FSB FINANCIAL STABILITY BOARD

# Press release

Press enquiries:
+41 61 280 8037

press@bis.org

Ref no: 44/2011

11 October 2011

## FSB publishes follow-up peer review on compensation practices

The Financial Stability Board (FSB) published today the follow-up peer review report on compensation practices, which assesses progress made both by national authorities and by significant financial institutions in implementing the FSB *Principles for Sound Compensation Practices* and their *Implementation Standards.*[1]

Compensation practices at large financial institutions were a key contributing factor to the global financial crisis. The FSB Principles and Standards, endorsed by G20 Leaders at their Summits in London in April 2009 and Pittsburgh in September 2009, were developed to align compensation with prudent risk-taking, particularly at significant financial institutions.

This follow-up review finds that relevant authorities and firms in FSB member jurisdictions have made good progress in implementing the Principles and Standards – many national authorities have taken the necessary regulatory actions, supervisory oversight has intensified, and the governance of compensation schemes at firms has improved. Since last year's peer review, an additional seven jurisdictions have implemented all 9 Principles and 15 Standards, bringing the total to 13 of the 24 FSB member jurisdictions, while five other jurisdictions have implemented all but one or two Standards.

The peer review also collected and analysed information from a sample of 66 banks and broker dealers identified by FSB member jurisdictions as significant for the purposes of this review. The 20 large internationally active firms in the sample were found to have made progress in implementing the Principles and Standards and their compensation practices appear, on average, to be broadly consistent with nearly all elements of the Principles and Standards. The progress at these firms may reflect the priority given to them in terms of supervisory attention as well as their location in jurisdictions that moved earlier in implementing the Principles and Standards. The progress at other firms – competing mostly in domestic markets – is much more varied, with some of these firms as advanced as the large internationally active firms, while others are at an earlier stage of progress.

Despite these considerable strides, more work is necessary to achieve sound compensation practices – both to overcome constraints to full implementation by individual national authorities and to address concerns over different interpretations of the standards that may give rise to an uneven playing field in the market for highly skilled employees. Those concerns have focused particularly on differences in the way that jurisdictions have implemented Standards 6-9 (pay structures), 11 (guarantees) and 14 (hedging) as well as in the identification of material risk takers. Increased transparency of supervisory policies and

[1] The FSB published the first thematic peer review report on compensation practices in March 2010.

guidance would help to mitigate such concerns, while more detailed data would be required to substantiate concerns that averages may conceal variation in pay structures for key employees within firms.

Achieving lasting change in behaviour and culture within firms is a long-term challenge that requires a sustained commitment. The report contains six recommendations to support advancement of the implementation of the FSB Principles and Standards by national authorities and firms in order to effectively impact firms' behaviour and risk-taking incentives:

- All FSB member jurisdictions should finalise the implementation of the Principles and Standards, and should periodically report to the FSB any significant implementation impediments and proposed actions to address them. Proportionality in the implementation of the Principles and Standards may be justified by the business model and risk profile of the institution, and FSB member jurisdictions should clearly define criteria for proportionality in national regulations or supervisory guidance and proactively ensure that it remains appropriate.
- National supervisors should work bilaterally to verify and, as needed, address specific level playing field concerns raised by their respective institutions, particularly with regard to the implementation of Standards 6-9, 11 and 14. They should report the nature of the concerns, the actions taken to address them and the outcomes at least annually to the FSB in order to inform the scope and intensity of its monitoring.
- The FSB should undertake ongoing monitoring and public reporting on the implementation of the Principles and Standards as part of its coordinated framework for monitoring agreed G20/FSB financial reforms. Based on the findings from the ongoing monitoring, the FSB should consider the scope and appropriate timing for a follow-up peer review on compensation practices as well as any decision to issue additional FSB guidance on the interpretation of the definition of material risk takers.
- Supervisory cooperation in the area of compensation practices should be stepped up, and supervisory networks should be used to exchange information to enhance the effectiveness and consistency of implementation.
- Supervisors should ensure that all financial institutions deemed significant for the purposes of the Principles and Standards take immediate steps to align their practices with the key requirements in the area of effective governance of compensation.
- Supervisors should ensure that all financial institutions deemed significant for the purposes of the Principles and Standards comply with the Basel Committee's Pillar 3 disclosure requirements for remuneration.

Mario Draghi, Chairman of the FSB, said "I am pleased to note the progress made by national authorities and firms to promote sound compensation practices." He added that "However, there is still room for improvement and efforts should continue in this area."

Tiff Macklem, Chairman of the FSB's Standing Committee on Standards Implementation (SCSI), said "This has been the most rigorous and intensive review that the SCSI has undertaken to date. The FSB's ongoing monitoring and public reporting on compensation practices will provide further impetus toward full implementation of the FSB Principles and Standards and thereby incentivise prudent risk-taking behaviour in financial institutions."

**Notes to editors**

The FSB has been established to coordinate at the international level the work of national financial authorities and international standard setting bodies and to develop and promote the implementation of effective regulatory, supervisory and other financial sector policies in the interest of financial stability. It brings together national authorities responsible for financial stability in 24 countries and jurisdictions, international financial institutions, sector-specific international groupings of regulators and supervisors, and committees of central bank experts.

The FSB began a regular programme of peer reviews in 2010, consisting of thematic reviews and country reviews. Thematic peer reviews focus on implementation of international financial standards, policies agreed within the FSB or, where such standards or agreed policies do not exist, a stock-taking of existing practices in the policy area. The objectives of the reviews are to encourage consistent cross-country and cross-sector implementation, to evaluate the extent to which standards and policies have had their intended results and, where relevant, to make recommendations for potential follow-up by regulators, supervisors and standard setters. They provide an opportunity for FSB members to engage in dialogue with their peers and to share lessons and experiences.

This report describes the findings of the second compensation peer review, including the key elements of the discussions in the FSB Standing Committee on Standards Implementation and Plenary. The draft report for discussion was prepared by a team of experts drawn from FSB member institutions and led by Klaas Knot, President, De Nederlandsche Bank. The FSB working group that drafted the assessment criteria used by the peer review team in analysing the responses was chaired by David Raikes, Remuneration Team Manager, UK Financial Services Authority.

The FSB is chaired by Mario Draghi, Governor of the Bank of Italy. Its Secretariat is located in Basel, Switzerland, and hosted by the Bank for International Settlements.

For further information on the FSB, visit the FSB website, www.financialstabilityboard.org.