Response from the Italian Banking Association
to the FBS consultation document

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

Consultative Document

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ABI Associazione Bancaria Italiana

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Preliminary remarks

The FSB, with its consultation document, prepares guidance to supplement the P&S published in 2009, in the form of recommendations on better practice that specifically address the link between compensation and conduct. The Supplementary Guidance should be read in conjunction with the P&S.

The Italian Banking Association is grateful for the opportunity to contribute to definition of the Supplementary Guideline.

Italian legislation places a great deal of emphasis on the conduct of personnel and ABI appreciates the attention focused on prevention of misconduct and the repercussions it may have on remuneration.

Regarding the specific matters addressed in the document (to which the following Annex replies) ABI deems it appropriate preliminarily to highlight a few topics.

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The Banca d'Italia provisions of November 2014 provide that "Remuneration and staff incentive schemes are designed to ensure compliance with all legal and regulatory provisions applicable to banks and banking groups. These aspects, particularly when they relate to internal and external networks, cannot be based solely on business objectives, but also on propriety in customer relations, limitation of legal and reputational risks, protection of customers and customer loyalty, compliance with applicable self-discipline provisions. For internal and external networks as well as for those who are entrusted with control tasks, the supervisory provisions on bank transparency and fairness between brokers and customers, as well as those concerning anti-money laundering regulations, should be noted. "

Regarding alignment of remuneration with the risk of misconduct, these provisions establish: "Regardless of the method of determination (top-down or bottom-up), the total amount of variable remuneration is based on actual and lasting results and also takes quality objectives into account. The parameters to which the salary ratio is related are clearly identified, objective and immediate. When discretionary assessments are used, the criteria on which they are based are clear and predetermined, and the entire decision-making process is appropriately explained and documented."

Provisions also provide for alignment of remuneration with the risk of misconduct through malus and claw back clauses to be applied to 100% of variable remuneration (see also the Answer to Question 4).

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ABI and Trade Unions focused attention on the topic of variable remuneration and incentive schemes related to business initiatives in the Agreement on Trade Policy and Labour Organization dated 8 February 2017.

The objective of the Agreement is to ensure that business practices and business behaviour are fully in line with the applicable regulatory framework, national collective agreements and the provisions of the Agreement, including with regard to incentive systems and business initiatives.

ABI and Trade Unions have stressed that incentive systems must be based on fair and transparent criteria over the medium and long term periods, as well as on sustainable quantity and quality targets, focusing maximum attention on steps involved in assigning targets and possible changes in those targets.

In addition, incentive systems should provide for a clear assignment of goals by the relevant corporate functions, both in terms of the rules and the tools available, enhancing teamwork and the professionalism of individual workers.

Everything indicated here above confirms that the regulations applied to Italian banks already provide for a strong focus on the conduct of staff and the consequences it may have on remuneration.

Response to the Consultation questions

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?

In the Guidance "*The board should oversee and senior management should ensure that the firm has in place a compensation system designed to promote ethical behaviour and compliance with laws, regulations, and internal conduct standards*".

ABI considers that the respective roles of the board or of senior managers with regard to compensation and misconduct are clear.

As an example of good practice, we ask to include the following: "Companies define a code of conduct / ethics that represents the set of principles that inspire the business of the company and the behaviour of all those who work for it, within their respective competencies and positions." This will allow any behaviour that does not conform with the codes and therefore is considered incorrect to be identified.

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.

In determining how to align compensation with risk, it would be important to have an additional guidance to suggest qualitative, non-financial assessments that should have a direct impact on compensation.

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 all three tools need to be available to a firm to establish appropriate incentives to deter misconduct?

Italian regulations already contains these three tools.

ABI believes that all three tools need to be available to establish appropriate incentives to deter misconduct.

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 guidance provides for formalization of policy scenarios and criteria that involve an ex ante and ex post remuneration adjustment.

In the described scenarios, there are some additions to the provisions in force in Italy.

In particular, in Italian regulations:

"The variable component is subject, through specific arrangements, to ex post (malus and claw back) correction mechanisms, among other things, to reflect performance levels net of the risks actually incurred or acquired and assets and to take account of individual behaviour; the mechanisms can therefore lead to a reduction, possibly significant, or even annulment, of the variable remuneration itself, especially in the case of results which are significantly lower than predetermined targets or negative. The bank identifies criteria and assumptions for the application of these mechanisms:

a) the claw back mechanism is applied at least to the incentives recognized and/or paid to those who have caused or contributed to causing:

   - behaviour resulting in a significant loss for the bank;

   - breaches of the obligations imposed pursuant to the Italian Banking Laws Consolidation Act (article 26 or, where the party is an interested party, article 53, paragraph 4), or the obligations on remuneration and incentives;

   - fraudulent conduct or gross negligence damaging the bank.

b) the malus mechanisms are applied not only in the cases under (a), but also to take account of performance net of the risks incurred or achieved and financial performance and liquidity.

The consultative document lists how, in good practice,

"*Such scenarios should include cases in which:*

(i) the individual was accountable for misconduct that led to significant losses for the institution or significant adverse outcomes ***for its customers or counterparties;***

or (ii) there is fraud, gross negligence or material failure of risk management controls, including serious breach of internal rules or regulations, ***regardless of the scale of the damage****."*

ABI shares inclusion of integrations, as they clarify the scope of norms and provide a useful tool to activate malus and claw-back clauses.

We kindly request clarification of the meaning of "*significant adverse outcomes for its customers or counterparties*".

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?

Under Italian law, the malus and claw-back clauses apply to the entire variable remuneration.

The total variable remuneration should be placed at risk of adjustment in order to effectively impact incentives for excessive risk-taking or other inappropriate conduct

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?

ABI deems that the Guidance adequately covers compensation incentives that may be relevant to addressing the misconduct risk in all sectors of the financial industry.

ABI believes that different levels of risk - even in terms of misconduct - are a function of the areas of activity in which individual employees work.

Therefore, in the definition of remuneration policy, companies assess all risks - including those of misconduct - and weigh them in an appropriate manner, using proportionality criteria.