIMS) represents firms acting on behalf of investors[1] in the retail sector. The majority of our members are common platform retail sector firms, subject to both the MIFID and the CRD. Their core business is the provision of investment advice, discretionary and non-discretionary private wealth management, and trade execution services in relation to a range of financial instruments, including stocks, shares and bonds, to their clients who are mainly individuals, families, trusts and charities. They operate on more than 500 sites in the UK, Ireland, Isle of Man and Channel Islands, employing over 30,000 staff. Around £400 billion of the wealth of these territories is under their management.

Our members do not work on the basis of commission for the sale of specific products but are remunerated by fees from clients for the services they offer. And most APCIMS firms do not manufacture financial or similar products. They are therefore not committed to marketing and selling a particular brand to clients. This ensures that they are not subject to the conflicts of interest that arise from such activity and that they can act independently when considering how client needs can best be met from the financial market place.

We welcome CP 42 and do hope that FSA takes it into account when drafting UK regulations. We support the approach outlined in CP 42 and prefer it to the approach proposed in FSA's most recent consultation. Our response to FSA CP10/19 is attached and provides background for the comments we provide in this letter. CP 42 goes some way towards clarifying some of the areas that APCIMS is concerned about in relation to remuneration regulation, particularly the proposed application of proportionality. We are supportive of APCIMS' firms having the opportunity to apply meaningful, risk based remuneration structures and practices instead of being required to work with regulatory solutions aimed at the banking sector.

We fear that a knee jerk reaction to the banking crisis may undermine the good work that firms in our sector have already undertaken on remuneration. Given the extremely short timeframes allowed for the development of regulation in this area, we are concerned that national regulators will be un able to take a measured and fully thought out approach to proportionality and this constitutes a major risk for APCIMS' firms which will be put to considerable competitive disadvantage if they are required to implement remuneration requirements drafted primarily with credit institutions in mind.

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[1] APCIMS has around 180 members, of which about 114 are private client investment managers and stockbrokers and the rest are associate members providing relevant services to them.

Specific comments on CEBS CP42

We agree with the analysis in Recital 1 (CRD III): "*Excessive and imprudent risk-taking in the banking sector has led to the failure of individual financial institutions and systemic problems in Member States and globally. While the causes of such risk-taking are many and complex, there is agreement by among supervisors and regulatory bodies, including the G20 and the Committee of European Banking Supervisors (CEBS), that the inappropriate remuneration structures of some financial institutions have been a contributory factor.*"

We would like to highlight that our industry has shown no signs of excessive and imprudent risk taking, even in the aftermath of the financial crisis. APCIMS firms' remuneration structures have not contributed to either individual market failures or to wider systemic problems.

We agree that *Directive 2006/48/EC requires competent authorities to review those arrangements, strategies, processes and mechanisms, and to determine whether the own funds held by the credit institution or investment firm concerned ensure a sound management and coverage of the risks to which the institution or firm is or might be exposed.* We believe that FSA must implement this requirement in terms of proportionality. We do not support a prescriptive approach to the regulation and supervision of remuneration in our sector as it will not take into account the nature, scale and complexity of our firms' business models.

We welcome the fact that for every remuneration principle guidance is provided for both firms and supervisors about how a proportionate approach might best be achieved. We are fully supportive of firms and supervisors implementing this proportionality wherever possible, in line with the CRD III requirements.

We support Paragraph 9, and in particular the conclusion that "*Supervisors should apply risk-based supervision; resources of supervisors should be directed primarily to those institutions that pose most risks.*" Given that FSA has not to date identified any remuneration risks in the APCIMS' sector we take the view that it must concentrate on regulating and supervising those firms whose remuneration risks are such as to pose a potential threat to financial stability.

Recital (3) CRD III We note that "control function" is different from the UK concept of "controlled function", in the context of an FSA authorised and regulated individual "approved person", a category that (in UK regulation) includes customer-facing staff as well as management and central functions. We are concerned about the statement "at least senior management" as we believe it is unclear, misleading and would encourage problems with implementation.

In 1.1.1 "*Both components of remuneration (fixed and variable) may include monetary payments or benefits (such as cash, shares, options, cancellation of loans to staff members at dismissal, pension contributions) or non (directly) monetary benefits (such as health insurance, discounts, fringe benefits or special allowances for car, mobile phone, etc.).*" We are keen to know whether trade associations like APCIMS will be able to guidance on this issue with a view to helping their members to this effect and determine which remuneration components should be included in the assessments particularly as regards deciding which staff have a "material" impact on a firm's risk profile.

In line with the proportional approach to interpretation and implementation of this guidance, we agree with the guidance in 1.1.3 paragraph 15 stating that "*It is primarily the responsibility of institutions to identify the members of staff whose professional activities have a material impact on the institution's risk profile*

according to these guidelines and any other guidance or criteria provided by supervisors. Institutions must be able to demonstrate to supervisors how they have assessed and selected Identified Staff." We take the view that FSA must adopt this approach when regulating firms.

In relation to Paragraph 16, we are keen for APCIMS to know whether the "*Executive members of the credit institution or investment firms' corporate bodies, depending on the local legal structure of the institution"* would include executive members of Limited Liability Partnership (LLP) firms?

We also welcome the following statements

- "*when assessing the materiality of influence on an institution's risk profile, institutions must define what constitutes materiality within the context of their institution."*
- *"Consequently, an analysis of job functions and responsibilities at the institution should be undertaken for a proper assessment of those roles that could materially affect the institution's risk profile".*

In Paragraph 16 where CEBS refers to 'other risk takers' we are nervous about their use of the term 'collectively' in 'such as staff members, whose professional activities – either individually or collectively can exert influence on the institution's risk profile'. Taken to the extreme, our UK FSA CF30s collectively could impact some APCIMS' firms' risk profiles, for example if they all collectively start mis selling to clients. We understand why CEBS wants to have 'collectively' here, i.e. so that risk-taking desks are caught as well as risk-taking individuals, but we don't want the FSA taking this too far and saying that collectively its CF30s are risk-takers, with the presumption that they must therefore be in scope.

Taking into account APCIMS' membership we are extremely supportive of Paragraph 17: "*Consideration must also be given to the position of individual sole traders and partnerships and, in certain cases, depending on the legal structure of the institution or entity, some of the remuneration requirements may not be applicable to staff at such ownerships or partnerships. Dividends that partners receive as owners of an institution are not covered by these guidelines (unless they represent a vehicle or method for circumvention, see paragraph 13); however, any imprudent extraction of capital out of the institution through pay outs of dividends would be covered by normal capital adequacy rules under Pillars 1 and 2.*"

And also welcome Recitals 4, 5 and 9 of the CRD III and point 24 of Annex V, Section 11 of CRD: "*The proportionality principle aims to consistently match the remuneration policies and practices with the individual risk profile, risk appetite and the strategy of the institution, so that the objectives of the principles are more effectively achieved*".

We welcome the fact that firms are able to "neutralize" elements of the CRD III requirements in the interests of proportionality (such as those detailed in Paragraph 20). We believe that APCIMS' firms should fall into this category of firms for the reasons we outline in both this response and the attached response to FSA CP10/19.Annex 1 to it. We consider it essential that regulators are required to take "*into account the overall financial market characteristics and the achievement of regulatory objectives.*" In this regard we would characterize the financial market that APCIMS firm operates within to be "low risk" in terms of its remuneration practices and arrangements. APCIMS' firms are not engaged in a high level of risk taking.

We support Paragraph 21 "*It is primarily the responsibility of the institution to assess its own characteristics and to develop and implement remuneration policies and practices which align appropriately the risks faced and provide*

adequate and effective incentives to its staff" and also Paragraph 22. APCIMS' firms should be required to implement remuneration policies and practices which are based on a meaningful assessment of their business activities and to report their conclusions where necessary to the regulator.

We welcome the fact that *"In line with the proportionality principle, small and less complex financial institutions may decide to outsource the entire review."* The only reservation we have with this is that in practice it is very costly for small firms to outsource such work.

In terms of proportionality we believe Paragraphs 24-25 to be very useful. On reading through their lists of things to consider regarding size, internal organisation etc, we conclude that APCIMS' firms can use this text to define themselves as low risk and thus largely exempted from the detailed requirements. We agree with these CESR lists, rather than any other lists produced by FSA, and feel that any gold plating must be strictly prohibited by national regulators in terms of proportionality.

In support of the principle of proportionality, the majority of APCIMS' members are small firms and would therefore not be adequately resourced to develop Remuneration Committees and to follow prescriptive guidance of the type outlined in 2.2 and 2.3.1.

We believe that in many APCIMS' firms, the remuneration structures are already organised so as to align the personal objectives of staff members with the long term interests of the firm. A good example of this being those firms that operate an equity bonus schemes.

We do not understand how in relation to 3.2.3 Paragraph 75 how firms or supervisors know if there was a breach (i.e. if an employee had taken out some personal insurance?).

We agree with Paragraph 79 to the effect that firms should set their own remuneration policies as regards the maximum ratios between fixed and variable remuneration and that this should not be a requirement or function of a regulator. Following on from this, we support Paragraph 81: *"81. Because situations vary enormously, it is not possible to decree one optimal relationship between the fixed and variable components of remuneration. To determine the actual institution specific ratio(s), the starting point is that a high ratio of variable to fixed components implies less discretion for the institution to make choices about how to comply with the other specific requirements on risk alignment. The reason is that a staff member with a high ratio of variable to fixed components tends to be incentivized to keep taking risks in order to maintain his level of income, whereas a staff member with a more balanced ration is less incentivized to do this. Institutions should be able to explain retained ratios of variable to fixed components through their remuneration policy. Institutions should also be able to explain how the ration will evolve when the institution is faced with a serious loss."* We also agree that is it for the regulator to "assess and challenge the rations" (Paragraph 84) but that for regulators to unilaterally fix such ratios would be disproportionate. We are concerned that for firms to achieve motivation based on its business model to ascertain how to react to and implement regulatory requirements. We are also extremely concerned about potential risks that may threaten a firm's relationship with its clients (and following this client retention issues). APCIMS firm are service providing firms and it is clearly in the interests of firms to maintain client satisfaction. APCIMS's firms may be at risk if its clients perceive them to behaving differently from its competitors.

We welcome the guidance provided in 4.2 regarding the risk alignment of variable remuneration, but believe that it should be a matter of discretionary for each firm to determine the methods it adopts so long as these are based on meaningful internal assessments. We believe this to be a sensible and

practicable approach given the fact that firms will be required to disclose this process to the regulator for supervisory purposes.

In response to Paragraph 97 we suspect that most APCIMS' firms are already in a position to evidence compliance with this, due to recent work carried out to comply with FSA's TCF requirements.

4.4.2. Cash vs. instruments ***Recital (7) CRD III*** *[...]To further align incentives, a substantial part of variable compensation of all staff members covered by those requirements should consist of shares, share-linked instruments , other equivalent non-cash instruments of the credit institution and, where appropriate, other long-dated financial instruments that adequately reflect the credit quality of this credit institution. Instruments could include a capital instrument, which in the circumstance of severe financial problems of the institutions is converted into equity, or otherwise written down. In cases where the credit institution concerned does not issue long- dated financial instruments, it shall be permitted to issue this substantial part of variable compensation in shares and share-linked instruments and other equivalent non-cash instruments. The Member States or their competent authorities may place restrictions on the types and designs of these instruments or ban certain instruments, as appropriate.* We request clarification that the design and type of long-dated financial instruments are incapable of being restricted by regulators? We are exceedingly concerned about APCIMS' unlisted firms being expected to issue shares or other financial instruments as remuneration as this is contrary to shareholder pre-emption rights. It is not logical or justified for APCIMS' members to "create" remuneration structures and arrangement as a result of being required to implement regulation, and this is nonsensical.

We support Paragraph 125 in particular: "*The institution should be able to explain how this minimum retention period relates to other risk alignment measures in its policies and should explain whether and how they differenciate between instruments paid upfront and deferred instruments, since deferred instruments carry already stronger risk adjustment possibilities. Supervisors will determine whether the retention periods proposed by the institution are deemed to be sufficient and appropriate.*"

We agree that complete neutralization ought to be applicable to those CRD requirements outlined in Paragraphs: f, o, q and v in the table in Annex 2.

Finally we are concerned about CEBS' continued use of the term 'variable' which seems to relate to everything but salary, but wish to clarification on the uses where CESB actually mean 'bonus'.

APCIMS is keen to engage with you in any future discussions and consultation on this matter and we hope that the end outcome is a proportional regulatory approach for APCIMS' firms. If you have any further questions or wish to discuss this further please do not hesitate to contact me.

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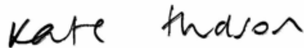
Yours Sincerely



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