

Financial Services and Markets

FSA consults on reforming remuneration practices in financial services

On 18 March 2009, the FSA published CP09/10 - its consultation paper on reforming firms' remuneration policies - together with a revised draft of the code of practice first published on 26 February 2009 (the "Code").

In February, the FSA clearly indicated that the draft Code would apply to all FSA regulated firms. However, recognising the practical difficulties of doing so, the regulator is now proposing to apply the Code itself only to a limited number of large banks, building societies and broker dealers (it estimates 45 firms in total). CP09/10 does, however, invite discussion on whether the Code should be extended to catch all firms. Furthermore, other high-level requirements relating to remuneration risk will apply to all firms with immediate effect and the FSA will be increasing its focus on inappropriate remuneration practices as part of its supervisory programmes (e.g. ARROW).

The Code

Although a number of changes have been made to the format of the Code, the key points in substance remain as summarised in our earlier alert of 27 February, which can be found here:

http://www.traverssmith.com/assets/pdf/Legal_Briefings/FSA%20publishes%20code%20of%20practice%20on%20remuneration%20policies.pdf

The FSA proposes to implement the Code by way of one high level rule, together with a number of evidential provisions and supporting guidance. The high level rule would require affected firms to establish, implement and maintain remuneration policies, procedures and practices that are consistent with and promote effective risk management. The FSA recognises that different firms will achieve this in a variety of ways, and has stated that it intends to apply the code in a proportionate and risk-based way.

Requirements applicable to all firms with immediate effect

While the immediate focus of the consultation is on the implementation of the Code by way of rules and evidential provisions against the biggest firms, all firms should be aware of the following:

- the FSA has encouraged all firms to benchmark their remuneration practices against the Code;
- FSA Principle 3 requires firms to take reasonable care to organise and control their affairs responsibly and effectively, with adequate risk management systems;
- the FSA has clearly stated that it intends to increase its focus on the risks posed by all firms' remuneration policies, including incorporation of remuneration risk into ARROW programmes and also into future ICAAPs and SREPs for firms subject to Pillar 2. The FSA does not need to consult before taking these steps and firms should therefore not delay in reassessing their remuneration practices in the light of the FSA's comments.

The next steps

Feedback on the consultation and final rules and provisions are expected to be published in late July. The FSA's intention is for them to have effect for those large firms within scope from November 2009, in time for their 2009 remuneration reviews (with some transitional relief to allow firms to bring certain existing contractual arrangements in line with the Code).

Since the FSA intends to take account of work currently being undertaken on remuneration practices by the Financial Stability Forum, the European Commission and the Committee of European Banking Supervisors, we may yet see further movement on the provisions of the Code.

CP09/10 is accessible online at: http://www.fsa.gov.uk/pubs/cp/cp09_10.pdf. The Code of practice is set out in Annex B of Appendix 1. Responses and feedback are invited by:

- 18 May 2009 on the proposals to implement the Code for large banks, building societies and broker dealers; and
- 18 June 2009 on whether the Code should be extended to apply to other FSA regulated firms.

If you would like further information or advice on this issue please contact Margaret Chamberlain, Jane Tuckley or Tim Lewis in the Financial Services and Markets Department.

Travers Smith LLP

24 March 2009

Travers Smith LLP
10 Snow Hill
London EC1A 2AL
T +44 (0)20 7295 3000
F +44 (0)20 7295 3500

www.traverssmith.com



Margaret Chamberlain
margaret.chamberlain@traverssmith.com
+44 (0)20 7295 3233



Jane Tuckley
jane.tuckley@traverssmith.com
+44 (0)20 7295 3238



Tim Lewis
tim.lewis@traverssmith.com
+44 (0)20 7295 3321