Finding your way through the regulatory storm

Reward regulations in financial services

May 2012

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Finding your way through the regulatory storm

Financial services pay models in the UK have changed profoundly since the financial crisis as a result of European Union (EU) and domestic regulation, but the story is far from over. It's likely that all financial services firms will face increased challenges as further regulations impacting remuneration arrangements are introduced over the next few years. Working through this sea of regulation can be complex – so we've provided a guide on what regulation is out there and the issues that firms should be thinking about and looking to address now.

In this briefing, we've summarised the regulatory response so far at the global, EU and national levels. We then take a closer look at current and future regulatory challenges for banks and securities firms, asset managers and insurers. Finally, we look briefly at the implications of the Retail Distribution Review, part of the FSA's consumer protection strategy.

Addressing the changes

Of all the regulations, the one with the biggest impact to date is the third capital requirements directive (CRD3). There are some key points that you will already need to have considered if your firm is within the scope of this directive. Key questions include:

- How will you respond to Financial Services Authority's (FSA) scrutiny through their advanced risk response operating framework (ARROW) and Internal Capital Adequacy Assessment Programmes (ICAAPs)?
- How will you demonstrate significant progress towards alignment with regulations?
- Are you ready for the impact of the proposals in the draft text of CRD4?
- Are your documents compliant with regulatory requirements?

Tier 1 and Tier 2 banking organisations need to be aware of the European Banking Authority's (EBA) forthcoming data requests on the remuneration of high earners and on the remuneration structures of staff affected by the FSA's Remuneration Code (Code Staff).

Asset managers likely to come into the scope of the Alternative Investment Fund Managers Directive (AIFMD) need to be aware of the FSA's thinking on implementation as it develops ahead of the FSA's autumn consultation paper and begin planning for he potential impact of the regulations.

Insurers face further uncertainty as the discussions in Brussels regarding Solvency2 continue.

As the scope of remuneration regulation continues to widen across financial sectors, financial institutions will need to take a holistic approach across businesses (and across territories) in order to manage the regulations in an effective, commercial manner.

Increased regulation in the wake of the financial crisis

Following the financial crisis, the Financial Stability Board (FSB) and a number of national regulators conducted reviews into the governance and structure of remuneration arrangements within the financial services sector. The main conclusions drawn from these reviews were that:

- firms (and regulators) had failed to appreciate the extent to which remuneration policies and practices could encourage excessive risk taking,
- the structure of remuneration specifically could encourage excessive risk taking by focusing on cash-based, short-term incentives,
- bonus pool calculations didn't sufficiently take account of firms' capital and liquidity costs and the risks they faced, and
- performance management systems often focused too heavily on financial performance and didn't take into account multi-year performance.

The FSB formalised the conclusions of its review into a set of principles in April 2009 and into more detailed standards, published in September 2009[1]. National regulators then began to draw up plans for regulating remuneration; in the US a set of high level guidance was published in late 2009 and here in the UK, the FSA implemented its first Remuneration Code (Code) in January 2010.

The EU Commission also produced proposals for incorporating remuneration rules into CRD3 during 2009. After negotiations with both the member states and the European Parliament, a final text was agreed in July 2010 and came into force from January 2011. The Committee of European Banking Supervisors (CEBS), now the EBA, was tasked with preparing guidance on the implementation of CRD3 which was published in December 2010. The FSA revised its Code to take account of the CRD3 requirements[2], and many other EU regulators enacted similar national legislation or supervisory rules.

The FSB principles and standards represent the global framework, but countries have implemented them in different ways. Some, particularly the EU regulators, have implemented the FSB principles and standards through legislation or binding requirements, as they were required to do by CRD3. Others, notably the US, have implemented through guidance that allows organisations more flexibility in interpretation and potentially the ability to meet less onerous requirements.

Organisations are continuing to work through and adapt to new financial regulations, but there is a lot of change yet to come. As part of any planning on how to fulfil the new regulatory requirements in the future, it will be critical to analyse the implications for your business and your people.

[1] http://www.financialstabilityboard.org/publications/r_090925c.pdf
[2] http://www.fsa.gov.uk/pages/Library/Policy/Policy/2010/10_20.shtml

The regulations

We've summarised the main regulations impacting remuneration within the financial services industry, together with those expected to come into force. We cover the expected regulation in more detail later in this report.

Regulations	Scope	Effective date
CRD3	Banks Building societies Full scope *Prudential sourcebook for banks, building societies, and investment firms (*BIPRU) firms Limited licence BIPRU firms including asset managers regulated by the Markets in Financial Instruments Directive (MiFID).	January 2011 i.e. already fully effective
Retail Distribution Review (RDR)	Firms and Independent Financial Advisers (IFAs) selling directly to retail consumers	December 2012
CRD4	Banks Building societies Full scope *Prudential sourcebook for banks, building societies, and investment firms (*BIPRU) firms Limited licence BIPRU firms including asset managers regulated by the Markets in Financial Instruments Directive (MiFID).	January 2013
AIFMD	Hedge funds Private equity houses Real estate funds Infrastructure	July 2013
Solvency2	Life and non-life insurers Insurance brokers Lloyd's of London insurers	January 2014
UCITS4/5	Undertakings for Collective Investment in Transferable Securities Directive (UCITS) registered asset managers	Likely to be 2014/2015

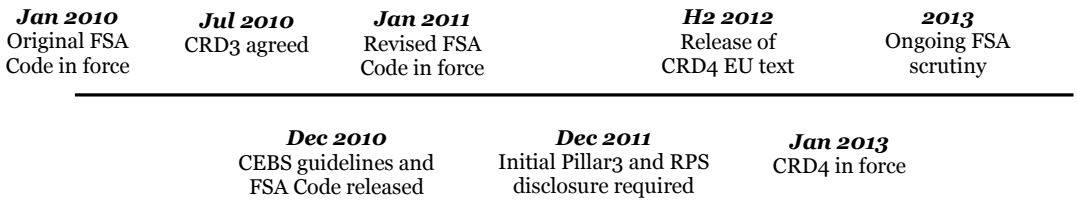
The rest of this briefing looks at the implications for the different financial services sectors in more detail.

Banks and capital markets

Following the recommendations made by the FSB on remuneration in financial services, the EU brought forward legislative proposals to amend CRD3. Final agreement on the text of the Directive was reached between the European Council and Parliament on 30 June 2010. The Directive applies to all credit institutions and investment firms, but it includes important proportionality principles to allow organisations to align with the requirements in a way that is appropriate to their size, internal organisation and the nature, scope and the complexity of their activities.

In the UK, the remuneration aspects of CRD3 were implemented via amendments to the FSA's Code which came into force on 1 January 2011 and consists of 12 principles dealing with remuneration governance, policy and structures. The Code applies to over 2,700 organisations, but the FSA has implemented CRD3 proportionality provisions via a four-tier proportionality system. This means that the full requirements only apply to the largest banking organisations (firms in Tier 1 and Tier 2), with less onerous requirements applying to agency businesses categorised as Tier 4 organisations.

The regulation timeline



FSA implementation of the Code during 2011 and early 2012

Embedding remuneration into regular supervisory processes

In addition to the close and continuous supervision of Tier 1 firms through the annual remuneration policy statement (RPS) review process, the FSA has been widening the range of tools it has available to make sure that all firms that are currently in scope of the Code are compliant. This will continue during 2012.

Action	Applies to
Reviews of selected areas by firms' internal audit functions	Selected Tier 1 firms
Review of remuneration policies and processes as part of firms' ARROW visits	All firms
Review of documentation of remuneration risks in ICAAP reports	All firms
Inclusion of compliance with the FSA Remuneration Code in the scope of Section 166 reviews	Firms subject to S166 reviews
Thematic review on alignment with Code	Likely to be for tier 3 and 4 firms

Regardless of how the FSA has scrutinised firms, a broadly consistent pattern in its areas of focus has emerged. These areas include:

1. Code Staff

Numbers	Code Staff numbers at some of the larger Tier 1 firms have increased in 2011 compared to those identified last year. However, these numbers are still some way below those of 'P8 employees' (the predecessor to Code Staff) identified by the same organisations under the original code in 2010. This is an area of concern for the FSA.
Material risk takers (MRTs)	Firms have been asked to set out the processes, tests and criteria used in order to satisfy the FSA that they have a robust approach for identifying MRTs.
Overseas based MRTs	During 2011 the FSA increased its focus on overseas employees. It has advised firms that all individuals based outside the UK, who are able to make decisions that have a material risk impact on the UK firm, should be included as MRTs.
High earners	In 2011 the FSA asked firms to set out the process used to demonstrate that they have identified high earners and considered the extent to which they are MRTs.

2. Governance and oversight

The FSA is focused on ensuring that appropriate governance frameworks are in place to oversee and challenge decisions in an independent and robust manner. This includes firms being asked to provide more information to demonstrate remuneration decisions are made with appropriate risk input. The FSA has been asking for copies of information provided by the risk function and for relevant extracts from remuneration committee minutes.

3. Risk adjustment of financial performance

The FSA has continued to press firms to provide detailed information setting out the processes used to adjust annual financial performance, used to calculate variable compensation pools, to take account of capital and liquidity costs, as well as all other material current and future financial and non-financial risks. Reviews by the FSA have focused on:

- the metrics and methodology used to identify, quantify and account for market risk, credit risk, liquidity and capital requirements together with an explanation of how these metrics are used to adjust profits,
- an explanation of the additional non-financial qualitative risk metrics applied (e.g. operational, legal and reputational risks) and how these are used to adjust financial performance, and
- where discretionary processes (rather than formulaic calculations or methodologies) are used, firms have been asked to set out the risk metrics used to adjust profits, the interaction between performance against those metrics and the level of adjustment applied to financial performance, and the role of the risk function.

The degree of compliance amongst Tier 1 banks is mixed. A number have made significant progress during 2011 towards achieving compliance with the Code requirements on risk adjustment. However, other Tier 1 banks (including some headquartered outside the UK where the home regulators are not focusing on risk

adjustment of financial performance) will need to make further material progress during 2012 in order to avoid significant challenge from the FSA.

4.	Guaranteed variable remuneration rules
Guarantees and sign-on bonuses	This has been a significant area of focus across all firms. The main areas of FSA focus have been: • The number of guarantees being offered (to both Code Staff and non-Code Staff) remains high and should be restricted even further. • There is insufficient documentation providing reasons for offering guarantees and supporting why the offers are considered to be made in exceptional circumstances. • There is a need for firms to enhance governance and oversight processes used in the approval of guarantees.
Buy-out awards	The FSA has taken a strict interpretation of the requirement to make sure that buy-out awards are not more generous in either terms or value than the forfeited awards being replaced. This strict interpretation requires firms to ensure vesting conditions and periods of buy-out awards are no more generous than those of forfeited awards. The FSA has challenged firms that made buy-out awards with shorter vesting periods and reduced the value/amount of those buy-out awards to account for the shorter vesting period.

EBA implementation review

In April 2012, the EBA published the results of its survey of the implementation of CRD3 requirements across member states. It concluded that there has been satisfactory implementation of the CEBS guidelines issued in 2010 into the respective legal and supervisory frameworks, and good progress by the industry in areas such as the governance of remuneration. However, the EBA highlights concerns about inconsistent application in a number of areas:

- The scope of the guidelines - some countries have extended the remuneration requirements beyond that of the CRD3, whilst others have not.
- Wide differences in the criteria used to identify staff that have a material impact on the firm's risk profile, and so in the number of Identified Staff (Code Staff in the FSA Code). The EBA takes the view that in most cases the criteria aren't sufficiently rigorous to identify all material risk takers.
- Inconsistencies have also emerged in the application of the proportionality principle with practices varying from predetermined fixed criteria to purely case-by-case approaches.
- The EBA points out that risk alignment practices across the industry remain underdeveloped, especially with regard to the interaction of parameters used for risk management and the structure of bonus pools.

The results of the EBA survey will be taken into account by the European Parliament when finalising future pan-EU regulations on remuneration, including CRD4.

What we expect to see in 2012: CRD4 and UK Government initiatives

The EU Commission is in the process of finalising CRD4. The primary purpose of this directive is to implement the Basel III capital rules into the EU regulations, but it's also expected to include some important changes to existing remuneration rules brought in by CRD3.

Fixed to variable remuneration ratios

The Commission's draft of CRD4 has been debated in the European Parliament's Committee on Economic and Monetary Affairs (ECON). As part of this process, many MEPs proposed amendments on the introduction of restrictions on the amount of variable remuneration that can be paid relative to the amount of fixed remuneration. The European Parliament voted on these changes in mid May and confirmed its desire for a cap of a 1:1 ratio, so that annual bonuses could not exceed base salary. These restrictions as currently drafted apply to Code Staff and could come into effect for all remuneration payouts made after 1 January 2013, the date that the Directive is due to come into effect. A transitional provision to delay the introduction of the rules might be agreed, but this can't be assumed.

Negotiations to agree a final text for CRD4 between the European Parliament, the member states (currently represented by Denmark, which holds the Presidency of the Council) will start in late May 2012. The Danish Presidency is aiming for political agreement on the new legislation before the end of its term (end of June 2012) when it hands over to Cyprus.

The initial draft of CRD4 tasks the EBA to develop a draft regulatory standard to set the criteria to determine the appropriate ratios[3]. However, given the specific nature of the proposals put forward by the European Parliament, it is less likely that the EBA will be consulted on the key area of remuneration leverage. This will significantly reduce the flexibility that member states have when implementing the regulations.

Code Staff criteria

The EBA has highlighted the low number of Identified Staff (Code Staff in the UK), being identified by banks across the EU as a proportion of total employees. In response to this the EBA will be preparing another set of draft regulatory technical standards to clarify (and probably amend) the current criteria used to identify material risk takers set out in the CEBS guidelines of December 2010. Again, the EBA has been asked to submit the draft to the Commission by the end of 2013, but this timetable may be accelerated. It is possible that amendments to these criteria could include the use of a total compensation amount or threshold. It is too early to speculate at what level this might be set, but the result could lead to a significant increase in the number of Code Staff.

Capital instruments

The EBA has also been tasked to develop a technical standard to specify the classes of capital instruments that satisfy the conditions laid down in CRD3 to be an alternative to shares. At present the conditions are so restrictive that no firm has been able to satisfy them. This should give banks greater flexibility in the way they structure their bonus deferral plans for Code Staff and should mean that banks subject to the FSA's Code can utilise alternative instruments to shares.

[3] http://ec.europa.eu/internal_market/bank/regcapital/index_en.htm. Recital 48 and Article 90 (2) of the Directive text.

Enhanced disclosure requirements

There are a number of other upcoming disclosure initiatives:

1. The EBA will shortly issue two requests for member states to collect data for publication at the aggregate level by country. The first will be on the remuneration policies and structures of Code Staff in major firms. The second will be on the number of high earners, defined as employees with total remuneration above €1m in a larger group of firms. The FSA will need to ask the firms affected to complete data requests, which the regulator will then send on to the EBA in aggregated form. This initiative stems from a requirement laid down in CRD3.

2. CRD4 builds on the disclosure requirements in CRD3 with a requirement for firms to disclose the number of employees receiving remuneration above €1m, broken down into bands of €500k as part of their Pillar 3 disclosures.

3. In the UK, the disclosure requirements which applied to the banks in the Merlin agreement with HM Treasury are being extended from this year to all UK-based firms with assets in excess of £50bn. We believe it's likely that this disclosure requirement will continue to be on an expected value rather than vested value basis, consistent with current HM Treasury regulation.

4. The Department for Business Information and Skills consulted on proposals for greater disclosure which is likely to require disclosure on a vested basis. As such, listed UK banks are likely to have to disclose under both approaches.

What firms need to consider

- How will you document and demonstrate compliance with the regulations in terms of governance, policy and structures? In addition, we expect reviews of remuneration policies and processes to increasingly focus on the capital, liquidity and risk management aspects of remuneration. If your firm has yet to make significant improvements in your risk adjustment processes, you will need to focus on key areas of remediation and, where required, engage with your parent company to make sure remediation starts sufficiently early in 2012 to enable the implementation and embedding of required processes.

- How do you take into account capital and liquidity costs, and risk adjustments as part of bonus pool calculations? Combining the additional requirements with lower financial performance (likely in an increasingly challenging business environment), bonus pools will be under significant pressure. This pressure will increase further if, as appears increasingly likely, limits or restrictions on levels of variable remuneration are introduced. What alternative structures have you considered in order to retain and incentivise key employees and talent?

- What will the impact of restrictions on variable remuneration levels be on your firm in terms of remuneration quantum and mobility of talent? CRD4 rules could be effective from 1 January 2013, impacting FY2012/13 variable remuneration paid after this date.

- What is the impact of changes to Code Staff criteria on existing remuneration governance structures and processes? These changes will likely result in a significant increase in Code Staff numbers.

- How might the EBA technical standard on capital instruments give you greater flexibility in how you structure your deferral arrangements, particularly for Code Staff?

Asset management

Limited licence asset managers have only recently implemented change programmes to align to CRD3 requirements. Looking forward there is a need to consider the application of at least four other separate regulations to your business. CRD4 will contain additional requirements that may impact asset managers already regulated under CRD3, and the asset management industry will also need to assess the impact on remuneration through the implementation of AIFMD, UCITS4 and UCITS5.

Capital Requirements Directive 3

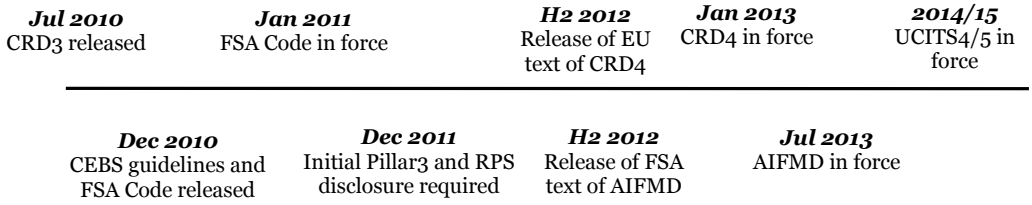
What we have seen during 2011 and early 2012

CRD3 contains a clause which allows regulators to take account of the size, scope and complexity of firms' businesses and national regulators have used this to apply a proportionate approach to the implementation of CRD3. Asset managers, which operate under a limited BIPRU licence, have been placed in the FSA's lowest proportionality tier, Tier 4.

Firms in Tier 4 have a less intensive supervisory regime than firms in proportionality Tiers 1 and 2, and are able to dis-apply some requirements, particularly with respect to remuneration structures.

Despite the application of proportionality in CRD3, in some ways the asset management sector faces more challenge than any other simply due to the number of different regulations being implemented. All of these different regulations have either a direct or indirect impact on remuneration. As well as the number of directives being implemented, firms need to deal with the complexity of scope, with some directives targeted at firms, some at products and some at consumers.

The regulation timeline



The FSA has so far had little interaction with Tier 4 firms, focusing instead on Tier 1 and some of the larger firms in Tier 2. An exception to this has been when asset management subsidiaries which form part of Tier 1 or Tier 2 groups have applied for re-tiering. FSA involvement in Tier 4 firms will increase as part of the planned embedding of remuneration into regular supervisory processes. It should be noted that those organisations within the scope of CRD3 should by now have completed their remuneration policy statement. These need to be kept up to date (with a six monthly or 12 monthly review), so that they can be supplied to the FSA if requested as part of a supervisory process, e.g. an ARROW visit or a thematic review.

What we expect to see going forward in 2012 and beyond

The FSA is expected to continue its review of remuneration policies and processes through ARROW visits and possibly via a thematic review. Since Tier 4 firms don't have to apply the majority of the rules on remuneration structures, we expect the FSA to focus on:

- identification of Code Staff,
- performance measurement systems,
- use of guaranteed variable remuneration,
- remuneration of staff in control functions, and
- governance of remuneration policies and practices.

The Alternative Investment Fund Manager Directive

The most imminent and arguably the most controversial directive aimed specifically at asset management operations, is the EU's Alternative Investment Fund Manager Directive (AIFMD), which is currently being finalised at an EU level. This directive will extend the scope of existing EU remuneration regulation to alternatives businesses including hedge funds and private equity funds.

The AIFMD is a complex directive and although the details of implementation are still not clear, we expect it to have a significant impact on firms that fall within its scope. As its provisions come into force, the benchmarks for the application of proportionality will shift and as a result we expect some of the largest asset managers to come under the more intensive scrutiny experienced by the large banking organisations. It's also likely that the AIFMD will bring in more asset management specific requirements (such as increased regulation of carried interest arrangements) that will impact the pay structures of the industry.

On 22 January 2012, the FSA published a discussion paper[4] on the implementation of the AIFMD. The paper issued provided only limited information on the FSA's implementation of the AIFMD remuneration principles. But it did set out a number of guiding principles we think will drive the FSA's eventual implementation.

Scope	Hedge funds, private equity and venture capital funds, property funds, real estate investment trusts, infrastructure funds and commodity funds. The FSA also expects UCITS and MiFID firms, currently subject to the FSA's Code, that manage Alternative Investment Funds (AIF) and depositaries and custodians of AIF assets, to also be in scope.
Employees impacted by the remuneration principles	The remuneration principles will apply to: • senior management; • control functions; and • individuals whose professional activities have a material impact on the risk profile of the Alternative Investment Fund Managers (AIFM) or the AIF they manage.
Application	Application of the remuneration principles will be subject to proportionality provisions, which take account of the size of the

[4] DP12/1 FSA Discussion Paper on implementation of AIFMD
http://www.fsa.gov.uk/static/FsaWeb/Shared/Documents/pubs/discussion/dp12-01.pdf

	AIFM and the AIF they manage, their internal organisation and the nature, scope and complexity of the activities of the AIFM and AIF. The key aspects considered will include the: • size of the AIFM and the size of fund they manage; • internal organisation of the AIFM; and • nature, scope and complexity of their activities.
Implementation	This could be achieved by: • extension of the Code to AIFMs and AIFs with a possible review of the Code's current tiering structure, or • a separate remuneration code to apply to AIFM and AIF which would be modelled closely on the Code.

Responses to the discussion paper had to be submitted to the FSA by 23 March 2012. The FSA will be working on its consultation paper which we expect to be issued in the second half of 2012. We hope this will provide much more detail than the discussion paper, in the form of specific proposals. But despite the built-in consultation process, the scope for the FSA to make major changes to its consultation paper proposals may be limited given the tight deadline for implementation of the directive. Firms will need to follow the evolution of the FSA's thinking on the AIFMD, and look to influence the regulator before the publication of the consultation paper.

In the event that changes to remuneration structures are required, there will be a number of challenges and areas of complexity facing the asset management sector. Current rules applying to Tier One and Two firms are based on the underlying principle that they are corporate entities able to use shares or share linked instrument for remuneration purposes. These rules would be much more difficult to comply with for smaller privately owned asset managers and especially those established as limited liability partnerships.

What firms need to consider

- How do you continue to demonstrate governance robust governance, performance management processes and compliant remuneration structures in line with CRD3 and current CRD4 proposals? These rules could be effective from 1 January 2013, impacting FY2012/13 variable remuneration paid after this date.
- Are you participating appropriately in the consultation process on AIFMD, and have you considered the final rules given the possible scenarios? Although the directive does not come into force until July 2013 it will almost certainly impact on remuneration for the 2013 performance year.

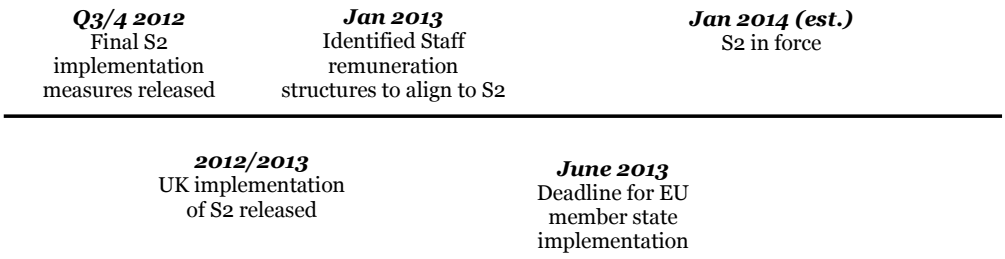
Insurance

What we expect to see going forward in 2012 and beyond

Until now insurers have escaped most regulatory requirements on remuneration as the firms fall outside the scope of CRD3. But the draft texts for Solvency2 (S2), the primary EU directive specifically aimed at the insurance sector, contains requirements on remuneration. The negotiations on the directive are proving extremely drawn out and we've now learnt that the European Parliament's discussions on the Level 1 text (the main directive text) will not take place until September 2012. This is despite the fact that the European Insurance and Occupational Pensions Authority (EIOPA) has prepared more detailed Level 2 text over the past 18 months or more.

The current drafts follow CRD3 principles and have, so far, adopted a high level approach, avoiding prescriptive rules on the structure of remuneration payouts. However, there is still much uncertainty about the final outcome of the negotiations in Brussels. The implementation date for Solvency2 had been expected to be January 2014, but even this deadline must be in doubt given the latest delay in the European Parliament.

The regulation timeline



What firms need to consider

While the effective date for Solvency2 is still some way off you should recognise that it will introduce new rules which are likely to have a major impact on remuneration policies, processes and structures particularly for employees considered to have a material influence on the risk profile of your firm. It's likely that the eventual implementation of Solvency2 will be heavily influenced by the FSA's approach already taken under the Code. If this is the case, insurers will need to identify people impacted by Solvency2 and begin to develop processes for identifying them. This could, for example, include mapping the risk taking processes and setting out who is ultimately responsible for the decisions which could result in material risks. Key considerations include underwriting limits, who sets them and how, how they're enforced and the escalation procedures for breaches.

While the identification process is an extensive exercise (particularly for larger insurers), existing processes including, for example, the capital evaluations and own risk and solvency assessment (ORSA) can be used. Capital assessments will also help to judge what risk taking can be considered material, both on a standalone and aggregated basis. ORSA will also include details of how risk is managed, listing who is responsible and describing how risk considerations are integrated into the chain of decision making reaching up to senior management and the board.

In addition to identified staff, Solvency2 will include requirements on remuneration policy, governance, and processes. Requirements will likely be similar to those currently applying to the banking and capital markets sector through the FSA Code, and will include:

- Development of group wide remuneration policy.
- Assessment of remuneration governance body terms of reference.
- Review of performance management systems and processes.
- Changes to remuneration structures.
- Greater disclosure of remuneration paid to key staff.

As a result, you will need to conduct an analysis of current practices against likely regulatory requirements as soon as possible to be able to develop an action plan to ensure alignment with requirements.

Once Solvency2 comes into force, the remuneration regulations covering insurers will be contained in a revised FSA Handbook. If Solvency2 is implemented by extending the current FSA Remuneration Code to insurers, we expect the FSA and its successors in the Prudential Regulatory Authority (PRA) to have developed significant knowledge and experience by 2014 so you will need to make sure your processes, tests, criteria, rationales for identifying impacted employees, are well documented and reflect emerging market practice.

The Retail Distribution Review

What is the Retail Distribution Review?

The RDR is the programme of regulatory change that the FSA is implementing for the sale of financial products to retail consumers. It covers:

- standards of professional competence and training for financial advisers,
- the way in which firms are required to describe the advice that they offer to consumers (independent advice or restricted advice), and
- the way in which advisers are remunerated. RDR is ending the system of commission payments (except trail commission for products sold before the RDR comes into effect).

The RDR regime comes into effect on 31 December 2012 and will impact all financial advisers, whether independent or employed by a product provider. The extent of the impact will depend on the business model operated by firms.

What you need to consider

The ending of commission remuneration structures will have major implications for remuneration policies and practices. You will need to consider the impact of RDR on a number of areas including:

- What are your existing performance management and reward systems and how will they be affected by this regulation?
- What new incentive structures could be implemented that can achieve the objective of recruiting, retaining and motivating staff?
- What financial and non-financial performance management metrics can be used to assess adviser performance?
- What technical and customer facing training will you introduce for advisers?
- What documents and processes are in place that will assist in the completion of the Retail Mediation and Activities Return (RMAR) with information on adviser charging and its submission to the FSA?

Summary

International regulators have drawn a line in the sand on remuneration practices in the financial services sector. This has been exemplified by proposals at an EU level that are more onerous and pervasive than any preceding regulation. As a result, all firms, regardless of size, complexity or risk profile, will have to make some changes to the way in which remuneration is governed within the business, ranging from additional disclosures and formalisation of processes, through to a complete overhaul of remuneration structures and the employment deal struck between an organisation and its employees.

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