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Dear Sir or Madam,

RE: CP16/24 Remuneration Reform

I am writing to you on behalf of The Investment Association (IA), which champions UK investment management, a world-leading industry which helps millions of households save for the future while supporting businesses and economic growth in the UK and abroad. Our 250 members range from smaller, specialist UK firms to European and global investment managers with a UK base. Collectively, they manage £9.1 trillion for savers and institutions, such as pension schemes and insurance companies, in the UK and beyond. 49% of this is for overseas clients. The UK asset management industry is the largest in Europe and the second largest globally.

We welcome the opportunity to respond to this consultation on remuneration reform of the PRA rulebook and FCA's handbook relating to remuneration for dual regulated firms. These rules were introduced as a result of the global financial crisis, in response to remuneration practices within the banking sector which were perceived to be encouraging short-termism and excessive risk-taking behaviours.

Our members have views on these rules as both investors in listed banks, subject to these rules, and some members are subject to these rules as dual regulated firms. The experience of our members has been that these rules and broader remuneration framework have worked well to encourage prudent risk taking and embed a culture of effective risk management within firms. It is important to recognise that the remuneration rules are only one aspect of the risk management and accountability framework which includes capital requirements and the Senior Manager and Certification Regime (SMCR).

The UK framework has become more complex and restrictive than other jurisdictions that have implemented similar regimes such as the EU. This has created complexity and additional costs for firms and raised concerns around the competitiveness of the UK market and the ability to retain and attract talent to firms.

We broadly support the proposed changes as they seek to address the competitiveness of the UK regulatory regime and address some of the concerns that we have previously highlighted with 'safetyism'.

Getting the balance right between encouraging competitiveness and accountability for risk taking will be important. Where the FCA/PRA proceed with changing the rules, firms should be able to demonstrate that there is not a material shift in the way that they approach risk or a change in culture as a result of relaxing the rules. This could be perceived as increasing risk in the short-term. Firms should therefore be able to demonstrate the governance and risk management processes they have in place, and how effective they are.

Given that some of our members are dual regulated firms that will follow these rules as well as shareholders into banks, we have sought to provide views from both of these perspectives. We have focused our feedback on the proposed changes to the Material Risk Taker (MRT) Proportionality Threshold, deferral periods and clawback. Our main feedback is set out below under the following headings:

IA members as Dual Regulated Firms

If the FCA/PRA decide to proceed with these rule changes, they should ensure that there is alignment with the wider rulebook to promote consistency for entities within scope of different regimes. There are some concerns around the lack of consistency between the proposals in this consultation paper and existing rules under the Investment Firms Prudential Regime, Solvency II, Alternative Investment Fund Managers Directive and Undertaking for Collective Investments in Transferable Securities regulations which are more demanding, for example through different proportionality thresholds for MRTs.

Some members have indicated that there is inconsistency in the provision of guaranteed awards in the EU and UK, and that this can create barriers to recruiting new talent into UK firms. The European Banking Authority (EBA) allows these awards to be granted before a candidate starts in a new role. These awards have been exempt from the banker's bonus cap as well as rules on deferral. The UK took a more stringent approach with these awards, where deferral periods and the bonus cap continued to apply. There is an opportunity for this approach to be reviewed so that it aligns with the EU's approach. This could create more opportunities for growth and competitiveness by encouraging new talent into the UK market.

At paragraph 6.18 the consultation is suggesting removal of retention periods for deferred instruments, meanwhile, at paragraph 1.8 it states that firms may have discretion "on what an appropriate retention period should be for deferred instruments". This is likely to create confusion and inconsistency for firms. If it is the intention of the PRA to not expect firms to set retention periods for deferred instruments, it should be clearer on this.

On retention awards more broadly, there is currently a requirement for firms to notify the regulator where they make retention awards and justify the case for the award. This process of informing the PRA can often be lengthy and members note that individuals have left the firm whilst the notification process is ongoing. While we recognise that this is not an explicit recommendation or proposal within the consultation, members believe that there is an opportunity to remove the notification process as it acts as a barrier to retaining and attracting global talent, which is key to achieving the UK's growth ambitions.

IA members as Shareholders in Banks

IA members are significant investors in UK listed companies, including banks. They want to invest in companies that deliver long-term returns for their shareholders and ultimately their clients, pension and retail savers. Given the broader debate around the competitiveness and attractiveness of the UK as a listing venue, we believe that there is an opportunity to streamline the regime so that it continues to incentivise behaviours which focus on the long-term performance and success of the company as well as create alignment with other jurisdictions such as the EU, thereby promoting economic growth in the UK.

Members welcome the regulators efforts to make the remuneration regime ‘more effective, simple and proportionate’, broadly aligning with the overarching aims of the IA Principles of Remuneration which encourage flexibility in the way that companies seek to structure their executive remuneration provided they are consistent with the long-term interests of the company and its shareholders.

MRT Proportionality Threshold: The PRA is proposing to amend the variable remuneration threshold at which firms can disapply certain remuneration rules (such as deferral or payment in instruments) by increasing the individual proportionality threshold to £660,000 total remuneration. Members broadly agree with this approach as it aligns the UK remuneration regime with the European framework for MRTs. We believe that it is important that those MRTs who are subject to this new threshold are still captured by performance adjustment rules like malus and clawback which will help align incentive based pay with the long-term performance of the company.

Deferral Periods: The PRA is proposing a two-tier deferral system which will give firms greater flexibility over the design of their remuneration structures. This includes:

- Reducing the 7-year minimum deferral period for certain Senior Management Functions' (SMF) to 5 years; and
- for vesting to start immediately from the time of the award rather than after 3 years.

We recognise the argument that longer-deferral periods can make it difficult for banks to attract talent from other financial services firms. As set out in the IA’s Principles of Remuneration, deferral policies should be aligned with the risk profile and time horizon of the business. These deferral periods were put in place to align with the average length of the business cycle and reflected the time frame during which risk-taking decisions are most likely to materialise. While we are not opposed to shortening these periods, relaxation of these measures should not incentivise a risk-taking culture which is not aligned with the long-term health and performance of the company, thereby undermining financial stability. Banks should continue to prioritise additional safeguards and governance around their risk management approach and the wider regulatory regime is important to underpin these standards.

Clawback Periods: The PRA’s research within the consultation paper indicates that 70% of risk cases will crystalise within 4 years. However, the clawback operation period for SMF’s is currently set at 7 years. Our members continue to believe in the importance of malus and clawback as important tools to facilitate the potential downward adjustment of variable pay where risk taking behaviour materialises. However, given the results of the research and the fact that deferral periods will continue to apply in combination with clawback, there is an opportunity to reduce the operation period to align with a shorter time frame (such as 5 years).

We would welcome the opportunity to discuss further any of the points raised in our response and look forward to continuing to engage with the FCA and PRA as they seek to implement these rule changes.

Yours faithfully,

Andrew Ninian
Director, Stewardship, Risk and Tax