

Response to FSA Consultation: General Guidance on Proportionality:

The Remuneration Code (SYS 19A) and Pillar 3 Disclosures on Remuneration (BIPRU 11)

1. Introduction: The Wholesale Markets Brokers' Association & London Energy Brokers' Association.

The Wholesale Markets Brokers' Association (WMBA) and the London Energy Brokers' Association (LEBA) (*referred to in this document as the WMBA*) are the European industry associations for the wholesale intermediation of Over-the-Counter (OTC) markets and trading venues in financial, energy, commodity and emissions markets and their traded derivatives. Our members are nearly entirely Limited Activity and Limited Licence firms and all act solely as intermediaries in the said wholesale financial markets. As Interdealer Brokers (IDBs), the WMBA members' principal client base is made up of global banks, primary dealers, large energy companies and other wholesale market participants. This paper should be seen in the context of WMBA members acting exclusively as intermediaries and not as own account traders. (Please see www.wmba.org.uk and www.leba.org.uk for information about the associations, its members and products.)

2. General Remarks

Operating solely as intermediaries, WMBA member firms are not systemically important and would not require resolution or administration in the event of bankruptcy. This has been evidenced by the fact that during the credit crisis our member firms did not seek or obtain taxpayer support.

The WMBA is of the opinion that the nature, risk profile and absence of complexity in the business models of our members do not reflect the concerns and objectivities that the FSA want to address in this Code. By adherence to the Code, despite the current exemptions, the FSA is still asking WMBA members to comply with requirements to mitigate losses that cannot potentiate and do not currently exist. WMBA members do not take any proprietary positions, they are not risk takers, and hence are not exposed to any of the credit or principal market risks, detailed in the Code, in the markets in which they operate nor in which they act as an arranger. Specifically, by dint of being Limited Activity/Limited Licence firms, IDBs only hold capital against operational risks under their internal capital guidelines.

WMBA members operate three models to facilitate trades: **Name Give Up**, **Exchange Agency** and **Matched Principal**. These models are detailed on our website. Albeit that members use their own capital to facilitate the settlement of matched principal trades, this is purely facilitation in cash bond markets and should not be considered the same as the risks associated with proprietary trading.

It is also important to underline that WMBA members do not give investment advice in their arranging and execution functions and, therefore, are also separate from the risks and responsibilities specific to the sales and distribution function as commonly recognised in the supervision of investment firms.

Consequently, the variable remuneration of brokers who are non-Code staff is derived from the commission earned for arranging a trade and based on the volume of business and number of tickets written. This is not obliged to be paid until the commissions have been received. As can be seen, the risk profile for this business model is substantially different to that of a market principal who earns a bonus based on the profitability of the trades he enters into or related to the sales function

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in the broker-dealer model. The WMBA is aware that other EU regulators do not apply the Remuneration Code rules to fee based income and would respectfully request that the FSA consider the total exclusion of this type of firm from the requirements laid out in the Code

WMBA members are concerned that the role of Limited Activity/Limited Licence firms are currently an FSA concept and not recognised in a European context where the role of the matched principal IDB is considered to be synonymous with trading for own account.

The WMBA, in conjunction with the FSA, has lobbied the EU Commission, EU Parliament and ESMA in respect of this perception and are worried that whilst the tier structure for the UK Remuneration Code is a purely domestic issue, the blurring of the distinction between tier 3 (*firms trading on own account*) and tier 4 (*Limited Licence/Limited Activity*) in the UK could have unseen repercussions in respect of other non-finalised European Regulation.

The WMBA is also concerned about the rationale and timing for this change in respect of Limited Licence/Limited Activity firms. The proposed discretion afforded to these firms in paragraph 32 of the consultation results in the new tier 3 being subdivided into two distinct subgroups which is analogous to the current tier 3 and 4 regime.

3. Comments on Proposed Guidance

The Guidance proposes that the current four tier structure (based on Capital Resources) be replaced with a three new levels (based on total assets).

The effect on our members, who are Limited Activity/Limited Licence firms, would be to reclassify them as tier 3 firms and theoretically subject them to the following:

Principles:

- *Principle 12: Remuneration Structures*
 - SYSC 19A.3.44R - Appropriate Ratios between fixed and variable components of total remuneration
- *Principle 8: Profit-Based Measurement and Risk Adjustment*
 - SYSC 19A.3.22 - This Remuneration Principle stresses the importance of risk adjustment in measuring performance, and the importance within that process of applying judgement and common sense. A firm should ask the risk management function to validate and assess risk-adjustment techniques, and to attend a meeting of the governing body or remuneration committee for this purpose.
- *Principle 12: Remuneration Structures - Assessment of Performance*
 - SYSC 19A.3.38R - Assessment of Performance to be on a multi-year framework in order to ensure that the assessment process is based on longer term performance and reflects the underlying business cycle.

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Pillar 3 Disclosures:

- *BIPRU11.5.18R (7) (a): The amount of remuneration for the financial year, split into fixed and variable remuneration, and the number of beneficiaries.*

These requirements are not relevant to Limited Licence/Limited Activity firms' business models and appear to be negated by the guidance in paragraph 32 of the consultation in respect of the expectations of Limited Licence/Limited Liability firms and the special features of firms differing types of activity. However, this paragraph is worded in a subjective manner and for clarity the WMBA would request that, as both the Banking Consolidated Directive and CEBs Guidelines endorse this approach, it is stated in a more affirmative manner in respect of Limited Licence and Limited Activity firms.

Contact:

If you require any further information or clarification in respect of this response please do not hesitate to contact us.

Alex McDonald, CEO

Telephone: +44 (0) 203 207 9740

Email: amcdonald@wmba.org.uk

or

Pamela Donnison, Compliance

Telephone: +44 (0) 203 207 9740

Email: pdonnison@wmba.org.uk

Email: compliance@wmba.org.uk

Wholesale Markets Brokers' Association

St Clements House

27-28 Clements Lane

London EC4N 7AE

Telephone: 020 3207 9740