NAPF
Securing the future of pensions

18 May 2009

Financial Services Authority
Via Email

david.paterson@napf.co.uk
Direct: +44 (0) 20 7808 1337

NAPF response to the FSA consultation on Reforming Remuneration Practices in Financial Services

The National Association of Pension Funds (NAPF) is the trade body for the UK's occupational pension schemes and for many years has both directly and through its members made a material contribution to the development of corporate governance policies in the UK. Its Corporate Governance Policies, which are based on the Combined Code and to which you refer in the Consultation Paper, reflect the practices of many UK pension funds. They also include detailed guidance on remuneration and the NAPF is frequently consulted by companies as they develop alterations to their policies.

In responding to your questions we have tried as far as possible to consider the interests of pension funds as the ultimate owners of companies. As you are aware most schemes delegate the day to day management of their assets to investment management firms. They also use a wide range of other service providers and thus have a direct and ongoing interest in a strong and well regulated financial services industry.

If you have any questions on our submission please contact David Paterson, Head of Corporate Governance at the NAPF.

Yours sincerely

David Paterson
Head of Corporate Governance

NAPF response to the FSA Consultation Reforming Remuneration Practices in Financial Services

Consultation Questions

Consultation Q1: Do you agree with our analysis on the need for change and the gaps in the current regulatory approach?

NAPF: We broadly agree with the analysis and the focus on risk management. Risk takers not only have access to shareholders' capital but also rely heavily on the reputation of the organisation under whose name they trade. We believe that the price/value of both is under-rewarded and changes to remuneration structures should be designed to take both into account. Rewards in the industry can be very high by comparison with other sectors of the economy and it is often far from clear as to how these rewards are linked to either skill or effort and the creation of value for customers. The industry and its regulators should consider how better to evaluate these factors and link them to rewards. However we caution against regulating remuneration itself, given its complexity and the very broad range of activities conducted by financial services firms. The focus should be on integrating risk management into the remuneration process.

Consultation Q2: Do you think that introducing this Code into the Handbook as proposed would have adverse implications for the UK as a financial centre? Or do you think its introduction might have neutral or positive implications?

NAPF: UK pension funds are best served by the establishment of an effective regulatory regime for financial services and while it is possible that some activities may choose to relocate the core activities of the financial services industry can be expected to remain in the UK. On balance we believe that this Code's introduction would have positive implications for the UK.

Consultation Q3: Do you agree with this analysis of market failure?

NAPF: We agree with much of this analysis. However, pension funds are by their nature have long time horizons and the NAPF Corporate Governance Policies are specifically written with that in mind. The focus on quarterly earnings is driven more by the sell-side seeking profitable trading opportunities than by conventional long-only investors. We also would emphasise the key role of remuneration committees in setting remuneration policies. These committees need to be resourced properly and *be clearly independent of management if they are to safeguard the interests of shareholders.*

Consultation Q4: Do you have comments on the content or the scope of the draft Code?

NAPF: Pension funds are evidently heavily reliant on banks and asset managers and the proposed Code offers the prospect of better alignment between their agents and the funds' own long term objectives. We therefore welcome the Code's introduction and have no comments on its content or scope at this point.

Consultation Q5: Do you agree with our proposal to make the general requirement into a rule and the specific principles into evidential provisions, so that the Code becomes enforceable?

NAPF: Agreed

Consultation Q6: What parts of this Code would be implemented by your firm (or all of the larger banks/broker dealers) if this Code were voluntary rather than mandatory?

NAPF: Not directly applicable, but it would be logical for pension funds to encourage their agents to comply with the Code in the interests of good governance and transparency.

Consultation Q7: Do you have any comments on the suggestion that firms publish an annual remuneration statement?

NAPF: As noted above we would expect pension funds to encourage compliance and it is thus in firms' interests to publish an annual statement.

Consultation Q8: Do you think that the scope of the Code should be extended to cover the remuneration policies in firms which are undertaking outsourced or contracted activities on behalf of a firm subject to the provision of the Code. If so, what should the scope of such a requirement be (for example should it just be limited to firms carrying out FSA regulated activities)?

NAPF: The link to FSA regulated activities is logical and the Code should apply to sub-contractors who carry out regulated activities.

Consultation Q9: Do you have any comments on our proposals for the implementation of the Code and transitional issues?

NAPF: The proposed timetable is tight and it is unlikely that there will be full compliance with the Code by end 2009.

<u>Consultation Q10:</u> Do you have any comment on our CBA of the proposals (Annex 4)?

NAPF: None

<u>Consultation Q11:</u> Do you have any comments on the compatibility statement in Annex 5?

NAPF: None

<u>Consultation Q12:</u> Do you agree that remuneration risk is part of business risk? Should remuneration risk be specified in GENPRU 1.2.30R as a separate major source of risk that firms should, where relevant, identify and manage?

NAPF: Yes

Questions from the DP Chapter (Chapter 6) for comment and feedback

Q13: Do you think that there are concerns about inappropriate remuneration practices in financial firms besides those covered by our consultation proposals? If so, what in your view are the principal causes for concern?

NAPF: None at present.

Q14: Do you think that the scope of the Code should be extended to all FSA-authorised firms?

NAPF: On balance: no. For smaller firms the burden of compliance is high.

Q15: If so, do you think that it should be on the same basis as for banks, building societies and the larger broker dealers, i.e. with one Handbook rule and ten Evidential Provisions?

NAPF: See above

Q16: In your view, what would be the benefits and costs of extending the Code to all FSA authorised firms?

NAPF: Real benefits but at a cost which may for some be prohibitive.