FINANCIAL STABILITY BOARD

22 December 2009

Thematic Review on Compensation

Review Template

This template guides member jurisdictions in providing input for the thematic review on the implementation of the FSB Principles for Sound Compensation Practices and Implementation Standards. The template is structured in two parts:

- *general questions on the overall approach and scope of application of the Principles and Standards in each member jurisdiction; and*
- *a template on progress being made by firms and national authorities with respect to each element of the Principles and Standards, and planned next steps.*

Member jurisdictions are kindly requested to return the completed template to the FSB secretariat (fsb@bis.org; tel. +41 61 280-8080) by 25 January 2010.

I. General questions

1. Do significant financial institutions in your jurisdiction make material use of incentives-based compensation (variable compensation, or bonuses)? Please explain, for instance in terms of an estimate of the fraction of variable-to-fixed compensation, on average, for relevant employee categories (i.e., executives, senior management, other risk takers) and by type of financial activity (e.g., investment banking, commercial banking, other).
2. What is your jurisdiction's overall approach to implementing the Principles and Standards? Please specify whether legislative, regulatory, supervisory or the specific mix. How is compliance checked and enforced?
3. How many financial institutions (domestic, foreign) operating in your jurisdiction are required to conform to the Principles and Standards or the respective national rules? Please specify the number of such institutions, their sector of activities (e.g., banking, insurance) and the share of the relevant market segment they represent. What is your process to determine which financial institutions are required to conform to the Principles and Standards?
4. Do the measures taken to implement the Principles and Standards apply at the group level for institutions headquartered in you jurisdiction? Do they also apply to foreign affiliates (and branches) operating in your jurisdiction?
5. What categories of employees do the measures taken in your jurisdiction to implement the Principles and Standards apply to?
6. How much supervisory activity (e.g., policy frameworks, engagement with individual firms, information collection on firms' practices) with respect to the Principles and Standards has occurred in the jurisdiction? How much is planned during 2010 and what are the priorities? For instance, of the number of relevant financial institutions noted

above, what fraction has experienced a supervisory review of compensation practices? What fraction will undergo one by end-2010?

7. Has the adoption of the Principles and Standards led to any material changes to date in the compensation practices of financial institutions operating in your jurisdiction? Please provide supporting information (see also template below).

8. Are there any unexpected implementation issues that have been encountered to date?

II. Review template

Please provide in the table below a detailed description of the steps being taken in your jurisdiction to ensure effective application of the FSB Principles and Standards and the evidence about whether the Principles have been or are being implemented by firms. The table maps Standards to the relevant Principles following the approach of the Basel Committee Compensation Assessment Methodology.

Insofar as possible and relevant, the description should include information on (i) relevant laws and regulations, including major tax provisions, as applicable, and those that are being planned and their expected timeframe; (ii) supervisory tools and activities, including those that are being planned and their expected timeframe; and (iii) current evidence of implementation by financial firms, including gaps identified by the supervisory authority and firms' action plans to address them.

Please ensure answers are brief and respond directly to the points made in the Principles and Standards. Where the answer is a negative, or not known, please say so. Where there is a degree of overlap, and your answer is adequately adequately covered in another response, a cross reference is encouraged.

a. Effective governance of compensation

Principle 1.	The firm's board of directors must actively oversee the compensation system's design and operation. The compensation system should not be primarily controlled by the chief executive officer and management team. Relevant board members and employees must have independence and expertise in risk management and compensation.
Steps taken to date	
Actions planned	
Firms' evidence	
Principle 2.	The firm's board of directors must monitor and review the compensation system to ensure the system operates as intended. The compensation system should include controls. The practical operation of the system should be regularly reviewed for compliance with design policies and procedures. Compensation outcomes, risk measurements, and risk outcomes should be regularly reviewed for consistency with intentions.
Steps taken to date	
Actions planned	
Firms' evidence	
Standard 1.	Significant financial institutions should have a board remuneration committee as an integral part of their governance structure and organisation to oversee the compensation system's design and operation on behalf of the board of directors. The remuneration committee should: ▪ be constituted in a way that enables it to exercise competent and independent judgment

	on compensation policies and practices and the incentives created for managing risk, capital and liquidity. In addition, it should carefully evaluate practices by which compensation is paid for potential future revenues whose timing and likelihood remain uncertain. In so doing, it should demonstrate that its decisions are consistent with an assessment of the firm's financial condition and future prospects; ▪ to that end, work closely with the firm's risk committee in the evaluation of the incentives created by the compensation system; ▪ ensure that the firm's compensation policy is in compliance with the FSB Principles and Standards as well as complementary guidance by the Basel Committee, IAIS and IOSCO, and the respective rules by national supervisory authorities; and ▪ ensure that an annual compensation review, if appropriate externally commissioned, is conducted independently of management and submitted to the relevant national supervisory authorities or disclosed publicly. Such a review should assess compliance with the FSB Principles and Standards or applicable standards promulgated by national supervisors.
Steps taken to date	
Actions planned	
Firms' evidence	
Principle 3.	Staff engaged in financial and risk control must be independent, have appropriate authority, and be compensated in a manner that is independent of the business areas they oversee and commensurate with their key role in the firm. Effective independence and appropriate authority of such staff are necessary to preserve the integrity of financial and risk management's influence on incentive compensation.
Steps taken to date	
Actions planned	
Firms' evidence	
Standard 2.	For employees in the risk and compliance function: ▪ remuneration should be determined independently of other business areas and be adequate to attract qualified and experienced staff; ▪ performance measures should be based principally on the achievement of the objectives of their functions.
Steps taken to date	
Actions planned	
Firms' evidence	

b. Effective alignment of compensation with prudent risk-taking

Principle 4.	Compensation must be adjusted for all types of risk. Two employees who generate the same short-run profit but take different amounts of risk on behalf of their firm should not be treated the same by the compensation system. In general, both quantitative measures and human judgment should play a role in determining risk adjustments. Risk adjustments should account for all types of risk, including difficult-to-measure risks such as liquidity risk, reputation risk and cost of capital.
Steps taken to date	
Actions planned	
Firms' evidence	
Standard 3.	Significant financial institutions should ensure that total variable compensation does not limit their ability to strengthen their capital base. The extent to which capital needs to be built up

	should be a function of a firm's current capital position. National supervisors should limit variable compensation as a percentage of total net revenues when it is inconsistent with the maintenance of a sound capital base.
Steps taken to date	
Actions planned	
Firms' evidence	
Standard 4.	For significant financial institutions, the size of the variable compensation pool and its allocation within the firm should take into account the full range of current and potential risks, and in particular: ▪ the cost and quantity of capital required to support the risks taken; ▪ the cost and quantity of the liquidity risk assumed in the conduct of business; and ▪ consistency with the timing and likelihood of potential future revenues incorporated into current earnings.
Steps taken to date	
Actions planned	
Firms' evidence	
Principle 5.	Compensation outcomes must be symmetric with risk outcomes. Compensation systems should link the size of the bonus pool to the overall performance of the firm. Employees' incentive payments should be linked to the contribution of the individual and business to such performance. Bonuses should diminish or disappear in the event of poor firm, divisional or business unit performance.
Steps taken to date	
Actions planned	
Firms' evidence	
Standard 5.	Subdued or negative financial performance of the firm should generally lead to a considerable contraction of the firm's total variable compensation, taking into account both current compensation and reductions in payouts of amounts previously earned, including through malus or clawback arrangements.
Steps taken to date	
Actions planned	
Firms' evidence	
Principle 6.	Compensation payout schedules must be sensitive to the time horizon of risks. Profits and losses of different activities of a financial firm are realized over different periods of time. Variable compensation payments should be deferred accordingly. Payments should not be finalized over short periods where risks are realized over long periods. Management should question payouts for income that cannot be realized or whose likelihood of realisation remains uncertain at the time of payout.
Steps taken to date	
Actions planned	
Firms' evidence	
Standard 6.	For senior executives as well as other employees whose actions have a material impact on the risk exposure of the firm: ▪ a substantial proportion of compensation should be variable and paid on the basis of individual, business-unit and firm-wide measures that adequately measure performance; ▪ a substantial portion of variable compensation, such as 40 to 60 percent, should be

	payable under deferral arrangements over a period of years; and ▪ these proportions should increase significantly along with the level of seniority and/or responsibility. For the most senior management and the most highly paid employees, the percentage of variable compensation that is deferred should be substantially higher, for instance above 60 percent.
Steps taken to date	
Actions planned	
Firms' evidence	
Standard 7.	The deferral period described above should not be less than three years, provided that the period is correctly aligned with the nature of the business, its risks and the activities of the employee in question. Compensation payable under deferral arrangements should generally vest no faster than on a pro rata basis.
Steps taken to date	
Actions planned	
Firms' evidence	
Principle 7.	The mix of cash, equity and other forms of compensation must be consistent with risk alignment. The mix will vary depending on the employee's position and role. The firm should be able to explain the rationale for its mix.
Steps taken to date	
Actions planned	
Firms' evidence	
Standard 8.	A substantial proportion, such as more than 50 percent, of variable compensation should be awarded in shares or share-linked instruments (or, where appropriate, other non-cash instruments), as long as these instruments create incentives aligned with long-term value creation and the time horizons of risk. Awards in shares or share-linked instruments should be subject to an appropriate share retention policy.
Steps taken to date	
Actions planned	
Firms' evidence	
Standard 9.	The remaining portion of the deferred compensation can be paid as cash compensation vesting gradually. In the event of negative contributions of the firm and/or the relevant line of business in any year during the vesting period, any unvested portions are to be clawed back, subject to the realised performance of the firm and the business line.
Steps taken to date	
Actions planned	
Firms' evidence	
Standard 11.	Guaranteed bonuses are not consistent with sound risk management or the pay-for-performance principle and should not be a part of prospective compensation plans. Exceptional minimum bonuses should only occur in the context of hiring new staff and be limited to the first year.
Steps taken to date	
Actions planned	
Firms' evidence	
Standard 12.	Existing contractual payments related to a termination of employment should be re-examined,

	and kept in place only if there is a clear basis for concluding that they are aligned with long-term value creation and prudent risk-taking; prospectively, any such payments should be related to performance achieved over time and designed in a way that does not reward failure.
Steps taken to date	
Actions planned	
Firms' evidence	
Standard 14.	Significant financial institutions should demand from their employees that they commit themselves not to use personal hedging strategies or compensation- and liability-related insurance to undermine the risk alignment effects embedded in their compensation arrangements. To this end, firms should, where necessary, establish appropriate compliance arrangements.
Steps taken to date	
Actions planned	
Firms' evidence	

c. Effective supervisory oversight and engagement by stakeholders

Principle 8.	Supervisory review of compensation practices must be rigorous and sustained, and deficiencies must be addressed promptly with supervisory action. Supervisors should include compensation practices in their risk assessment of firms, and firms should work constructively with supervisors to ensure their practices conform with the Principles. Regulations and supervisory practices will naturally differ across jurisdictions and potentially among authorities within a country. Nevertheless, all supervisors should strive for effective review and intervention. National authorities, working through the FSF, will ensure even application across domestic financial institutions and jurisdictions.
Steps taken to date	
Actions planned	
Standard 10.	In the event of exceptional government intervention to stabilise or rescue the firm: ▪ supervisors should have the ability to restructure compensation in a manner aligned with sound risk management and long-term growth; and ▪ compensation structures of the most highly compensated employees should be subject to independent review and approval.
Steps taken to date	
Actions planned	
Standard 13.	Significant financial institutions should take the steps necessary to ensure immediate, prospective compliance with the FSB Standards and relevant supervisory measures.
Steps taken to date	
Actions planned	
Standard 16.	Supervisors should ensure the effective implementation of the FSB Principles and Standards in their respective jurisdiction.
Steps taken to date	
Actions planned	
Standard 17.	In particular, they should require significant financial institutions to demonstrate that the incentives provided by compensation systems take into appropriate consideration risk, capital, liquidity and the likelihood and timeliness of earnings.
Steps taken to date	

Actions planned	
Standard 18.	Failure by the firm to implement sound compensation policies and practices that are in line with these standards should result in prompt remedial action and, if necessary, appropriate corrective measures to offset any additional risk that may result from non-compliance or partial compliance, such as provided for under national supervisory frameworks or Pillar 2 of the Basel II capital framework.
Steps taken to date	
Actions planned	
Standard 19.	Supervisors need to coordinate internationally to ensure that these standards are implemented consistently across jurisdictions.
Steps taken to date	
Actions planned	
Principle 9.	Firms must disclose clear, comprehensive and timely information about their compensation practices to facilitate constructive engagement by all stakeholders. Stakeholders need to be able to evaluate the quality of support for the firm's strategy and risk posture. Appropriate disclosure related to risk management and other control systems will enable a firm's counterparties to make informed decisions about their business relations with the firm. Supervisors should have access to all information they need to evaluate the conformance of practice to the Principles.
Steps taken to date	
Actions planned	
Firms' evidence	
Standard 15.	An annual report on compensation should be disclosed to the public on a timely basis. In addition to any national requirements, it should include the following information: ▪ the decision-making process used to determine the firm-wide compensation policy, including the composition and the mandate of the remuneration committee; ▪ the most important design characteristics of the compensation system, including criteria used for performance measurement and risk adjustment, the linkage between pay and performance, deferral policy and vesting criteria, and the parameters used for allocating cash versus other forms of compensation; ▪ aggregate quantitative information on compensation, broken down by senior executive officers and by employees whose actions have a material impact on the risk exposure of the firm, indicating: – amounts of remuneration for the financial year, split into fixed and variable compensation, and number of beneficiaries; – amounts and form of variable compensation, split into cash, shares and share-linked instruments and other; – amounts of outstanding deferred compensation, split into vested and unvested; – the amounts of deferred compensation awarded during the financial year, paid out and reduced through performance adjustments; – new sign-on and severance payments made during the financial year, and number of beneficiaries of such payments; and – the amounts of severance payments awarded during the financial year, number of beneficiaries, and highest such award to a single person.
Steps taken to date	
Actions planned	
Firms' evidence	