Prudential Regulation Authority (PRA)

20 Moorgate

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E-mail: clawback@bankofengland.co.uk

28 April 2014

Dear Sirs,

Consultation Paper 6-14: clawback

Introduction

The Investment Management Association (IMA) is the trade body for the UK asset management industry, representing around GBP4.5 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.

We welcome the opportunity to comment on the latest consultation.

Key messages

We support the efforts of the authorities, at all levels, to establish robust capital requirements and risk management frameworks, which are commensurate with the nature, scale and complexity of the activities undertaken by institutions, and to implement governance and remuneration requirements across the sectors of the financial services industry in a manner which helps ensure an appropriate level-playing field in terms of regulatory standards, but is sufficiently flexible to recognise the different characteristics of the institutions within the scope of each regime.

We support the objectives of the authorities in ensuring that incentives do not threaten the viability of firms and the stability of the wider system, the interests of their employees are aligned with those of their employers, shareholders, and the interests of their clients.

As clients to broker-dealers / banks and investors in bank / investment bank securities, we also welcome the effects of the Capital Requirements Directive (CRD) IV and Capital

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Requirements Regulation (CRR) remuneration policy – as we do that of CRD policy as a whole – on the banks who stand as counterparty to us and in whom we invest.

In addition to capital adequacy, which will be reviewed in 2015 with the objective of more appropriate arrangements for investment firms, we are particularly interested in the corporate governance and remuneration provisions, and the interaction of these rules across frameworks such as those of MiFID, UCITS and AIFMD.

As an overall principle, we believe that it is important for the remuneration provisions in the different applicable EU Directives to be applied proportionately and consistently so that they have a similar effect on individuals managing the same type of portfolios under the different Directives and their national versions. Otherwise, the same text in each Directive can have very different impact and implications given the different universe of each Directive.

We believe that the PRA proposal should be used with caution and as a final option should other controls and actions have been exhausted. For example, should there be a downturn in financial performance, this may not have anything to do with employees, but if yes, in year pay may be reduced, and/or where warranted, deferred awards can be forfeited, reduced, withheld still further or rights taken away.

Conclusion

The IMA looks forward to working with the PRA and its peers to develop a framework that is appropriate and effective for all stakeholders.

The annex to our letter contains our formal response to the consultation, and further specific observations and questions arising from the proposals.

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

Yours sincerely,

Irving Henry

Prudential Specialist

Investment Management Association

Annex

Questions

The PRA invites comments on the propositions set out above, particularly with respect to:

• The proposal that the grounds for applying clawback should be as wide as the grounds for malus.

It would be helpful for the PRA to identify the potential scope of its proposals / final rules. Are the non-bank affiliates of banks and PRA-regulated investment firms in scope, e.g. insurers and asset managers? Will there be any proportionality in terms of both firms and employees within firms, i.e. senior management and staff who have a material impact on the risk profiles of their employer (Material Risk Takers [MRTs])?

Will the rules be applied outside the United Kingdom? It is reported that some jurisdictions do not permit clawback after title to property has transferred from the employer to the employee, i.e. vested, and malus, i.e. the clawback of unvested remuneration? The UK implementation of such provisions ahead of actions by other countries will result in the playing field between the UK and rest of Europe/rest of the world becoming more "uneven".

How does the PRA expect the mechanics of clawback to operate? Will contracts, which are being revised at the moment as CRD IV/R and AIFMD came into force, have to be amended to enable such action?

Clawback should be regarded as one of the actions a firm may take where it is warranted that past remuneration decisions are reviewed. There will be cases where in year reductions to remuneration are appropriate, supplemented in certain cases by forfeit/reduction of unvested remuneration. Clawback should be expected to be used in limited circumstances for example in cases of egregious behaviour rather than being an action to be used on a routine basis. In practice, it is most likely to be useful as a deterrent.

The cost and complexity involved in applying clawback is likely to be significant. In certain jurisdictions (many firms may have overseas MRTs/senior persons), neither malus nor clawback are legally enforceable. In some cases the cost of applying clawback (in practice recovery may involve legal action rather than an individual simply returning amounts to a firm) may exceed the amount recovered. We would hope this cost/benefit issue is reflected in final regulations, permitting firms the ability to apply clawback on a pragmatic basis.

For persons to whom clawback is being applied no longer be employed in the UK, and possibly resident outside the United Kingdom, how does the PRA envisage the action to be enforced?

There is the possibility, if not probability, of such action being contested in court and distracting the employer.

Has counsel's advice on the enforceability of post-vesting clawback in UK employment law been sought and/or received?

Will the amount clawed back be gross or net of tax? Either way, HM Revenue and Customs (HMRC) would need to be engaged and able to deliver, as either the employer would get its net amount back and then want the pay as you earn element (PAYE) (and employer's national insurance contributions (NICs)) from HMRC; or, in the more extreme example of the employee repaying gross, the employee would need to reclaim the PAYE element from HMRC to be neutral – and the employer would still want its employer's NICs back as well.

The draft uses words like "reasonable" and "materiality", which can be interpreted differently. Does the PRA plan to elaborate what it means by these terms?

• The proposal to limit the application of clawback to a period of six years from the point of vesting.

We have no comment about the time from vesting. Our concerns, highlighted above, are with regard to scope, the impact on recruitment and retention, and in some cases the delegation of investment and risk management mandates to third parties / firms in third countries, and mechanics. When combined with increasing deferral periods (typically 3 years plus) this can mean remuneration is effectively "at risk" of forfeit or recovery for long periods, in some cases in excess of the business cycle to which the remuneration relates. Mirroring the clawback period with deferral periods seems sensible. Extended clawback periods may result in firms reducing deferral periods as they consider deferral and clawback periods in totality.