HSBC

Email: fsb@fsb.org

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Dear Sir/Madam

We welcome the opportunity to respond to FSB's consultation paper on "Supplementary Guidance to the FSB Principles and Standards on Sound Compensation Practices".

In principle, we are in agreement with the guidance outlined in the document and welcome the FSB's work to further increase the effectiveness of compensation tools in addressing misconduct risk.

However, we remain concerned that there will be 'level-playing field' issues if the proposed guidance is not implemented across all regions in a uniform, consistent and timely manner. You will be aware that there have been inconsistencies in both timing and the way in which the previous FSB principles (issued in 2009) have been applied by various jurisdictions (and their application, or otherwise, to different parts of the financial sector). We would, therefore, request that the FSB consider how the proposed guidance could be implemented consistently and in a specified timeframe across all jurisdictions.

We have provided below our answers to the individual questions raised:

1. Should the Guidance be more specific with regard to the respective roles of the board or that of senior managers with regard to compensation and misconduct?

We are supportive of the proposed guidance as it sets out the broad principles for firms. We believe more prescriptive guidance would reduce the flexibility that is necessary across different group / corporate structures.

2. The Guidance suggests that qualitative, non-financial assessments should have a direct impact on compensation and that they are important in determining how to align compensation with risk. Would additional guidance be helpful? Please provide data if your firm uses such provisions including the types of metrics used, and a discussion of any challenges you face in their use.

We agree with use of non-financial measures and that assessment against such measures should have an impact on compensation. We do not believe additional guidance or granularity on the specific measures to be used is required as firms should be able to choose the measures that is aligned with their strategic objectives and priorities. We currently use non-financial measures such as:

- Achieving and sustaining compliance with global financial crime compliance policies.
- Maturity level achieved against conduct outcomes.
- Effective risk management with anti-money laundering, sanctions, anti-bribery and corruption policies.
- Improving customer satisfaction and employee diversity.

In our view, the key challenge in using non-financial measures is to have an appropriate framework and internal policies/processes to monitor, independently assess performance against these measures and ensure the assessments are consistently taken into account in determining the performance rating and variable pay recommendation. We believe an effective implementation of such a framework requires involvement and support from different functions such as Risk, Compliance, Internal Audit, and other internal stakeholders who will have a clear and closer line-of-sight on how a business and/or individual is performing against such measures.

3. The Guidance identifies three tools most commonly used to address misconduct: in-year adjustment (adjustment to the current year's variable compensation before it is awarded); malus (reduction of deferred compensation before it has vested or fully transferred); and clawback, which permits recovery of variable compensation that has already been paid and vested. Given the particular characteristics of misconduct risk, do you believe that <u>all</u> three tools need to be available to a firm to establish appropriate incentives to deter misconduct?

We agree that all three tools should be available for a firm to deter misconduct. Our in-year adjustment and malus policy applies to all employees. We apply the clawback policy to individuals identified as Material Risk Takers for the purpose of the UK's Prudential Regulation Authority's Remuneration Rules.

We would recommend the application of clawback is limited to senior employees given the complexity that would be involved in applying clawback in certain jurisdictions. In our view, application of clawback more widely to all employees would not be feasible in terms of materiality and the costs that would be involved in enforcing clawback.

4. The Guidance suggests minimum scenarios where adjustment of compensation should occur. Are there additional circumstances in which adjustments to compensation should be expected? What are the advantages and disadvantages of suggesting such minimum conditions? In particular, is there evidence from past use of such tools that might be instructive in how to formulate such scenarios?

The suggested minimum scenarios are broadly in line with the scenarios that we would consider for making any adjustments.

5. How much variable compensation should be placed at risk of adjustment in order to effectively impact incentives for excessive risk-taking or other inappropriate conduct?

We would say up to 100% of the variable compensation/outstanding deferred awards should be placed at risk of adjustment. However, the actual adjustment for each individual should be determined based on each individual's role/responsibility, proximity to the incident and the risk severity of their involvement and actions in the relevant incident.

6. Does the Guidance adequately cover compensation incentives that may be relevant to addressing misconduct risk in all sectors of the financial industry? Are there additional specific provisions that should be considered to better address misconduct risks in particular financial sectors? Are there specific provisions in the guidance that may not be relevant to a particular financial sector?

In our view, the proposed guidelines broadly refer to financial and non-financial incentives and should therefore cover all types of compensation incentives.

The challenge, as indicated it the outset, is ensuring consistent application across jurisdiction, including with regard to the way in which the guidelines are applicable to different parts of the financial sector (e.g., Banking versus Asset Management).

We would be happy to discuss the content of this response in more detail and answer any questions you may have.

Yours sincerely

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