Comments

of the German Insurance Association (GDV)

on the Consultative Document of a

Supplementary Guidance to the FSB-Principles and Standards on Sound Compensation Practices

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Executive Summary

The consultative document „Supplementary Guidance to the FSB-Principles and Standards on Sound Compensation Practices" is **in general helpful** for companies to interpret the FSB-Standards and Principles.

But the German insurance industry doubts that a **uniform approach for banks and insurance companies** is appropriate in terms of remuneration. The business model of banks and insurance companies is too different to apply a uniform standard.

FSB should furthermore take care about setting **no extra set of new rules and standards** with this paper which is meant to guide through existing rules. Especially the guidance recommendations on page six and seven of the consultative document are not needed. Also should no new risk categories like **"misconduct risk"** be incorporated in the document. The companies should be free to use the kind of performance criteria that is suitable with the risk profile of each single company.

Because variable remuneration at lower level does not set disincentives for the affected persons within a company, there must be an **exemption limit** under which the companies are not forced to implement the provided regulation for variable remuneration.

1. Introduction

The German Insurance Association welcomes the opportunity to comment on the consultative document of a „Supplementary Guidance to the FSB-Principles and Standards on Sound Compensation Practices". In general this document is a helpful support for the companies involved to interpret the FSB-Principles and Standards. But FSB should ensure that this document is really **only a support to interpret existing FSB-Principles and not a repository for new rules beside the existing ones**. Under this aspect especially the guidance recommendations on page six and seven of the document should be deleted. Hereinafter the German Insurance Association would like to focus on some critical issues related to the consultative document.

2. No uniform approach for banks and insurance companies

The German insurance industry does not consider it appropriate to draw up **uniform remuneration** requirements for banks and insurance companies. The long-term business models of insurance companies differ in principle from the operation of the banking business. It follows that the risk profile of insurance companies has a different structure from that of banks. The remuneration requirements must be based on this. Therefore, a number of issues relating to remuneration in the two sectors of the financial industry may and **must be dealt with differently**. This applies in particular to the determination of the material portion of the variable remuneration, which is to be paid out with a delay. Such high limits as in the banking sector are not useful in the insurance sector, given the supervisory objectives.

In the future, therefore, uniform requirements for banks and insurance companies should be dispensed with. If at all, a **sector-specific regulation** should be considered.

3. No new rules through "Supplementary Guidance"

The FSB-Principles have proved their worth following the financial crisis. In the last nearly ten years new sound compensation practices have been implemented in the finance industry. Although primarily banks have caused the financial crisis, also insurance companies were affected by those new practices heavily. Within the European Union the **regulation of Solvency II** has set new rules for sound compensation practices in the insurance industry. It should be avoided that those effective rules of Solvency II are distorted by new international standards. Insofar – also as an answer to the first and the second question on page three of the consultative document – no more detailed guidance is needed.

Especially Guidance No. 7 is related to this topic a cause of concern. Therefore companies involved should have written detailed **"performance adjustment policies"** with processes, criteria, scenarios and examples for the adjustment of variable remuneration. While we agree that those adjustments should take place in case of misconduct of business, we do not think it is necessary for companies to have detailed written policies about that. Adjustments of the variable remuneration in cases of misconduct of business can also be made within the existing forms of the ongoing valuation of performance.

4. Exemption limit necessary

Variable remuneration at lower level is unsuitable to set disincentives for the affected persons within a company and their conduct of business. Because of that it is necessary to have a **reasonable exemption limit** under which the strict regulation for the variable remuneration has not to be exercised by the companies. Otherwise there would be for lower variable remuneration a **bureaucratic burden for companies without any effective impact on the regulatory targets**. So FSB should incorporate into the consultative document a sufficient high exemption limit (for example: 100.000 US-$ of total variable remuneration) to avoid such undesirable bureaucratic effects.

5. Flexible performance criteria for variable remuneration important

The consultative document conveys the impression that conduct of business is the only / central criteria to assess the performance for the variable part of the remuneration. It should be clarified within the document that conduct of business is one of the assessment criteria, but that companies are allowed to **measure their own mix of performance criteria**. For the assessment of performance and the adjustment of the variable remuneration there are a lot of other important criteria than only the conduct of business. It should be clarified that companies have the opportunity to define and weight their own appropriate kind of **qualitative and quantitative criteria** beside the conduct of business.

The same applies to the possible **instruments for the adjustment** of the variable remuneration FSB proposes (inyear adjustment, malus, clawback). Companies should have the opportunity to decide by themselves which kind of instruments they use. It should be clarified that there is no obligation for companies to use one or all of those criteria FSB suggests (cf. question 3. on page three of the consultative document). This flexibility is necessary for the companies because the **effectiveness of some of those instruments** may be questioned. Especially clawback provisions in remuneration contracts can under some circumstances – as newer scientific studies have shown – be counterproductive in the light of additional risk-taking.[1]

6. No new risk categories

On page five under the point "Background" the consultative paper refers to a specific **"misconduct risk"** beside the reputational and the operational risk. Also question 6. on page three of the consultative document covers this kind of risk. Such a "misconduct risk" is from our point of view – and under any normal risk management approach – part of the general operational risk of a company and **no specific risk category**. Under Solvency II for example the term of "misconduct risk" doesn't exist. This kind of risk is integrated in the other risk forms of an insurance company. The term of "misconduct risk" should be avoided in the consultative document.

Moreover it is inappropriate that companies following the guidance to Principle 5 (2.1. of the consultative document) should take into account the "misconduct risk" for adjustments during the whole **life cycle of employment**. Such long time periods are not suitable for adjustments of the variable remuneration.

Furthermore it should be noted that Principle 4 refers to different kind of risks like liquidity risk, reputation risk and capital cost. For **small and medium sized companies** this reference is not conducive because those companies often do not have the key figures to use those categories for remuneration related performance criteria.

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[1] Hirsch, B., et. al., The impact of clawback provisions on information processing and investment behavior. Manage. Account Res. (2017), https://dx.doi.org/10.1016/j.mar.2016.12.001.