

## Remuneration Policies

### Introduction

The FSA has raised concerns that many remuneration schemes, especially in the areas of investment banking and trading are inappropriate and have contributed to the present market crisis; and that the remuneration structures of firms may be inconsistent with efficient risk management. Criticism has been directed mainly at firms who have been offering incentives to staff to pursue risky policies. The FSA want to ensure that firms follow policies that are consistent with sound risk management systems and controls, and with the firm's stated risk appetite.

### Action for FSA

1. The FSA gathered information from various firms during September to seek input on what constitutes good practice. This will be communicated to firms in the first quarter 2009.
2. The FSA wishes to assist firms to review their remuneration policies and change them if necessary.

### Action for Firms

1. Firms that have a remuneration process with an end of year review need to review this as soon as possible to ensure that it is aligned with sound risk management. If this is not found to be the case, firms are required to take action immediately.
2. Firms need to actively begin considering how to implement performance adjusted, deferred compensation schemes, and set a date that they will realistically be implemented.
3. Firms need to highlight and avoid bad practices where remuneration is concerned. The FSA have provided criteria set out below:

## Criteria for good and bad remuneration policies

### Measurement of performance for the calculation of bonuses

<b>Bad or poor practice (firm view)</b>	<b>Good practice (initial thoughts)</b>
Calculated on the basis of revenues, without any counterbalancing risk controls	Calculated on profits, and by reference to other business goals if appropriate
Does not take risk or capital cost into account	Uses a measure of risk-adjusted return. Measure likely to be based upon economic capital calculation, and should take proper account of a range of risks including liquidity risk.
Performance assessed entirely on the results for the current financial year	Performance assessed on a moving average of results (link to deferred compensation, see below)
Employee bonuses calculated solely on the basis of financial performance	Bonuses awarded take into account appraisal of other performance measures, including risk management skills, adherence to company values and other behaviours

### Composition of the remuneration

<b>Bad or poor practice (firm view)</b>	<b>Good practice (initial thoughts)</b>
Remuneration which has little or no fixed component.	Fixed component of the remuneration package to be large enough to meet the essential financial commitments of the employee.
Paid wholly in cash	Appropriate mix of cash and components which are designed to encourage corporate citizenship and alignment of interests between those of the employee and those of the firm. (For example shares, or appropriately priced share options).
No deferral in the bonus element	A major proportion of the bonus element is deferred so that the impact of the performance (see 1 above) in one year on the firm/unit's long term profits can be established

### Performance adjusted deferred compensation

<b>Bad or poor practice (firm view)</b>	<b>Good practice (initial thoughts)</b>
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Payout of the deferred element is not linked to the future performance of business undertaken in previous years.	A significant proportion of the deferred compensation element to be held in a trust or escrow account, from which funds can only be vested according to rules which take account of the performance of business undertaken in earlier years. Deferred compensation is determined by a performance measure which is calculated on a moving average over a period of several years.
Performance adjusted deferred compensation schemes can be waived/ not enforced despite evidence of poor performance or wrong doing.	Performance adjusted deferred compensation schemes are legally robust and contractually enforced.

## Governance

<b>Bad or poor practice (firm view)</b>	<b>Good practice (initial thoughts)</b>
No independent oversight of remuneration policies or of remuneration awards to executives or senior staff	Board level remuneration committee with majority of non-executives. Committee has effective control of remuneration policies across the firm and of individual remuneration awards above a certain threshold
No process, or no transparent process for managing conflicts of interest	Areas such as HR and Risk have strong and independent role in setting compensation for the business areas.
Business areas can determine the compensation of staff in risk and compliance	Compensation for staff in risk and compliance is determined independently of the business areas.
Staff have an ability to influence unduly the valuation of their own positions and hence the determination of performance measures. Ability also to front load profit from transactions	Valuations and risk reporting subject to independent verification
Incomplete separation of duties between front and back office: ability of the front office to influence back office procedures. (See also SYSC 5.1.6R to 5.1.11G on the segregation of functions).	Overall control of the back office vested in operations.

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