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The UK's Financial Services Authority Issues the Final-Form Remuneration Code

Introduction

On 17 December 2010, the UK's Financial Services Authority ("**FSA**") issued the final form of the revised Remuneration Code (the "**Code**")[1]. The Code introduces significant restrictions on the way in which remuneration policies and structures are operated within financial institutions in the UK and beyond. The Code builds upon international standards set by the Financial Stability Board at a European level and goes beyond those standards in a number of key respects.

In this briefing, we have set out an overview of the background to the Code, a summary of the key provisions of the final form of the Code, as well as our commentary on some relevant provisions of the final-form guidance issued by the Committee of European Bank Supervisors ("**CEBS**") on 10 December 2010. Finally, at the end of this briefing, we have focused in depth on some specific issues which may be of particular interest to our clients.

Background

The global regulatory response to the financial crisis examined the role that remuneration practices, in particular bonuses, played in causing the crisis. The FSA published a consultation paper in March 2009 in relation to introducing a Remuneration Code that would apply to large banks, building societies and broker-dealers[2]. The consultation paper was followed by a policy statement in August 2009[3] in which the FSA set out its proposals for amendments to the FSA Handbook so as to incorporate the Code. The Code came into force on 1 January 2010 and contained a number of high-level principles on remuneration and drew upon the Financial Stability Forum's "Principles for Sound Compensation Practices" of 2 April 2009[4], which were endorsed by the G20 leaders at their London summit of April 2009.

[1] The Code will be set out in SYSC 19A of the FSA Handbook of Rules and Guidance. (the "FSA Handbook").

[2] FSA Consultation Paper: Reforming remuneration practices in financial services (CP 09/10).

[3] FSA Policy Statement: Reforming remuneration practices in financial services (PS 09/15).

[4] The Financial Stability Forum was succeeded by the Financial Stability Board in April 2009.

On 13 July 2009, the European Commission adopted a proposal to amend the Capital Requirements Directive[5]. This proposal – known as "**CRD3**" – contains a set of requirements relating to remuneration that would apply to all banks and investment firms subject to the Capital Requirements Directive. On 30 June 2010, the European Parliament agreed on a number of amendments to the CRD3 proposal with the European Council. These amendments incorporated a number of prescriptive rules and limits on bonuses into the text of CRD3, such as capping upfront cash bonuses at 30% of the total bonus (20% for particularly large bonuses), a requirement to defer a minimum of 40% of a bonus (or 60% for particularly large bonuses) and a requirement that 50% of a bonus be paid in the form of shares or contingent capital.

In July 2010, the FSA published a consultation paper on amending the existing Code in order to comply with CRD3[6]. Subsequently, on 8 October 2010, CEBS issued draft guidelines giving detail on how it expected the remuneration principles under CRD3 to be implemented within Europe. The final form of the CEBS guidelines was published on 10 December 2010 and the FSA has now revised the Code to take account of responses received as well as the draft and final forms of the CEBS guidelines.

Separately, the European Parliament published the draft Alternative Investment Fund Managers Directive ("**AIFMD**") on 11 November 2010[7]. AIFMD will impose restrictions on remuneration structures in relation to alternative investment fund managers (including private equity funds and hedge funds). The principles under AIFMD are broadly similar to those under the CEBS guidelines and the Code. Although AIFMD is not due to enter into force until March 2011 and EU Member States are only required to implement it by March 2013, it should nevertheless be noted that CRD3 and the Code already apply to many fund managers.

When will the Code come into force?

For those firms currently within the scope of the Code, it will come into force on 1 January 2011.

However, for those firms that have not previously been subject to the Code, the FSA recognises that firms may require additional time to comply in full with the requirements of the Code. As such, firms may be able to rely on certain proportionality principles to justify not complying with those Code requirements relating to remuneration structures (*e.g.*, guaranteed bonuses, deferral, minimum share-based element of bonuses, etc.), provided that they take all reasonable steps to comply as soon as reasonably practicable and, in any event, by 1 July 2011.

To which institutions will the Code apply?

The Code will apply to all institutions falling within the scope of the Capital Requirements Directive, including all banks and building societies, investment banks, broker-dealers, fund managers, asset managers and financial advisers. Activities

[5] The Capital Requirements Directive consists of two directives: (i) the Recast Banking Consolidation Directive (Directive 2006/48/EC) and (ii) the Recast Capital Adequacy Directive (Directive 2006/49/EC).

[6] Please refer to the Shearman & Sterling LLP client briefing of 13 August 2010 - http://www.shearman.com/proposed-changes-to-the-fsas-remuneration-code-08-13-2010/

[7] Please refer to the Shearman & Sterling LLP client briefing of 12 November 2010 - http://www.shearman.com/european-regulation-of-fund-managers-aifm-directive-agreed-and-adopted-11-12-2010/

carried out by such institutions in other jurisdictions of the European Economic Area ("**EEA**") under a passport would also be covered. "Exempt CAD" firms (*i.e.*, those firms authorised to provide investment advice and/or execute or transmit orders without holding any client monies or assets) will not be subject to the Code. The Code also applies to firms established outside the EEA but only in relation to their activities carried out from establishments in the UK.

Does the Code apply to the non-UK operations of a UK-headquartered group?

The Code will apply both to non-UK branches and non-UK subsidiaries of a UK-headquartered group. We discuss the issue of territoriality further below.

Does the Code apply to UK subsidiaries/sub-groups of non-EEA headquartered groups?

For firms headquartered outside of the EEA, any branches or subsidiaries within the UK are subject to the Code[8]. In addition, any sub-groups of companies within the chain of ownership of FSA-regulated subsidiaries are also subject to the Code.

It should, however, be noted that the proportionality principles (see below) will apply to such entities and so, in practice, it may be possible to mitigate the effect of some of the Code's provisions through the application of such principles in some circumstances.

Which staff will be affected by the Code?

The Code defines a group of employees to whom it will apply, known as "Code Staff". The FSA will essentially use the same definition for Code Staff as that used in CRD3, which will cover those categories of staff whose professional activities have a material impact on the firm's risk profile, and will include directors, senior management, risk-takers, control functions and any employees receiving total remuneration that takes them into the same remuneration bracket as senior management and risk-takers. The FSA has explained that it would normally expect all employees who are registered with the FSA under "significant influence functions" to be included in a firm's list of Code Staff. Individuals who are in a "significant influence function", employed by a branch or subsidiary based in the UK but nevertheless physically located outside the UK, would also be required to be included as Code Staff, although the FSA may be willing to grant an exemption in cases where such an individual has global responsibilities and where the group's UK entities only form part of those responsibilities.

Firms will be required to maintain their own records of Code Staff and take steps to ensure that Code Staff understand the implications of being categorised as such (including the potential for remuneration, which does not comply with the Code, to be rendered void and recoverable by the firm).

The Code also applies to those individuals on secondment to the firm in the UK, even if such individuals remain employed and remunerated by the non-UK entity in a group of companies.

8 Although the Code will not apply to UK branches of firms whose home state is within the EEA, such firms will effectively be covered by similar provisions as their EEA home state will be required to apply similar provisions under CRD3.

Are there any de-minimis exceptions?

The provisions of the Code that relate to remuneration structures (*i.e.*, the requirements on deferral, retention, performance adjustment and guaranteed bonuses) will not apply to individuals if their variable remuneration is equal to or less than 33% of total remuneration and their total remuneration is no more than £500,000.

Key remuneration structure principles

Probably the most important part of the Code are the requirements as to how variable remuneration must be structured. The key principles are summarised below:

Fixed versus variable ratios

Firms must set appropriately-balanced ratios between fixed and variable remuneration. In doing so they should ensure that the fixed remuneration element represents a sufficiently high proportion of the total to allow the operation of a fully flexible remuneration policy, including the potential to pay no variable remuneration at all. This particular requirement (both in the Code and in the CEBS guidelines) does not specify what will be appropriate ratios and leaves it to firms in discussions with regulators to set appropriate ratios according to the circumstances of their business, the particular business unit and the staff concerned.

Bonus deferrals

At least 40% of the variable remuneration of Code Staff must be deferred with a vesting period of not less than three to five years. Such deferred amounts must be correctly aligned with the nature of the firm's business, its risks and the activities of the individual in question. Such deferred variable remuneration must also not vest faster than on a *pro-rata* basis[9].

Where the variable remuneration is of a "particularly high amount" a minimum of 60% must be deferred. The threshold for variable remuneration to fall within this category is set at £500,000, but the Code also states that firms should consider whether lesser amounts should be considered "particularly high" taking into account, for example, whether there are significant differences in the levels of variable remuneration paid to Code Staff within a firm.

Firms will be expected to have a firm-wide (and group-wide where appropriate) policy on deferral of bonuses, which should include a rising proportion of deferment according to the level of variable remuneration.

[9] The CEBS guidelines indicate that vesting should not occur faster than annually and the first vesting should not occur until 12 months after the award of the deferred element. Although the Code does not reflect this specific requirement, firms would be advised to comply with the CEBS requirement nonetheless.

Requirement to pay proportion in shares

The Code requires that at least 50% of any variable remuneration must be paid in the form of shares, share-linked instruments or other equivalent non-cash instruments of the firm. In certain cases, contingent capital instruments that are convertible into equity in emergency situations or on the exercise of a regulator option[10] could also be used as part of the variable remuneration element.

In response to the final form of the CEBS guidelines, the Code has now clarified that this 50% requirement will apply to each of the deferred and upfront portions of the variable remuneration, whereas previously the FSA took the view that the 50% requirement only applied to the variable remuneration as a whole.

Share retention policy

Those elements of variable remuneration that are provided in shares or share-linked instruments must be subject to an appropriate retention policy (so that shares or share-linked instruments which have vested to an individual cannot be sold or transferred for a certain period after vesting). The retention policy is designed to align incentives with the long-term interests of the firm. This requirement applies to the shares or share-linked instruments delivered in both the upfront and deferred elements of variable remuneration. The Code does not set out any specific minimum retention periods but merely indicates that it must be aligned to the firm's long-term interests. The CEBS guidelines give a little more detail on what may be expected by way of minimum retention periods. For example, those guidelines indicate that if a firm chooses to apply a deferral period above the minimum (the minimum being three years for staff with less material impact and five years for staff with the highest material impact), the retention period for deferred instruments could be shortened accordingly. However, it would be appropriate to apply longer retention periods for staff with the most material impact on the risk profile of the institution.

The effect of the retention requirement for the upfront element in particular may have significant tax implications for individuals, as to which see the discussion set out below.

Performance adjustment (*i.e.*, "malus" reductions/clawbacks)

All deferred remuneration (both the cash and share-based elements) should be subject to reduction through an appropriate form of "performance adjustment". The firm is required to have the ability to reduce the amount of an employee's deferred remuneration after the date on which it has first been communicated to the employee to reflect actual performance outcomes (including evidence of employee misbehaviour or material error, the firm or relevant business unit suffering a material downturn in its financial performance or a material failure of risk management). Such adjustments would either be through "malus" adjustments (where unvested amounts are forfeited) or clawbacks (where an employee is required to return cash or shares that have actually been transferred to the individual).

[10] These instruments must be included at Stage B1 of the non-core Tier 1 "hybrid capital" element of a firm's capital resources.

It should be noted that, in relation to the share-based element of variable remuneration, the performance adjustment must be to the actual number of shares or share-linked instruments which vest, rather than simply the value of them. The CEBS guidelines further indicate that a decrease in the share price of the shares or share-linked instruments over the deferral period is, in itself, not an acceptable form of performance adjustment. The rationale from CEBS is that there may be a very weak link between movements in share price and the risk outcomes of the performance of staff, other than in relation to the most senior employees.

Restrictions on guaranteed bonuses

Firms must not offer guaranteed bonuses unless they are "exceptional", made in the context of hiring Code Staff and are limited to the first year of service only. In addition, a firm should not provide guaranteed bonuses when hiring new Code Staff unless it has taken reasonable steps to ensure that the remuneration is not more generous in amount or terms, including as to deferral or retention periods, than the variable remuneration offered by the previous employer. In practice employers may need to think about requiring new employees to make contractual representations in employment documentation on joining to obtain a degree of protection on this issue. Finally, the Code also requires that guaranteed remuneration should be subject to appropriate performance adjustment.

Retention bonuses should only be used in exceptional circumstances where the firm is undergoing a major restructuring and a case can be made for using such bonuses on prudential grounds. An example of this would be the launch of a new business line or a takeover or merger.

The final form of the Code has also been amended to reflect the provisions in the CEBS guidelines which state that the restrictions on guaranteed bonuses must be applied on a firm-wide basis, rather than there being any implication that the requirement only applies to a limited category of staff within the firm.

Severance pay

The Code states that payments relating to the early termination of an employment contract must reflect performance achieved over time and must not reward failure. Firms should review existing contractual payment provisions to ensure that these are consistent with this requirement.

Enhanced discretionary pension benefits

The Code places restrictions on "enhanced discretionary pensions". These are enhanced pension benefits paid on a non-standard, one-off discretionary basis as part of an individual's remuneration package. The restrictions are not intended to apply to an employee's standard pension arrangements or the firm's employer pension contribution obligations. The Code requires that, where an employee leaves the firm before retirement, any such discretionary pension benefits must be held by the firm for five years in the form of shares or share-linked instruments. It is likely that such provisions will only be relevant to the most senior management.

Capital and liquidity

The Code states that firms will have to ensure that their remuneration policies do not limit their ability to strengthen their capital base if and when this becomes necessary. They should also ensure that they take into account the implications on liquidity of their remuneration policies. The Basel Committee on Banking Supervision and the European Commission, in their proposals to reform the regulatory capital regime applicable to banks[11], contemplate the introduction of a "capital conservation buffer" which would be an additional amount of Tier one capital that would be built up in good years and applied (*i.e.*, reduced) in bad years. Where an institution eats into its capital buffer, for example in periods of financial stress, it would be restricted in the bonus distributions that it could make[12].

Voiding powers

Under the Financial Services Act 2010 the FSA has the power to restrain certain remuneration practices which do not comply with the Code. Specifically, it can prohibit a firm from remunerating staff in a particular way, render void a provision in an agreement which contravenes such a provision and require recovery of payments or property provided to an employee pursuant to a void provision.

The FSA have made clear that these voiding provisions will only apply in relation to Code Staff and only in relation to the requirements relating to minimum deferrals and restrictions on guaranteed bonuses. In the final form of the Code, the FSA has also introduced a transitional provision which makes clear that, for 2011, the voiding provisions will only apply to firms which were already within the scope of the initial Code in 2010. For other firms, the FSA has stated that during 2011 it intends to introduce a new limited provision on voiding, such that voiding will only apply to firms broadly equivalent to proportionality tier one (see below).

The FSA made clear in its initial consultation paper published in July 2010 that it expects firms to take reasonable steps to amend or terminate the provisions of existing contractual arrangements to ensure that they comply with the Code as soon as possible.

Proportionality

The final form of the Code contains a revised structure applying the principle of "proportionality". The aim of the proportionality principle is to allow firms to match remuneration policies and practices to a firm's individual circumstances. The Code requires a firm to apply the proportionality principle in a manner that is appropriate to the size, internal organisation and the nature, scope and complexity of its activities. Under the proportionality principle it is possible to disapply certain provisions of the Code (referred to in the CEBS guidelines as "neutralisation").

In the final form of the Code the FSA has devised a framework of four "proportionality tiers" within which firms would be categorised for the purpose of the application of the proportionality principle. Tiers one and two are intended to capture larger banks, building societies and broker-dealers that engage in significant proprietary trading or investment banking. Tier three will consist primarily of small banks, building societies and firms that may occasionally take overnight or short-term

11 Strengthening the resilience of the banking sector (Basel Committee on Banking Supervision) and Public consultation regarding further possible changes to the Capital Requirement Directive ("CRD IV") (European Commission).

12 The Basel proposals are due to be implemented at the EU level through further amendments to the Capital Requirements Directive in 2011.

risks with their balance sheet. Tier four will broadly cover firms such as brokers and advisors that generate income from agency business without putting their balance sheets at risk. Tier four should in practice include most asset managers. The FSA stresses that this is not a rigid framework and there will be a degree of flexibility in how it applies the boundaries.

Firms in tiers three and four will have the most flexibility with regard to proportionality. For example, firms in tier three will be permitted to disapply the requirements on deferral and performance adjustment. Firms in tier four will be able to disapply the requirements on leverage ratios, retention of shares, deferral and performance adjustment.

It should, however, be noted that, if a firm is in a proportionality tier that does not allow the disapplication of a particular requirement (*e.g.*, a firm in tier one could not disapply the deferral requirements) it would not be able to use the proportionality principle to apply a numerical threshold which is lower than the specified minimum criteria. For example, it would not be possible for a firm in proportionality tier one to choose to apply a deferral of only 20%, that being below the minimum numerical threshold of 40% (or 60% for particularly large bonuses) for deferrals.

We have set out as an Appendix to this briefing a table summarising which key remuneration structure principles in the Code can be disapplied by a firm, depending on the proportionality tier into which it falls.

Particular issues

The following discussion highlights some specific issues that may be of interest to readers of this briefing.

The application of the Code/CEBS guidelines to non-EEA based staff

One of the most controversial aspects of the Code and the CEBS guidelines is the territorial reach of both. As set out above, the Code will potentially apply to the worldwide operations of a UK-headquartered group. Significant concern has been raised by many institutions about the potential of this to create a non-level playing field in non-EEA markets. For example, subsidiaries of UK-headquartered groups operating in Asia may find themselves subject to UK or European restrictions on guaranteed bonuses whilst local competitor firms will be subject to much less stringent requirements (because, in general, Asian regulators have not applied such prescriptive restrictions on variable remuneration as in the UK and the rest of Europe). In the United States, the rules of general application on variable remuneration have thus far tended to be more principles-based and less specific than in the UK and the rest of Europe.

The final forms of the CEBS guidelines and the Code, however, may offer a small degree of comfort. The CEBS guidelines state that “the remuneration policies and practices should apply to any subsidiary of an EEA parent institution that is located offshore, including in a non-EEA jurisdiction, **but proportionality remains valid in this context also**” [our emphasis]. In addition, the CEBS guidelines state “the remuneration practices of any subsidiary should take into account the nature, scale and complexity of the activities of the subsidiary along with the level and types of staff members working at that subsidiary. If the subsidiary poses a higher risk to the EEA parent institution, then more robust remuneration policies and practices should be required for either or both of the entities”. This may give some latitude for firms to narrow the non-EEA application of the CEBS guidelines by arguing that the CEBS guidelines should not apply to non-EEA operations that do not present a systemic risk to the parent organisation and/or should be restricted in application only to individuals who are in management or risk-taking roles that could present a risk to the parent organisation.

A separate concern is the potential applicability of the CRD3 remuneration provisions to the staff of parent companies that are headquartered outside of the EEA. Where, for example, a US-headquartered bank has subsidiaries within the EEA, the CEBS guidelines appear to indicate that the CRD3 requirements would apply to the staff of the US parent to the extent that those individuals are performing duties for EEA subsidiaries, even if such individuals are based in the US, employed and paid by the US parent and subject to other regulatory requirements (such as the US Dodd-Frank Act). However, the Code does not appear on its face to go as far as this in its application, although some non-EEA staff who are registered with the FSA for the performance of controlled functions would be caught by the Code.

Given the application of the CRD3/CEBS guidelines and the Code to subsidiaries, and the fact that larger banks will almost always fall within tier one, some firms may consider whether intra-group reorganisations may be worthwhile, for example, moving non-EEA subsidiaries of EEA entities so that those subsidiaries no longer have an EEA-based parent company heading up the relevant sub-group. Alternatively, larger banks may wish to consider whether to reorganise certain parts of their universal bank business into separate subsidiaries (*e.g.*, brokerage businesses) so that such discrete businesses can be categorised in lower proportionality tiers than if they were part of a universal bank. Nevertheless, care would need to be taken in implementing any such arrangements as the CEBS guidelines make clear that the creation of special group structures or offshore entities in order to circumvent the rules may be in breach of the principles of anti-avoidance in CRD3 and the CEBS guidelines.

The continued use of guaranteed and retention bonuses

The restrictions in the Code on the use of guaranteed bonuses are of particular concern. It is arguable that the FSA has taken a position that is even more restrictive than the CEBS guidelines in this area. For example, the CEBS guidelines simply state that guaranteed bonuses should "be applicable only for the first year of employment and in the context of hiring new staff". The Code reflects this, but also provides that the amount of a guaranteed bonus should not exceed the amount of variable remuneration given by the previous employer both in terms of amount and timing. This additional requirement is not reflected at all in the CEBS guidelines. We consider that this is a substantive addition by the FSA which may potentially result in UK-based firms having significant restrictions on the amount that can be offered by way of guaranteed bonuses whilst firms headquartered in other EEA countries may not have such restrictions if their regulators simply reflect the CEBS guidelines.

The Code also applies very specific and additional restrictions on retention bonuses, stating that they can only be used in the context of a "restructuring". The CEBS guidelines are noticeably less strict, with the only reference to retention bonuses stating that: "a retention bonus is a form of variable remuneration and can be allowed to the extent that risk alignment requirements are properly applied." As such, the Code appears to place tighter restrictions on the use of retention bonuses than the CEBS guidelines.

The result of the Code's approach on guaranteed and retention bonuses may mean that UK firms find themselves at a competitive disadvantage in the global hiring market. In addition, the scope for UK firms to operate "buy-back" arrangements (*i.e.*, where an employee is approached by a competitor employer and his existing employer offers a guaranteed incentive to stay in employment) will become much more limited in the future.

There is, however, one respect in which the Code seems to take a less strict line on guaranteed bonuses than the CEBS guidelines. The CEBS guidelines indicate that the provisions on guaranteed bonuses must be applied on a firm-wide basis (*i.e.*, the restriction is not limited in its application to only a specific category of employees) and cannot be disapplied through proportionality. Whilst the Code now has a strengthened statement that reflects that the principles of guaranteed bonuses must be applied on a firm-wide basis, nevertheless the Code allows for the guaranteed bonus restrictions to be disapplied if the individual's remuneration falls below the *de-minimis* threshold. In our view, this is something that is not reflected or permitted under the CEBS guidelines and si-+ts uneasily with the requirement in the Code that the restrictions on guaranteed bonuses should be applied on a firm-wide basis. Accordingly, in some respects, the Code may offer greater flexibility than the CEBS guidelines.

Possible tax implications of remuneration structures

One key concern for many firms and Code Staff will be the tax implications of the remuneration structure requirements and, in particular, the effect of the requirement for a minimum portion of variable remuneration to be paid in shares, coupled with the requirement for retention periods. Suppose, for example, an employee receives a total bonus of 100 of which 60 must be deferred and 40 can be paid upfront. Of the 40 paid upfront, 50% must be provided in shares or share-linked instruments, leaving 20 payable in cash. Assuming that the individual is a UK additional-rate taxpayer paying UK income tax at 50%, in relation to the cash-based element he will receive 10 in his hands after tax. In relation to the other 20 provided in shares, he may also incur a tax charge at 50% on the value of those shares at vesting, meaning he is liable to pay 10 in tax on that share-based element. Normally in the UK, one would expect there to be arrangements whereby a portion of the shares could be sold to meet that tax liability, but because of the CRD3/CEBS/Code requirements for a retention policy, such shares cannot be sold. Accordingly, the individual would effectively have to fund the tax on the shares (10) with the net amount of 10 he received in cash, thus leaving him with nothing in his hands as a cash element after the payment of tax.

Despite the hopes of some commentators in the consultation undertaken by the FSA, the final-form Code has not introduced any provision that would allow for shares to be sold to meet such tax liabilities. Whilst it may be possible to defer the payment of the tax on the share-based element through the use of particular types of share-linked instruments (*e.g.*, phantom shares or share appreciation rights which would only provide actual payment at the end of the retention period and, as such, should only be taxable at such payment date), careful advice would be needed to structure these in the correct manner, and such alternatives may not necessarily be attractive to firms or individuals, particularly if the deferral of the tax charge depended on there being the possibility of forfeiture prior to payment.

Can global bonus and share plans survive?

For many global banks, their practice in structuring and drafting the terms of bonus and share plans has been to have one global structure and set of rules that applies to all participants irrespective of the jurisdiction in which they are based. For non-EEA headquartered banks, it is possible that the effect of the EU and UK rules may mean that global plans become difficult to maintain. In many banks, particularly those headquartered in the US, concerns have been raised that if a bonus or share plan had to be structured to meet the EU requirements, this would effectively result in the EU requirements dictating the terms of that plan globally (given that in many respects the EU requirements are the toughest and most prescriptive globally) even though the EU rules would not strictly apply to many of the employees outside of Europe. This has given rise to some banks considering whether to “regionalise” their bonus and share plans, such that there would be different plan rules and structures for different areas of the globe, such as Europe, Asia-Pacific and North America.

Conclusion

It remains to be seen what the long-term impact of the CRD3/CEBS guidelines and the Code will be. There has been considerable press speculation as to whether some UK-headquartered institutions will move all or parts of their operations out of the UK and Europe to avoid such rules, but to date there has been no significant movement. Nevertheless, one immediate impact of the new rules has been the effect on fixed remuneration. Many institutions have responded to the new rules by increasing fixed remuneration as a means of navigating the new requirements. Whilst that may have the result of decreasing the portion of an individual's remuneration that may incentivise an individual to take risks, it is ironic that the result is not only that the key risk-takers will have less of their remuneration aligned with the performance of their institutions and the interests of their shareholders, but also that those institutions will have less flexibility to adapt total remuneration awards during difficult times in the future.

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FSA Remuneration Code – Summary of key remuneration structure requirements and possible disapplication under proportionality

REMUNERATION STRUCTURE REQUIREMENT	TIER 1	TIER 2	TIER 3	TIER 4
General requirement that remuneration structure is consistent with and promotes effective risk management	Applicable	Applicable	Applicable	Applicable
Requirements for assessment of performance in setting variable remuneration	Applicable	Applicable	Applicable	Applicable
Guaranteed bonus restrictions	Applicable	Applicable	Applicable	Applicable
Severance payment restrictions	Applicable	Applicable	Applicable	Applicable
Minimum 50% shares/share-linked instruments	Applicable	Applicable	Should normally be able to disapply	Should normally be able to disapply
Minimum deferral (40% - 60% of variable remuneration)	Applicable	Applicable	Should normally be able to disapply	Should normally be able to disapply
Performance adjustment	Applicable	Applicable	Should normally be able to disapply	Should normally be able to disapply
Fixed/variable ratios	Applicable	Applicable	Applicable	Should normally be able to disapply if the firm is a limited licence firm or limited activity firm
Requirement for remuneration committee ("RemCo")[13]	Applicable	Applicable	Desirable for a RemCo to be established and the FSA would normally expect larger tier three firms to do so, but it may be appropriate for the governing body of the firm to act as a RemCo	Desirable for a RemCo to be established and the FSA would normally expect larger tier four firms to do so, but it may be appropriate for the governing body of the firm to act as a RemCo

[13] The Code requires that a firm that is significant in terms of its size, internal organisation and the nature, the scope and the complexity of its activities must establish a RemCo. The RemCo must be responsible for the preparation of decisions regarding remuneration, including those which have implications for the risk and risk management of the firm.