TRAVERS SMITH

Financial Services and Markets

Remuneration Code: FSA publishes final guidance and consults on proposed "Dear CEO" letters

The FSA has now published finalised guidance on the Remuneration Code in SYSC 19A. At the same time, it has launched a consultation on two proposed "Dear CEO" letters, one for firms in proportionality Tier 1 and the other for firms in proportionality Tiers 2, 3 and 4 – each of these includes some additional proposed guidance on selected issues. This briefing note is intended only to draw the attention of our clients to the new material. We know that many firms have been working with the consultation versions and will want to understand what changes have been made.

Finalised guidance

The finalised guidance is set out in a number of documents, which are collected together here.

Guidance specific to firms in proportionality Tier 2:

- A template to help firms complete a Remuneration Policy Statement.
- An Excel spreadsheet tool for keeping a record of all Remuneration Code Staff for a performance year.

Guidance specific to firms in proportionality Tiers 3 and 4:

- A template to help firms complete a Remuneration Policy Statement.
- An Excel spreadsheet tool for keeping a record of all Remuneration Code Staff for a performance year.

Generally applicable guidance:

- Remuneration: retention periods.
- Guaranteed Variable Remuneration.
- Remuneration Code FAQs - the finalised FAQs reflect the fact that the FSA has extended the transitional period for compliance with Remuneration Principle 12(f) (SYSC 19A.3.47R) until 1 July 2012 for those firms which are non-listed (and whose parent undertakings are all non-listed) to allow them more time in order to implement the requirement to pay a substantial portion (at least 50%) of variable remuneration in shares or other non-cash instruments.

We have prepared a table outlining the differences between the documents as consulted on and as finalised.

Consultation: Proposed "Dear CEO" letters – guidance on remuneration

In addition, the FSA has issued a guidance consultation on two proposed "Dear CEO" letters, together with, in the case of proportionality Tier 1 firms only, a draft RPS statement and Excel Remuneration Code Staff list (since these did not form part of the April 2011 consultation). The guidance consultation is open for four weeks and closes on **Friday 2 September 2011**:

For firms in proportionality tier 1:

- Draft "Dear CEO" letter - this includes detailed provisions regarding the basis upon which the FSA will conduct its annual review of a Tier 1 firm's remuneration arrangements for the 2011/2012 round. The process will involve the requirement to (i) submit a Remuneration Policy Statement questionnaire (see below), (ii) have a meeting with the FSA during the fourth quarter of the firm's financial year, (iii) provide final payout data for Remuneration Code staff no later than 5 working days before payout and (iv) provide information on firm-wide payout structures no later than two weeks before announcement of the awards.

- A template to help Tier 1 firms complete a Remuneration Policy Statement: - the FSA states in the draft "Dear CEO" letter that, although the template is not compulsory, it recommends that Tier 1 firms use it since it is "likely to reduce and if possible eliminate the need for us to request additional information". Tier 1 firms are warned that, if they have completed an RPS before, there are some "significant changes" since last year, so staff should study the new template well ahead of the time for completing and submitting it.

- An Excel spreadsheet tool for keeping a record of all Remuneration Code Staff for a performance year.

For firms in proportionality tiers 2, 3 and 4:

- Draft "Dear CEO" letter.

Draft guidance common to both "Dear CEO" letters:

Each of the draft "Dear CEO" letters includes an Annex containing additional (and identical) guidance on the following issues:

- *Defining Remuneration Code Staff* – as regards SYSC 19A.3.4R firms should first identify those staff comprising (i) senior management, (ii) risk takers and (iii) staff engaged in control functions. Then firms should prepare a list of employees whose remuneration places them in the same remuneration bracket as those in the above three categories; any employees in that list "whose professional activities have a material impact on the firm's risk profile" should be included as Remuneration Code staff.
- *Long Term Incentive Plans (LTIPs)* (relevant to firms in Tiers 1 and 2) – in a gloss on SYSC 19A.3.24(3) (which broadly provides that LTIPs may be included in the calculation of the deferred portion of variable remuneration only if upside incentives are adequately balanced by downside adjustments) the FSA proposes to include guidance to the effect that the following conditions would have to be satisfied before such plans could be included: (i) the scheme had been explicitly approved by the shareholders (or members if the firm is a mutual), (ii) awards made under the LTIP are subject to risk adjustment in accordance with Remuneration Principle 8 (i.e. SYSC 19A.3.22R to SYSC 19A.3.24G), (iii) the payout conditions allow the realistic possibility of a zero payout; and (iv) the LTIP agreement specifically provides for performance adjustment in accordance with Remuneration Principle 12(h) (i.e. SYSC 19A.3.51R and SYSC 19A.3.52E)
- *Structure of alternative instruments* (relevant to firms in Tiers 1 and 2) – as regards Remuneration Principle 12(f) the FSA proposes some additional interpretative guidance on using alternatives to shares to satisfy the "substantial portion (at least 50%) requirement" under SYSC 19A.3.47R:
    - *Share-linked instruments* – the FSA points to traditional phantom share schemes which track the share price of the company (or its parent), including those which pay out in cash only;
    - *Equivalent non-cash instruments for non-listed firms* – an equivalent non-cash instrument may be accepted if (i) its value reflects and tracks a full valuation by an independent third party on a periodic basis or (ii) its value reflects the value of the firm by reference to the firm's Return on Risk-weighted Assets, or a similar risk-based measure that may be verified by an independent third party – a related entity (including a group member) would not be considered to be independent for these purposes;
    - *Capital instruments* – the FSA is continuing to follow the Basel Committee's deliberations on contingent convertible instruments (CoCos) and whether these might adequately reflect the credit quality of a firm as a going concern.

The FSA suggests that firms "should engage with their advisers to devise schemes which comply with SYSC 19A.3.47R and are suitable to their internal structure". There is also a reminder that all firms in proportionality tiers 1 and 2 are required to comply with Remuneration Principle 12(f) (SYSC 19A.3.47R). Put another way, the guidance on LTIPs and alternative instruments is unlikely in practice to be relevant to the majority of firms within Tiers 3 and 4 which will seek to disapply the Remuneration Code rules on deferral and/or share-based payments on the grounds of proportionality.

For further information on these issues please contact one of the following partners in our Financial Services and Markets department or your usual contact at Travers Smith.

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

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

Phil Bartram
philip.bartram@traverssmith.com
+44 (0)20 7295 3437