

October 6, 2010

*Via Electronic Filing*

Lindsey Dawkes  
Remuneration Team  
Financial Services Authority  
25 The North Colonnade  
Canary Wharf  
London E14 5HS

**Re: Consultation Paper 10/19 Revising the Remuneration Code**

Dear Ms. Dawkes:

The Investment Adviser Association (IAA)<sup>1</sup> appreciates the opportunity to comment on the Consultation Paper on Revising the Remuneration Code (10/19) issued by the Financial Services Authority (FSA).<sup>2</sup> The IAA is a not-for-profit US association that represents the interests of investment adviser firms registered with the US Securities and Exchange Commission (SEC). IAA's membership consists of investment advisory firms that manage assets for a wide variety of institutional and individual clients, including pension plans, trusts, investment funds, endowments, foundations, and corporations, and many of our members manage, or have affiliates that manage, assets on behalf of clients in the UK.

Regulators in the G20 countries and the EU have been making efforts to achieve international alignment of remuneration principles to address unsound compensation systems that may have contributed to the financial crisis. Although the focus of the principles for sound compensation practices endorsed by the G20 countries has been on significant financial firms,<sup>3</sup> the EU's Capital Requirements Directive (CRD3) has extended application of the principles to all investment firms subject to the Capital Adequacy Directive.<sup>4</sup> In the UK,

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<sup>1</sup> For more information, please visit our web site: [www.investmentadviser.org](http://www.investmentadviser.org).

<sup>2</sup> FSA Consultation Paper 10/19 Revising the Remuneration Code July 29, 2010 (CP).

<sup>3</sup> See Summit Commitment No. 72, Progress Report on the Economic and Financial Actions of the London, Washington and Pittsburgh G20 Summits (Nov. 2009) ("In London Leaders endorsed the Principles on pay and compensation in significant financial institutions developed by the FSF") available at [http://www.g20.org/Documents/20091107\\_progress\\_report\\_standrews.pdf](http://www.g20.org/Documents/20091107_progress_report_standrews.pdf).

<sup>4</sup> Amendments to CRD3 are expected to be published in the Official Journal this fall at which time the amendments will enter into force.

investment firms subject to CAD include a large number of asset managers (including all UCITS investment firms, most hedge fund managers, firms engaged in venture capital, and firms providing financial advice).

In the Consultation Paper, the FSA proposes to revise its Remuneration Code to incorporate changes brought on by the latest amendments to the CRD3 and the UK Financial Services Act of 2010, which became effective in April 2010. The FSA contemplates the revised Code to become effective on January 1, 2011. As indicated by the FSA, there are a number of significant proposed changes to the Code and asset managers would be subject to the Code for the first time.

The IAA applauds the FSA's "commitment to adopt a proportional approach in applying the rules"<sup>5</sup> in recognition of the significant expansion of the application of the remuneration principles. We believe it is critical to understand that the asset managers now proposed to be covered by the Code engage in vastly different businesses from that of banking institutions, undertake different types of risks, and do not necessarily pose systemic risk to the financial system. Therefore, we fully support the FSA's proposal to permit firms to comply with the principles in a way and to the extent that is appropriate to their size, internal organization, and the nature, the scope, and the complexity of their activities.

Although we appreciate the proportionality approach in applying the Code to particular firms, we also believe that proportionality must be considered in determining the scope of the Code. In this regard, we urge the FSA to clarify that the Code will not apply to non-UK affiliates of UK investment firms that are not part of a UK financial holding company. Moreover, we respectfully seek further guidance on how firms can apply the principles proportionally within their firms and request that the FSA incorporate explicitly or otherwise formalize within the Code the tables included as Annex 5 to the Consultation Paper. We discuss these concerns in more detail below.

#### Remuneration Code Should Not Apply to Non-UK Affiliates of UK Investment Firms

The FSA proposes to impose the Code on any entity that is part of a UK group/subgroup even if the entity is located outside the UK. The Consultation Paper also states that UK subsidiaries of third country groups must apply the Code to all entities within the subgroup, including those based outside the UK.

We understand that the FSA is seeking to ensure that firms do not circumvent the Code principles by setting up special group structures or offshore entities and by having staff employed at these off-shore entities. Although we understand the FSA's concerns, we believe that the FSA can better prevent intentional avoidance of the rule by specifically prohibiting firms from circumventing the Code by deliberately creating evasive structures. We believe this approach would be a more tailored method of achieving the FSA's regulatory goal rather

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<sup>5</sup> See Section 1.14 of the CP.

than extending the FSA's Code to groups that may only have one UK entity or situations in which only a small portion of the corporate group are UK entities.<sup>6</sup>

In addition, we believe that G20 countries, such as the United States, that have agreed to align remuneration principles should primarily be responsible for establishing remuneration principles for the entities that they supervise. For example, in a group with a US parent and multiple subsidiaries all over the world and one UK subsidiary, we believe applying the FSA's Code to all of the UK entity's sister entities would be inappropriate and could result in subjecting entities to inconsistent requirements by different regulators. Therefore, we seek clarification that non-UK subsidiaries of non-UK parent companies will not be subject to the Code.

### FSA Should Provide Further Guidance on Proportional Application of Table 2 Principles

We appreciate the FSA recognizing that asset management firms are fundamentally different in the businesses in which they engage than depository institutions or brokerage firms and that these firms generally do not undertake risk on a principal basis.<sup>7</sup> Given that the risks undertaken are vastly different in a bank and an asset manager, we agree that, for asset management firms, the Code should be proportionally applied. Therefore, we generally support the approach set forth in Annex 5 of the Consultation Paper, which includes three proportionality tables.

Although we agree with the general sentiment, we are concerned that there are not enough specific guidance on how proportionality for Table 2 would be applied to an asset management business and the remuneration that would be paid to asset management personnel. For example, not all asset management firms are incorporated and the "employees" covered by the Code may include principals or owners of the firms (such as in a partnership). Therefore, we request that the FSA provide more specific guidance on how proportionality would be applied for each principle listed on Table 2.

### The Code Rules Should Explicitly Provide for Proportionality

We understand that firms will continue to be able to use the approach set forth in Annex 5, including the three proportionality tables, beyond July 2011 – the date by which firms that are covered by the Code for the first time must comply. We urge the FSA to include this approach specifically into the Code rules either by incorporating or otherwise formalizing the tables within the Code.

We believe it is important for asset management firms to be able to use the "Comply or Explain" approach to certain principles, including share-based awards, deferrals,

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<sup>6</sup> For example, the FSA can expand Remuneration Principle 11: Avoidance of the Remuneration Code to require firms to ensure that they do not use off-shore entities to facilitate avoidance of the Code.

<sup>7</sup> See Section 2.20 of the CP ("for an asset management or investment firm, investment risk is invariably assumed on an agency rather than a principal basis, as investment decisions made by staff are carried out on behalf of clients in line with the mandates they have agreed between them").

performance adjustments, and guarantees. For example, an asset management firm that does not issue shares may conclude that developing share-linked instruments may be prohibitively expensive or cannot be developed but that rigorous policies and procedures that monitor risks taken by their employees on behalf of clients could be an appropriate alternative. Permitting firms the flexibility to explain the rationale for not applying a specific type of restriction or structure would make the Code more workable.

We also recommend that Principle 8, which requires a firm to ensure that variable remuneration take into account all types of current and potential risk, be moved from Tables 1 and 2 to Table 3. It would be more appropriate for firms that generally do not take on risk on a principal basis and manage assets in accordance with the investment guidelines agreed to by clients to determine whether they can comply with the principle and the rationale behind the decision. We believe that, for asset management firms that do not take on principal risk, firms should have the flexibility to calculate variable remuneration based on the performance obtained for clients rather than exclusively on the profits of the firm.

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The IAA strongly supports the FSA's efforts to implement sensibly changes to the CRD3 and to fulfill its commitment to align the remuneration policies with other G20 countries. We respectfully request that the FSA not impose its Code on non-UK subsidiaries of non-UK parent companies. We also request that the FSA provide further guidance on how Table 2 principles can be applied proportionally under various circumstances. Finally, we recommend that the FSA incorporate the proportionality approach into the Code rules and permit firms with risk profiles that are different from depositary institutions to take a comply or explain approach. We appreciate the opportunity to provide our views on these issues and would be pleased to provide any additional information. Please contact the undersigned or Karen L. Barr, General Counsel, at (202) 293-4222 with any questions regarding these matters.

Respectfully submitted,

/s/ Jennifer S. Choi

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