Investment Management Association

ima

Secretariat of the Financial Stability Board (FSB)

c/o The Bank for International Settlements

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Financial Stability Board - Workshop on Compensation Practices

Dear Sirs,

The Investment Management Association (IMA) welcomes the opportunity to comment on the FSB's observations on remuneration practices.

The IMA is the trade body for the UK asset management industry, representing around EUR5 trillion of funds under management. Its member firms include managers of a wide range of asset classes for a wide range of clients, including institutional funds, authorised unit trusts and open ended investment companies.

Key messages

We support the efforts of the authorities, at all levels, to implement sound compensation and risk governance practices, and, under the auspices of the FSB, to align their approaches.

We support the aims of the authorities in ensuring that incentives do not put the viability of firms and the stability of the wider financial system at risk, the interests of employees are aligned with those of their employers and shareholders, and the interests of fund managers are aligned with those of their investors.

It is essential that a distinction be made between banks and non-bank financial institutions. The latter do not pose the same risks to financial stability as the former.

Asset management is an agency business in which the risks taken are ultimately those of the client given to the manager by mandate and publicly (or contractually) acknowledged by both parties.

This sets fund management apart from bank risk-taking which is proprietary, dictated by the profit motive rather than an investor mandate and not disclosed to outsiders.

NB banks run a mixed (liability driven) balance sheet business model. They are funded by investors and depositors, often retail. In the case of individual depositors, depositor protection comes into play.

The concern is not limited to differences between jurisdictions, but often to frameworks that apply in the same jurisdictions, vide banking and investment management rules in the European Union (1.3).

It's not just banks that will require a re-assessment of their rules during an economic upturn (1.4). The same applies to investment managers, especially as welfare states are scaled back during fiscal consolidation and individuals are encouraged to make their own arrangements for retirement.

Firms are still trying to find the optimal solution with regard to risk adjustment (2.1). The process is a mix of qualitative and quantitative, with perhaps more emphasis on the former. They would appreciate regulatory guidance and forbearance, and examples of good practice.

We support the multi-year assessment of performance, but caution that such measurement must be appropriate for the industry (2.1). What is appropriate for banks is not so for fund managers, especially in terms of years and discounting by employees.

The concern about material risk takers (MRTs) is not limited to differences between jurisdictions, but often to frameworks that apply in the same jurisdictions, vide banking and investment management rules in the European Union (2.3).

Conclusion

We look forward to engaging with the Board on its reforms of remuneration and risk management, and coming up with solutions that are targeted. In summary, we believe it is right that incentives are aligned, but we do not support the application of bank rules to fund managers as the activities and risk profiles of the sectors are different.

The annexe to our letter details the differences between investment managers and banks.

We hope that you will find our comments useful. Please contact us by way of e-mail (ihenry@investmentuk.org) or telephone on (00 44) (0) 20 7831 0898 should you require further information.

Yours faithfully,

Irving Henry

Prudential Specialist, Investment Management Association

Annex

Fundamental differences from banks – further details

(a) all assets held and managed by a limited licence firms are segregated and placed with an independent depositary or custodian. In the event of the failure of such a firm, these assets would remain segregated and held by the custodian. Consequently, the impact upon markets would be negligible as the volume of money circulating in the system would not change, and the impact upon consumers would simply equate to the administrative task of transferring the investment management mandate;

(b) costs are largely fixed (relating to staff and running costs) and as no deposits are accepted, there is immaterial maturity mismatch between balance sheet assets and liabilities. Liquidity management is thus a simplistic exercise with known requirements. There is consequently limited potential for a run on the firm, and even if one were to occur, the impact on markets and consumers would be insignificant as the assets managed would remain segregated;

(c) many limited licence firms are privately owned and not therefore publicly traded; those which are publicly owned are primarily funded by equity and retained earnings and have no reliance upon either retail or wholesale depositors. In the event of any concerns arising in relation to the firm, an investor could sell his equity stake but this would not generate a run on the firm in the same way as a withdrawal of deposits would for a bank. Similarly, if concerns promulgated into the funds managed by the firm, any redemptions of shares or units in a fund would equate only to a sale of transferable securities and would not therefore have an adverse impact upon markets or consumers; and

(d) operational risk is the principal risk to which a limited licence firm is exposed. With no dealing on own account permitted, market risk relating to trading book activities is minimal, and as credit cannot be provided, credit risk relates primarily to the counterparty risk associated with cash positions. The crystallisation of operational risk in a limited licence firm is unlikely to migrate to the broader financial system and should not therefore have an adverse impact upon financial stability or markets