2011 Thematic Review on Compensation

Peer Review Report

7 October 2011

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Foreword

The Financial Stability Forum's (FSF) *Principles for Sound Compensation Practices* and their *Implementation Standards* (the Principles and Standards) were endorsed by the G20 Leaders at their Summits in London in April 2009 and Pittsburgh in September 2009. In their Pittsburgh statement, the G20 Leaders tasked the FSB "to monitor the implementation of FSB standards and propose additional measures as required by March 2010." The FSB completed its first peer review on compensation in March 2010, concluding that, at that relatively early stage in the process, some key issues were yet to be resolved and effective implementation was far from complete. The 2010 review therefore recommended that the FSB undertake a follow-up peer review in 2011. This second review assesses the progress made by national authorities and significant financial institutions in implementing the Principles and Standards, as well as the impact on compensation practices at financial institutions of national policy measures taken to align incentives.

The peer review surveyed supervisors and regulators of FSB member jurisdictions and 70 banks and broker dealers that FSB members deemed as significant for the purpose of the review. The findings of this review are based on the responses to questionnaires that gathered information from FSB member jurisdictions on their national initiatives and from significant financial institutions in those jurisdictions on their compensation practices. The assessment of the status of national implementation is based on the information provided by national authorities. National authorities also assessed the implementation by firms in their jurisdiction based on high-level criteria that were developed by the FSB for this purpose.

This report describes the findings of the review, including the key elements of the discussion in the FSB Standing Committee on Standards Implementation (SCSI). The draft report for discussion was prepared by a team chaired by Klaas Knot (DNB, Netherlands), comprising Ian Beckett (Australian Treasury), Carlos Augusto de Aguiar Ferreira (Central Bank of Brazil), Hervé Dallerac (Banque de France), Alexander Drung (Deutsche Bundesbank), Cheng Wai-Leung (Hong Kong Monetary Authority), Tsuyoshi Saitou (Japan Financial Services Agency), Oleg Letyagin (Central Bank of Russia), Adeline Quah (Monetary Authority of Singapore), Qian Zhang (UK FSA), Mark Carey (US Federal Reserve Board), Claire Bury (European Commission) and Mats Isaksson (OECD). The team that drafted the assessment criteria was chaired by David Raikes (UK FSA), and comprised Antoine Merieux (French Ministry of Economy and Finance), Alexander Drung, Tsuyoshi Saitou, Paul Chung Kong Seng (Monetary Authority of Singapore), Mark Carey and Grant Kirkpatrick (OECD). Simonetta Iannotti and Grace Sone (FSB Secretariat) provided support to both teams and contributed to the preparation of the peer review report.

The peer review on compensation has been conducted under the FSB *Framework for Strengthening Adherence to International Standards*.[1]

1 A note describing the framework is at http://www.financialstabilityboard.org/publications/r_100109a.pdf.

FSB thematic peer reviews

The FSB has established a programme of thematic peer reviews of its member jurisdictions. Each review surveys and compares the implementation across the FSB membership of regulatory or supervisory measures in a particular policy area important for financial stability. 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.

Thematic peer reviews complement FSB country peer reviews, which focus on the progress made by an individual FSB member jurisdiction in implementing IMF-World Bank Financial Sector Assessment Program (FSAP) regulatory and supervisory recommendations.

Executive summary

Compensation practices at large financial institutions were a key contributing factor to the global financial crisis. The FSB Principles for Sound Compensation Practices and their Implementation Standards (Principles and Standards, P&S) were developed to align compensation with prudent risk-taking, particularly at significant financial institutions; importantly, they are not intended to prescribe particular designs or levels of individual compensation. This peer review finds that relevant authorities and firms in FSB member jurisdictions have made good progress in implementing the P&S – many national authorities have taken the necessary regulatory actions, supervisory oversight has intensified, and the governance of compensation schemes at firms has improved. 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 at the firm level over an uneven playing field in the market for highly skilled employees. Achieving lasting change in behaviour and culture within firms is a long-term challenge, and requires ongoing monitoring of the implementation of the P&S. The review sets out several recommendations to address these issues.

The relevant *authorities* in member jurisdictions of the Financial Stability Board (FSB) have made good progress toward implementing the P&S – see Annex A that updates the table from the 2010 review. Since the first thematic review in March 2010, an additional seven jurisdictions have implemented all 9 Principles and 15 Standards, bringing the total to 13 of the 24 FSB member jurisdictions (see section II), while five other jurisdictions have implemented all but one or two Standards. To support and strengthen implementation, the majority of FSB member jurisdictions have taken the necessary regulatory actions and engaged in relevant supervisory activities. Nonetheless, more progress is needed to reach full implementation across the FSB membership, as a number of gaps remain (see Annex B for more details).

For those jurisdictions that had started to implement the P&S at the time of the first thematic review (“early movers”), the primary focus has shifted to fine-tuning regulatory requirements and reviewing implementation progress by relevant industry participants. National regulators have been working intensely with firms on detailed implementation and some authorities have revised their frameworks after reviewing their efforts. Many jurisdictions have focused on implementation by large, significant financial institutions, and the review finds good overall progress by those firms. Smaller financial institutions are generally expected to be subject to future increased scrutiny as the scope and depth of implementation increase. In addition, a number of jurisdictions apply the principle of proportionality to their firms using characteristics such as the firms’ risk profile determined by their business models.

In order to assess the impact of the implementation of the P&S on compensation practices at *firms*, the peer review collected and analysed information from a sample of 66 firms identified by FSB member jurisdictions as significant for the purposes of this review (see section III). Of the 66 firms, 20 were classified by the peer review team as “large internationally active firms” due to their size and significant international presence, i.e. generating a substantial amount of revenue from cross-border activities.[2] At these firms, unsound risk-taking incentives could be particularly problematic because of the geographic spread and diversity of their businesses. “Other firms” consists of a variety of firms ranging from some large firms in advanced economies to smaller firms, more retail-oriented or local firms in emerging markets.

The 20 large internationally active firms have made progress in implementing the P&S and their compensation practices appear, on average, to be broadly consistent with nearly all of the elements of the P&S. This finding is reassuring as these firms are the ones competing most directly for highly skilled employees globally, while their activities and reputation influence compensation practices in the financial sector. 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 P&S. On the other hand, the report finds much greater variation in the progress achieved by other firms that – although competing mostly in domestic markets – were identified by national authorities as significant for the purpose of this peer review. Some of these firms are as advanced as the large internationally active firms, while others are at an earlier stage of progress. The reasons for such variation may reflect the length of time since the P&S have been incorporated into national frameworks, the intensity of supervisory attention, and the challenges posed by local impediments, such as national labour laws or the stage of development of the domestic equity market.

Much public attention has focused on the characteristics of the pay structure in different jurisdictions. The peer review collected and analysed *average* characteristics for different sets of employees at each firm. Among the large internationally active firms, certain pay structure characteristics – such as deferral rates, vesting periods, variable pay fractions, the use of

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[2] It should be noted that the concept of a “large internationally active firm” is different to that of a "global systemically important bank" developed by the Basel Committee on Banking Supervision, and is intended to be used purely for analytical purposes in this report.

equity and the use of ex post adjustments like maluses and clawbacks – are roughly similar and in almost all cases are consistent with the numbers mentioned in Standards 6-9. However, the data collected was not sufficient to provide a measure of the degree of variation or the precise details of pay structure across employees *within* each firm. In general, average pay structure characteristics were found to vary more among the other firms.

Despite the review's finding that there is no compelling evidence of uneven or inconsistent implementation of the P&S across large internationally active firms, a number of supervisors and firms – many of which are located in jurisdictions that have adopted a more prescriptive approach to implementation – have raised concerns over inconsistent implementation as a source of competitive disadvantage 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.

There are two possible explanations for this apparent paradox. First, the perceived consistency of implementation, and perhaps of implementation efficacy, might depend on the degree of transparency of supervisory requirements. Some jurisdictions have published detailed laws, regulations or supervisory guidance that cover each aspect of the P&S, while others have been less explicit in publicly available documents about certain aspects of their requirements. Although the peer review found that practices are broadly consistent among large internationally active firms, increased transparency of supervisory policies and guidance would help to mitigate concerns related to the different interpretation of the standards that may give rise to a non-level playing field. In that context, it is worth noting that whether jurisdictions have adopted a regulatory or supervisory approach to implementation does not appear to have a significant effect on the implementation outcomes, as even within these two approaches there is variation with respect to the flexibility of interpretation (prescriptive rules versus high-level principles), transparency of supervisory guidance and degree of enforceability. Second, the quality of the data used in the review was based on averages reported by firms, which may conceal variation in practice within firms. Concerns over a level playing field may stem from firms' bidding for a few key employees, rather than the average employee, and more detailed data would be required to substantiate these concerns.

Achieving lasting change in behaviour and culture within firms is a long-term challenge that requires a sustained commitment. Additional time is needed for a common supervisory understanding to evolve and for effective and consistent implementation of the P&S. Even for the firms that are closer to full implementation, it is too early to assess the effectiveness of recently adopted compensation policies with regard to risk-taking incentives and behaviour.

Progress should be fostered by increased dialogue on these issues among supervisors, both in supervisory networks and via international monitoring processes; in particular, more information should be gathered on effectiveness, potential inconsistencies and unintended consequences of the implementation of the P&S. Better and more detailed information will be needed, including the details of competitive bidding for key employees, to assess the extent of differences in practice and to address the main causes of level playing field concerns.

The following recommendations are set out to support advancement in the implementation of the FSB P&S by both national authorities and firms in order to effectively impact firms' behaviour and risk-taking incentives.

List of recommendations

Recommendation 1 - Full implementation by national authorities

(a) All FSB member jurisdictions should finalise the implementation of the P&S. Jurisdictions should undertake actions, including legislation where needed, to eliminate any impediments to full implementation.

(b) Proportionality in the implementation of the P&S may be justified by the business model and risk profile of the institution. FSB member jurisdictions should clearly define in national regulations or supervisory guidance the specific criteria supporting the application of the principle of proportionality. In addition, jurisdictions should proactively ensure that proportionality remains appropriate and does not give rise to regulatory arbitrage as a result of market developments and emerging risks.

(c) National authorities should periodically report to the FSB on the nature of any significant impediments and proposed actions to address them as well as on the specific criteria supporting the application of proportionality in their jurisdiction. This reporting will form part of the FSB's ongoing monitoring of the implementation of the P&S.

Recommendation 2 – Addressing level playing field concerns

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. The nature of the concerns, the actions taken to address them via supervisory cooperation and the outcomes should be reported at least annually to the FSB and should inform the scope and intensity of its ongoing monitoring of the implementation of the P&S.

Recommendation 3 – Ongoing implementation monitoring

The FSB should undertake ongoing monitoring and public reporting on the implementation of the P&S as part of its coordinated framework for monitoring the implementation of agreed G20/FSB financial reforms. This monitoring should focus on remaining gaps and impediments to full implementation by member jurisdictions as well as on the actions taken by relevant parties in response to this report's recommendations. 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.

Recommendation 4 – Supervisory cooperation

Supervisory cooperation in the area of compensation practices should be stepped up. Greater efforts need to be made to include remuneration on the agenda of supervisory colleges and to enhance home-host supervisory cooperation and coordination for significant, cross-border financial institutions. In order to enhance the effectiveness and consistency of implementation of the P&S, supervisors should use appropriate supervisory networks to exchange information on the interpretation and technical implementation of the P&S in their jurisdiction, including with respect to the definition of material risk takers. They should also discuss evolving firm practices, especially in the areas of risk adjustment and performance alignment.

Recommendation 5 – Effective governance of compensation

Supervisors should ensure that all financial institutions deemed significant for the purposes of the P&S take immediate steps to align their practices with the key requirements in the area of effective governance of compensation. Particular attention should be given to the independence and expertise of the institution's remuneration committee, to the independence of risk and compliance functions in the compensation process, and to evidence of real cultural change within the institution.

Recommendation 6 – Disclosure

Supervisors should ensure that all financial institutions deemed significant for the purposes of the P&S comply with the Basel Committee's Pillar 3 disclosure requirements for remuneration from 1 January 2012.

I. Introduction

The March 2010 peer review on compensation practices recommended that the FSB conduct a follow-up review in 2011 as implementation of the FSB Principles and Standards (P&S)[3] were at a relatively early stage. This review assesses progress made toward implementing the P&S by both national authorities and significant financial institutions, in particular the impact of national policy measures taken on compensation practices at financial institutions.

The peer review surveyed supervisors and regulators of FSB member jurisdictions and 70 firms and broker dealers that FSB members deemed as significant for the purpose of the review. The review focuses on banks and broker dealers because the problems associated with compensation structures are most acute for these types of institutions. In future reviews, the FSB may examine a broader set of financial institutions, including insurance companies and other non-bank financial institutions. Of the 70 firms, information provided by 66 firms were used in the assessment of firms' progress toward implementation; one Russian firm did not respond and three firms are subsidiaries of parent groups already included in the peer review, so their responses have been considered by home authorities together with the response of the parent company. Summary tables for certain jurisdictions are provided in the Annexes for those cases where accurate information from at least three firms was available, so as to respect the confidentiality of individual firm information.

The findings of this review are based on responses to the questionnaires that were designed to gather information from FSB member jurisdictions on their national initiatives and from significant financial institutions. National supervisors were asked to assess firms' progress toward implementing the P&S, as well as the accuracy and completeness of the responses provided by firms headquartered in their jurisdiction. High level criteria were developed to help provide some consistency to supervisors' assessment of firms' progress in four broadly defined areas: i) effective governance of compensation; ii) ex ante risk adjustment; iii) alignment of compensation with performance; and iv) disclosure. No criteria were provided on Standards 6 to 9 as not enough is known at this stage on the range of firms' practices in identifying the material risk takers (see Annex R).

It is important to highlight that the review team did not attempt to challenge or verify the accuracy of the information provided in the responses and a degree of interpretation and assessment was necessary in order to conduct the analysis. The questionnaire for national authorities builds on that used for the first peer review, with information on the following areas: i) overall approach taken by national authorities to implementing the P&S, including goals and priorities; ii) new legislation, rules and guidance on compensation practices introduced since the completion of the first peer review; iii) actions taken at the supervisory level to implement the P&S; and iv) supervisors' views on challenges to overall progress.

Significant financial institutions were asked to provide information about their compensation policies and practices in the following areas: i) nature and size of the firm's business; ii) governance structure of compensation policies and practices; iii) policies and procedures for

[3] The full text of the Principles is at http://www.financialstabilityboard.org/publications/r_0904b.pdf; and of the Standards is at http://www.financialstabilityboard.org/publications/r_090925c.pdf.

ex ante risk adjustments; iv) structure of compensation and alignment of compensation policies with performance, including policies and procedures for ex post risk adjustments; v) disclosure of compensation practices; and vi) other elements of the P&S.

Analysis of the progress in implementing the FSB P&S in Sections II and III reflects quantitative and qualitative information provided by firms and national supervisors. The tables portraying the assessment on the degree of implementation of the P&S by the firms have been compiled by making reference to the high-level assessment criteria, to the national authorities assessments based on those criteria, and to the views of the peer review team to ensure consistency across assessments.

It should be noted that the findings of this report, and in particular of section III, are subject to the limitations of the information received. Data quality varied considerably and, due to the judgemental nature of assessing compensation practices, information provided by firms and supervisors can only provide a broad indication of implementation progress. As a result, the application in practice and the effectiveness of firms' assertions could not be fully assessed.

Section II discusses the progress in implementation at the national level, based on the responses given by national authorities and Section III examines the degree of progress observed for a sample of firms that have been identified by national authorities as significant for the purpose of the peer review, based on the questionnaire directed to firms and on the supervisory assessment of firms' responses. Section IV presents the peer review assessments of firms' implementation status and section V presents the conclusions and recommendations to promote full implementation of the FSB P&S in order to better align firms' compensation practices with prudent risk taking.

II. Overview of implementation by national authorities

FSB members have made good progress toward implementing the P&S since the first thematic review was completed in March 2010, especially in some emerging market jurisdictions. Annex A updates the table from the 2010 review and provides a summary of national implementation of each Principle and Standard. The majority of FSB members have taken further regulatory actions and engaged in supervisory activities to enhance adherence to the P&S. Since the March 2010 review, Argentina, Brazil, Mexico and Turkey have introduced new national frameworks, while Indonesia, India, Russia and South Africa are in the process of introducing new regulatory frameworks covering compensation.[4] In the European Union (EU), there has been convergence towards a rules-based regulatory approach following the implementation of the Capital Requirements Directive (CRD) III.[5]

Of the 24 FSB member jurisdictions, 13 have implemented all 9 Principles and 15 Standards, which is a significant improvement from 6 jurisdictions in the March 2010 thematic review.[6] All but one of the Standards have been implemented in Australia, Switzerland and the US,

[4] The frameworks in Brazil and Turkey will come into legal force at the start of 2012. Indonesia expects new regulations to be finalised in the second half of 2011.

[5] The CRD III is an EU-wide directive that came into force on 1 January 2011 and includes detailed provisions on remuneration that Member States are required to transpose into domestic legislation.

[6] The 13 jurisdictions that have achieved full implementation are: Canada, France, Germany, Hong Kong, Italy, Japan, Korea, Mexico, the Netherlands, Saudi Arabia, Singapore, Spain, and the UK.

while Brazil and China have yet to implement two Standards. India, Indonesia and Russia are making progress toward closing significant implementation gaps identified in the last thematic review, while significant gaps remain in Argentina and South Africa (see Annex B). National authorities find the P&S in the area of effective alignment of compensation with prudent risk taking as the most challenging to implement. Moreover, a number of jurisdictions stated that they did not see compensation practices as significant sources of risk within their financial systems for a variety of reasons.[7] Some of these jurisdictions have nevertheless implemented or plan to largely or fully implement the FSB P&S, while others, such as Argentina, have elected not to implement significant elements of the P&S.

1. Differences in overall approach of national implementation

There are some distinctive differences in how national authorities are implementing the P&S in terms of approach (e.g. regulatory or supervisory), scope of application (e.g. based on bank size and level of employees) and sectoral coverage. Each of these areas is discussed below. One common theme seen across the FSB membership is the treatment of financial institutions receiving government support. These firms are frequently subject to special regulatory frameworks governing compensation arrangements, in some cases with more stringent provisions (Germany, Japan, the Netherlands, Spain, US). Jurisdictions also report that these firms are subject to more intensive supervisory activity (France, Germany, Japan, Russia, Spain).

1.1 *Regulatory and supervisory approaches*

There are differences in national interpretation and implementation of the P&S, and national authorities' approach to implementation generally comes under one of two categories: regulatory or supervisory approach. Generally speaking, a regulatory approach is characterised by a greater reliance on prescribing detailed requirements, while the supervisory approach is characterised by increased use of high-level principles that allow more flexibility for firms and a greater role for supervisors. In practice, however, the differences are more blurred since both approaches can be characterised by different degrees of flexibility, transparency and enforceability (see below).

Differences in implementation approaches are particularly evident in relation to Standards 6 to 9. Some jurisdictions (Singapore and the 6 FSB members of the EU: France, Germany, the Netherlands, the UK, Italy, Spain) have incorporated the numbers in Standards 6 to 9 as minimum requirements.[8] Other jurisdictions (Australia, Canada, Hong Kong, Japan, US) have allowed firms more flexibility in implementing Standards 6 to 9, taking account of differences

7 The reasons include: ownership of banks by a single majority shareholder or small groups of shareholders (Brazil); low levels of variable remuneration (Indonesia, Italy, Japan); lack of use of equity as compensation (China); absence of a 'bonus culture'; and a tendency for employees to spend a long time with a single employer (Japan).

8 Some jurisdictions have imposed minimum requirements in their domestic frameworks that go beyond the numbers in these Standards - for example, Dutch banks have agreed to maximise variable pay to 50% of total remuneration for the management board.

in their business models and risk profiles, by interpreting the numbers in Standards 6 to 9 as examples rather than minimum requirements.[9]

However, the regulatory versus supervisory characterisations are too broad in their definition to fully capture differences in jurisdictions' application of the P&S. For example, there are cases of principles-based regulation, and of prescriptive supervision. That is, not all jurisdictions that have adopted the regulatory approach have set out the requirements that apply to firms in laws and regulations. In some cases, these are set out in legally-binding requirements issued by supervisors (Argentina, Mexico, Saudi Arabia, Switzerland, Turkey). Annex E provides a categorisation of the implementation approaches across the FSB membership.

In addition, both approaches can involve varying degrees of prescription since they provide jurisdictions with the choice of establishing prescriptive rules or high level principles. Singapore and the six EU member jurisdictions have both incorporated the numbers mentioned in Standards 6 to 9 into their respective national frameworks despite having different implementation approaches – the EU members take a regulatory approach while Singapore adopts a mix of regulation and supervisory oversight. Australia has adopted an approach similar to Singapore, but it has not prescribed the numbers given in Standards 6 to 9 as minimum requirements for firms.

In addition, both approaches can involve varying degree of transparency – for example, supervisory requirements can be spelled out ex ante in detailed manuals or other forms of regulatory guidance (e.g. Japan), and regulatory requirements can he stated as high-level principles. The absence of clarity about the exact requirements could potentially create uncertainty in other jurisdictions about whether or not the P&S are being applied effectively. In both approaches, therefore, a higher degree of transparency about guidance provided and enforcement would help to facilitate a more accurate assessment of the overall level of cross-border consistency in national implementation.

Regardless of the different approaches adopted by jurisdictions to implementing the P&S, national authorities should have the capacity to take enforcement actions at firms for non-compliance with national regulations and guidance. Supervisory guidance could have a similar effect to regulation if enforcement actions in response to non-implementation can be issued under authority granted by other laws and regulations (this applies, for example, to Hong Kong, Japan and the US). National regulations and supervisory guidance are enforceable across the FSB membership and enforcement measures depend on the significance of the violation. Weaknesses in implementation are often first addressed via moral suasion, but can escalate to more serious measures, ultimately leading to revocation of licences in some jurisdictions. No FSB member jurisdiction has yet taken enforcement action on issues related to remuneration, as supervisors prefer to promote changes in behaviour through guidance and dialogue with the firms. Some of the different types of available enforcement options are set out below in Table 1.

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[9] Nevertheless, prescriptive instruments can still play a significant role in addition to principles-based requirements – for example, in the case of the United States, the Troubled Asset Relief Program (TARP) rules prescribe pay of some employees of U.S. banks that received extraordinary public assistance.

Table 1: Examples of enforcement options available to supervisors

Enforcement measure	Examples of jurisdictions authorised to enforce
Amendment of compensation policy	Australia, Brazil, Hong Kong, France, Italy, Japan, Saudi Arabia, Spain, UK, US
Fines or other pecuniary sanctions	Argentina, France, Germany, Mexico, the Netherlands, Italy, Russia, Saudi Arabia, Singapore, South Africa, Spain, Turkey, UK, US
Lower supervisory rating	Argentina, Australia, Canada, Hong Kong, Japan, Russia, Turkey, US
Legally binding order	Australia, Germany, Japan, the Netherlands, Singapore, Switzerland, Turkey, US
Publication	France, Japan, UK, US
Capital add-on	Australia, Brazil, Germany, Hong Kong, Italy, South Africa, Singapore, Spain, Switzerland, UK
Removal of manager	Brazil, Germany, France, Japan, Saudi Arabia, Switzerland

1.2 *Scope of application*

There are significant differences among jurisdictions in the proportion of firms subject to the P&S. Most jurisdictions regulate or plan to regulate compensation practices at all firms,[10] while some jurisdictions have adopted a tiered approach that differentiates firms on the basis of their systemic importance (Canada, Germany, Italy, UK). China only regulates compensation at major or systemic firms. Some jurisdictions whose national frameworks do not formally distinguish between different tiers or categories of institutions still appear to have focused their supervisory activities on large, systemically important banking groups (Australia, Hong Kong, Spain, US).

There are also differences in the extent to which provisions in national compensation frameworks apply to staff at different levels within firms. This is most clearly evident in relation to P&S on the alignment of compensation with performance and on disclosure of remuneration arrangements. It is difficult, however, to get a sense of the extent to which lower level staff members are subject to the P&S at major firms in different jurisdictions. In Brazil, China, Russia and South Africa, compensation policies apply (or will apply) only to board members and top executives. Australia, France, Hong Kong, Mexico, the Netherlands, Singapore, Spain, Switzerland, the UK and the US apply their frameworks to material risk takers and control staff at all levels of a firm. While Germany and Italy also apply their

[10] These jurisdictions include: Argentina, Brazil, Australia, Canada, France, Germany, Hong Kong, Italy, Japan, the Netherlands, Singapore, Spain, the UK, and the US.

frameworks to material risk takers and control staff at all levels of a firm, smaller institutions have more discretion in how they extend these rules below the level of top executives.

1.3 *Sectoral coverage*

Although the review has focused on banks and broker dealers, some members extend compensation requirements to non-bank intermediaries. All FSB members indicate that they regulate (or intend to regulate) compensation in relation to the banking sector. Several jurisdictions report that that their frameworks apply to broker dealers and investment firms, or at least to large systemically significant firms[11], and in some jurisdictions[12] to insurance firms. In the EU, compensation requirements for other financial intermediaries are specified in the Undertakings for Collective Investments in Transferable Securities (UCITS[13]) and Alternative Investment Fund Managers (AIFM[14]) directives. The Netherlands has indicated that it is considering extending its regime to the pension fund industry.

2. Regulatory and supervisory actions taken to ensure implementation

Most FSB members have taken the necessary regulatory actions and increased supervisory oversight to strengthen and support implementation of the P&S. Since March 2010, Argentina, Brazil, Mexico and Turkey have introduced national frameworks for compensation practices. In the jurisdictions that moved first to implement the P&S, the primary focus has now shifted to reviewing implementation progress by firms and fine-tuning regulatory requirements.

In particular, further progress has been achieved in the governance of compensation policies, placing statutory obligations on the board with respect to the oversight of compensation schemes.[15] However, the Principles on effective governance are considered "low hanging fruit" and more progress needs to be made to ensure that the changes are sustainable and effective through the economic cycle. Meanwhile, the Basel Committee on Banking Supervision's (BCBS) proposal on Pillar 3 disclosure requirements for remuneration will facilitate progress toward full implementation of Principle 9 and Standard 15, particularly for those jurisdictions that waited for the finalisation of this proposal.[16]

Despite public concerns over inconsistent implementation of the P&S related to the alignment of compensation with prudent risk-taking, convergence is evident. However, this is an area

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[11] This includes the FSB's 6 EU members as required under CRD III, Hong Kong, Korea, Japan, Mexico and the US.

[12] Compensation policies cover insurance companies to some degree in Australia, Canada, Germany, Japan, Korea, the Netherlands, Singapore, Switzerland, Turkey and the US.

[13] Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) Published in OJ L 302, 17.11.2009, p. 32.

[14] Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010 Published in OJ L 174, 1.7.2011, p. 1.

[15] Rulemaking in the area of governance of compensation policies has progressed in Argentina, Brazil, Indonesia, Mexico and Singapore. India and South Africa expect to issue similar rules in the second half of 2011.

[16] The July 2011 BCBS proposal on Pillar 3 disclosure requirements on remuneration can be found at http://www.bis.org/publ/bcbs197.pdf.

where jurisdictions express the most difficulties in implementation. For example, clawback or malus provisions appear difficult to implement in some jurisdictions due to other provisions of the labour law (Argentina, Spain, Switzerland), while a few jurisdictions do not deem these issues as relevant to their firms.

Regulators and supervisors have intensified their activities on large, systemically important firms, placing less priority on compensation practices at small firms (although these are generally expected to be subject to increased scrutiny in the future). Jurisdictions have also focused regulatory and supervisory attention on compensation at financial institutions that have received extraordinary taxpayer support during or ahead of the global financial crisis, especially where such support has yet to be repaid (France, Germany, Japan, the Netherlands, Spain, US).

To assess progress at firms, most jurisdictions have undertaken industry surveys.[17] Many of these jurisdictions have also incorporated an examination of firms' remuneration practices into their on-going supervisory assessments. Some jurisdictions that have not yet fully implemented the P&S have undertaken surveys of existing industry practices (India, Russia, South Africa); Turkey will conduct a survey in 2012. Further supervisory reviews of remuneration practices are planned for 2011 in a number of jurisdictions, including Australia, France, Germany, Italy, the Netherlands (with a focus on smaller institutions), South Africa, Spain and the UK.

Self-assessments against the P&S and to a lesser extent, horizontal reviews are other common tools used by national authorities.[18] Horizontal reviews have taken place in Spain (for savings banks that received government support) and the US (for approximately 25 large banking organisations) throughout 2010 and into 2011. The US reviews were concluded in mid-2011 and have included an information gathering exercise by supervisors and the development of remediation plans. Canada has initiated a review of 92 other financial institutions following a review of its largest 6 banks (and 3 largest life insurers) in 2009. Meanwhile, China, Hong Kong, Japan, Mexico and Korea have conducted on-site and off-site monitoring and meetings with senior management as part of supervisory processes.

Despite the large amount of supervisory activity that has taken place, no jurisdiction has yet launched enforcement action specifically in relation to implementation of the P&S. Rather, jurisdictions prefer to shape firm behaviour through guidance and dialogue. The approach has generally involved communication of findings to the firm and, where weaknesses have been identified, to request rectification or mitigation actions, including changes to remuneration governance, policies, approach, and structure as necessary.

3. Challenges identified by national authorities

National authorities recognise that they face a long-term challenge in achieving lasting behavioural and cultural change within firms. At the same time, some national authorities note

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[17] Australia, Brazil, Canada, France, Germany, Hong Kong, Italy, Japan, the Netherlands, Russia, Singapore, Switzerland, the UK and the US.

[18] Australia, Italy, the Netherlands, Singapore and the UK undertook a second round of bank self-assessments against the Principles and Standards in 2010-11. Switzerland, South Africa and Hong Kong also required banks to undertake self-assessments.

several factors hindering progress toward achieving full implementation of the P&S. As noted earlier, labour laws in some jurisdictions limit the capacity of regulators to apply the P&S to a wide range of employees (rather than just directors and top executives) as well as for firms to pay variable non-cash compensation or to claw-back payments in the event of future problems. Labour laws were identified as a key constraint by Argentina, Brazil, Russia and Switzerland. Some jurisdictions also noted that it was difficult to apply the P&S to institutions beyond direct supervisory control (such as government-owned banks in India) or to cooperatives that are unlisted or whose shares are not widely traded since they are privately owned or government entities. For some jurisdictions, resource capacity is an issue due to increased demands for continuous monitoring of compensation frameworks along with generally higher expectations for more intense regulatory and supervisory oversight of large, complex financial institutions.

One of the key challenges for national authorities relates to the principle of proportionality, which is particularly important in jurisdictions whose frameworks cover all types of institutions within a particular sector (both large and small banks). Some of the challenges in applying the P&S to smaller institutions include high cost, low resource capacity, and in the case of cooperatives, an inability to use equity as an instrument of variable remuneration. Canada, Germany, Hong Kong, Italy, the Netherlands, UK and US highlighted the need for regulatory frameworks governing compensation to take account of differences in the size and riskiness of institutions as well as differences in their capacity to implement the changes.

4. Supervisory cooperation

Underlying the progress made toward implementing the P&S are concerns over the effective and consistent implementation across the FSB membership, particularly of Standards 6 to 9. This concern was most evident in responses by EU members that have adopted the numbers given in Standards 6 to 9 as minimum standards under CRD III. Some of these authorities expressed concerns that other jurisdictions are providing their firms with more flexibility in relation to the structure of compensation and that these differences could disadvantage their banks in recruiting and retaining key personnel. In particular, four jurisdictions (Germany, the Netherlands, Singapore and Spain) raised concerns over the different interpretations of a 'material risk taker' and highlighted the need for firms to consider coverage of lower level employees, especially in relation to the treatment of groups of lower level employees that may have a collective impact on the riskiness of a firm's activities. These concerns were most acute in relation to other jurisdictions that house large internationally active firms (see firm classifications in section III) that compete directly with one another. Concerns over consistency in implementation were also raised about Standard 11, where the UK identified potential inconsistencies in the definition of a guaranteed bonus, and about Standard 14, where Switzerland highlighted potential inconsistencies in the hedging practices.

Strengthening the exchange of information and cooperative dialogue between supervisors, either bilaterally or through supervisory networks, would be especially useful to address these concerns. Currently, the extent of the discussions between national authorities to promote consistent implementation of the P&S ranges from no attempts of engagement to the adoption of common rules and guidelines. The range of practices reflects the extent to which relevant national rules have been implemented, the existence of bilateral cooperation agreements, and the extent of supervisory cooperation already in place (for example, whether joint inspections of the overseas operations of firms are carried out).

Several regulators discuss remuneration practices of firms in supervisory colleges, although the extent of discussion has varied. Jurisdictions mentioned several reasons for this observation:

- a difference in the necessity to exchange information depending on whether the national authority is acting as a home or a host supervisor;
- the initial need of supervisors to focus on local implementation of the FSB P&S; and
- legal impediments to exchanging information, which could be resolved through bilateral mechanisms (e.g. MoUs).

One of the ways to mitigate concerns over consistent implementation of the P&S is to strengthen supervisory cooperation. In particular, the information exchange between home and host supervisors should include observed practices and the issuance of recommendations and reports sent to the head office of the foreign banks' branch and its home regulator.

III. Overview of firms' implementation progress

1. Firms under review

In order to assess firms' progress toward implementing the P&S, the peer review surveyed financial institutions selected by FSB members based on the following criteria: a) banks or broker-dealers incorporated locally; b) institutions that, because of their activities or reputation, influence compensation practices in the financial sector; and c) institutions that national authorities identified as significant for the purpose of the first FSB peer review on compensation.[19]

FSB members identified 70 institutions to participate in the peer review (see Annex D), of which 66 firms have been considered for the analysis – one firm in Russia has not yet responded, and three firms are subsidiaries of parent groups already included in the peer review and their responses have been considered by home authorities together with the response of the parent company. For purposes of this review, firms have been grouped on the basis of firm type, activity, geographic region, national approach to implementation and stage of national implementation (see Annex E).

Of the 66 firms, 20 were classified by the peer review team as "large internationally active firms" due to their size and significant international presence, i.e. generating a substantial amount of revenue from cross-border activities.[20] At these firms, unsound risk-taking

[19] Firms provided information on a consolidated group basis, covering operations across all branches and majority-owned subsidiaries worldwide. However, they were permitted to exclude subsidiaries that are engaged in activities other than banking or broker dealing, provided that such subsidiaries are not engaged in investments for the firm's own account, such as proprietary trading units.

[20] It should be noted that the concept of a "large internationally active firm" is different to that of a "global systemically important bank" developed by the Basel Committee on Banking Supervision, and is intended to be used purely for analytical purposes in this report.

incentives could be particularly problematic because of the geographic spread and diversity of their businesses. “Other firms” consists of a variety of firms ranging from some large firms in advanced economies to smaller firms, more retail oriented or local firms in emerging markets.

It is important to note that the analysis of firms’ progress in implementing the P&S reflects quantitative and qualitative information provided by firms and national supervisors. The tables portraying the assessments on the degree of implementation of the P&S (Annexes F – K) have been compiled by making reference: (i) the high level assessment criteria (see Annex R); (ii) the national authorities’ assessments based on those criteria; and (iii) the views of the peer review team to ensure consistency across firms. Furthermore, because the data quality provided by firms varied considerably and supervisory assessments were primarily judgemental, the information supplied by firms and supervisors can only provide a broad indication of implementation progress. Based on this information, it was difficult to evaluate the firms’ assertions about the extent and effectiveness of their application of the P&S.

2. Effective governance

Remuneration committees are part of firms’ governance structures in virtually all of the firms surveyed, and at most firms, are comprised entirely or mostly of non-executive directors. Only a few firms, however, provided detailed information on the expertise and experience of the members of the remuneration committee. For the compensation governing body to exercise competent and independent judgment on compensation policies, better practices included structuring the remuneration committee in such a way that:

- is composed solely or predominantly of non-executive directors who collectively have the knowledge and experience in compensation, human resources, finance and risk management;
- composition is reviewed periodically to ensure that it has independence, skills and experience to fulfil its duties;
- has at least one member of the risk committee as a member to provide practical skills and experience of risk management;
- has free and unfettered access to management and employees; and
- may seek to engage external advisers on remuneration, risk and other related matters to supplement members’ knowledge and expertise.

Although responsibilities of remuneration committees vary across firms and jurisdictions, their duties typically include: (i) designing and operating compensation policies and practices[21]; (ii) approving (or recommending for board approval) the amount and form of distribution of variable pay and total compensation and; (iii) reviewing and assessing the effectiveness of bank’s remuneration policies and practices including compliance with legal and regulatory requirements. In some firms, the human resources division has an extensive role, focusing generally more on lower-level employees.

[21] Many firms focus on the oversight of senior management remuneration and other important staff members who can pose individually material risks to firms’ exposures, whereas other firms place an emphasis on a broader range of employees.

Large and internationally-active firms often establish a broad group-wide remuneration strategy that encompasses remuneration policies for individual jurisdictions and markets, which take into account regional business profiles, local regulatory requirements and regional labour practices and market conditions.

For most firms, risk and control functions show an appropriate degree of involvement in the process for developing their remuneration policies. Such involvement includes regular reporting from risk and control functions to the remuneration committee and the engagement in periodical reviews of remuneration policies. In some firms, members of the firm's risk committee attend meetings of the remuneration committee. In other firms, there is an overlap in membership between the risk and the remuneration committee to ensure effective coordination of compensation principles and risk management policies.

The vast majority of respondents indicated that the remuneration for employees in the risk and function is determined independently. However, the responses are not always clear with respect to their ability to override decisions or pressure from the revenue producing functions.

3. Performance measurement and ex-ante risk adjustment

A variety of methods have been used for ex-ante risk adjustment for different risks. The degree to which top–down and bottom-up approaches are used, either in isolation or in combination also differs.

All of the large internationally active banks appear to have incorporated some form of (ex-ante) risk adjustments into their performance measurement frameworks, which generally consider credit, market, operational and liquidity risks. The use of economic efficiency measures to assess risk-adjusted performance and application of risk adjustment to compensation is common among the large internationally active firms. The most common risk adjusted metric is Economic Profit (EP). Another metric used is the risk adjusted return on capital (RAROC). Other frequently used quantitative performance metrics and indicators include Tier 1 capital ratios, Profit After Taxes (PAT), Return on Equity (ROE) and Total Shareholder Return (TSR). In many cases more than one quantitative metrics is applied in order to cover the different risk exposures of the firm and business units.

A few large internationally active firms reported using qualitative indicators for risk adjustment at firm and business level, but little detail was provided as to how these indicators are defined or applied. In general, qualitative performance measures play a more central role for assessing the individual performance of an employee, e.g. compliance with internal controls and teamwork, than for determining the size of the bonus pools.

The methods for ex-ante risk adjustments in respect of credit, market, and operational risks are generally more developed; they are often grounded on the Basel II economic capital computation methodologies. Adjustment for liquidity risk is more varied in practice and on average less sophisticated, reflecting less developed practices in liquidity risk management; best practice, at very few firms, is to derive adjustments by assessing the impact of stress scenarios on financial performance measures and to consider contingent as well as current liquidity needs, applying such charges to revenues. Some firms also reported attempts to take into account refinancing cost when calculating bonus pools.

For risks that are difficult to quantify (e.g. business, legal, and reputational risks), the methods for ex-ante adjustment are even more varied. Adjustments are usually made through the other risk elements of the balanced scorecard. The cost of capital allocated to cover these risks is usually based on the group's Economic Profit measure and through the setting of balanced scorecard targets, and qualitative adjustments and targets usually play an important role. For example, business risk and legal risk are usually captured by non-financial measures such as Key Performance Indicators (KPIs) and employee's compliance records respectively.

3.1 *Discretionary adjustment and formulaic approach*

It is desirable to use a combination of quantitative and qualitative methods for ex-ante risk adjustment; but the ideal combination depends on the specific circumstances of an institution. The degree of discretion in ex-ante risk adjustment differs widely. Some firms do not follow a formulaic approach to using risk adjusted performance indicators for calculating bonus pools, but refer to these indicators when making discretionary adjustments to the firm-wide bonus pool. Other firms use quantitative risk-adjusted metrics to decide on the size of their bonus pools and then qualitative assessment to allocate the pool.

A number of the firms use a combination of top-down and bottom-up approaches for determining the firm-wide bonus pool, allocating the firm-wide pool to different businesses, and setting individual compensation, with reference to various indicators (including risk-adjusted financial results, risk indicators, firm's business strategy and plans, competitors' performance, market trends, and other economic indicators). Often, firms' major businesses lines submit initial proposals for variable compensation pools based on a bottom-up analysis of market pay levels and their business performance. Simultaneously, a top-down view is developed through the assessment of firm's business performance, risk indicators, strategic aims, and affordability.

Many firms prefer to retain some discretion and are of the view that a formulaic approach may encourage inappropriate risk-taking because cannot cover all scenarios. In many firms, although bonus pools are calculated based on pre-determined formulas, individual performance awards are not determined mechanically. A discretionary process is used to set individuals' incentive compensation amounts, taking into account various performance metrics and risk-related indicators. These firms believe that it is essential that their remuneration committees can exercise discretion, within a structured framework, in order to achieve the desired compensation outcomes. Many firms also reported that through discretionary adjustments at the pool and sub-pool level, they can consider multi-year business performance and risks, as well as future risks that cannot be fully quantified.

3.2 *Timing and process of ex-ante risk adjustment*

In general, ex-ante risk adjustment is used for performance measurement and performance evaluation at the level of a firm, its business units, and individual employees; when determining variable compensation pools (firm-wide bonus pool and/or business-line bonus pools) and when allocating bonus pools to business units and employees. However, the observation points for the various indicators used in ex-ante risk adjustments vary across firms. In determining the size of the firm-wide pool or pools of business lines, firms' remuneration committees and other governing functions will make discretionary adjustments based on inputs from financial analysis conducted by finance and risk functions. Performance evaluations, including risk-related targets, often play a significant role in allocating bonuses to business units and individual employees.

3.3 *Quality of revenue*

Some businesses involve positions or activities for which valuations are done by models that are difficult to verify rather than using market prices. For example, highly structured derivative transactions may be one-of-a-kind and depend on models that involve difficult-to-verify assumptions. If such valuations flow through to financial performance measures used in incentive compensation, especially at the inception of transactions, employees will tend to produce over-optimistic valuations and embed future losses into the bank's book of business. For the purposes of calculating compensation, most firms recognise accrued revenues in line with accounting standards, even if payment has not yet been received. However, many firms recognise that the uncertainties regarding the receipt of such revenues, and establish reserves in ways consistent with IFRS, US GAAP, and other generally accepted accounting standards. Firms vary in the extent to which they use flexibility offered under accounting rules to limit recognition of revenue for purposes of incentive compensation until the payment is received. Many firms also make fair value adjustments for future revenues. Bonus pools are then adjusted for risks due to illiquid positions and uncertainty in receipt of payments by recognizing accounting provisions and write downs. Another approach used to address uncertainties in future receipt of revenue is based on a balanced scorecard which incorporates elements of such future risk.

3.4 *Innovative elements of methods for ex-ante risk adjustment*

While the development and use of methodologies for ex-ante risk adjustment are still at a relatively early stage, a number of practices are worth highlighting. These are described below.

3.4.1 *Balanced scorecard*

The balanced scorecard framework, which encompasses quantitative performance measurement and qualitative evaluation and refers to risk indicators, is a method that can link remunerations to firm's strategy and various objectives. Performance is often evaluated against objectives at the firm and business unit level. These objectives can contain risk adjusted metrics, including risk-weighted assets, return on risk weighted assets, impairment, and operational-risk loss levels, which are embedded in the firm's risk management framework in some cases.

3.4.2 *Quantitative analysis of ex-ante risk adjustment measures*

Most of the firms conduct back testing or other forms of quantitative analysis to study the effectiveness of their ex-ante risk adjustment measures. For example, some firms conduct sensitivity analysis of changes in pools on risk-adjusted performance metrics. Analytical models are developed to forecast the implications of remuneration on capital levels and profitability. One firm conducts a correlation analysis of performance ratings (with a focus on risk performance) and incentive compensation outcomes to determine the strength of the relationship between performance and compensation outcomes.

3.4.3 Capital planning and remuneration

Some firms have also incorporated their remuneration process into their capital planning and they evaluate their remuneration systems under their Internal Capital Adequacy Assessment Process (ICAAP). These firms will usually take into account the impact of bonus pools on their capital on an annual basis.

3.5 *Challenges and potential impediments to full implementation*

The key challenges and potential impediments in respect of ex-ante risk adjustments are:

- improving the transparency and visibility of risk adjustment processes to regulators as well as those who are subject to such adjustment in the firm, in terms of how the bonus pool is determined, and how the allocation of reward at divisional, business unit and individual levels is risk-aligned;
- risk measurement, particularly for difficult-to-measure risks, such as reputational risks and liquidity risks, is at the early stage of development or still evolving;
- aligning risks with time horizon (concerning length of the deferral period) and carrying out an appropriate performance adjustment of compensation; and
- the lack of sharing of best practices for ex-ante risk adjustment within the industry and supervisory community.

4. Alignment of compensation with performance

Overall, progress to align compensation with performance has been made by the 20 large internationally active firms. Nearly all of these firms have broadly implemented Principle 5 and Standard 5, with a relatively high degree of consistency in implementation choices made. Progress is assessed on the basis of whether a firm has generally implemented credible policies and sound procedures for aligning compensation with performance. However, given the close links between the measures for aligning compensation with performance and those for aligning compensation with risk taking (Principles 4, 5 and 6 and the related Standards), performance adjustment of deferred compensation (Standard 9) as well as the requirements as regards guaranteed bonuses, golden parachutes and personal hedging arrangements (Standards 11, 12 and 14), one can only get a complete picture of the progress made in aligning compensation with performance if progress in these related areas are also considered.

Measures that have been implemented by the large internationally active firms include policies to vary the firm-wide bonus pool and the business bonus pools in line with the financial performance of the firm and the relevant business units based on a mix of (risk adjusted) quantitative and qualitative performance metrics and risk factors. Compensation levels for employees, especially the risk takers, are usually determined as a combination of their individual performance, the overall firm's performance and the performance of the relevant business unit(s).

Although good progress has been made by the large internationally active firms, some existing practices and circumstances may potentially undermine the effectiveness of measures for aligning compensation with risk and performance. First, some firms allow a relatively high level of discretion for performance adjustments of both the current bonus pools and individual pay awards. In these cases it is not always clear if the criteria for discretionary decisions are determined at the beginning of a bonus season so that these criteria could have a positive effect on staffs' behaviour and if there is transparency of the decision-making processes to ensure an effective and consistent performance adjustment. Second, some firms have implemented malus and/or clawback arrangements with high activation barriers for adjusting deferred compensation with risk outcome. These provisions are only triggered in the event of material losses, limiting the necessary sensitivity of compensation with risk outcomes.

In comparison to the 20 large internationally active firms, there is more variation in the extent of progress among the other firms. Progress differs significantly depending on the type of firm, even within the same country. While some firms already have practices similar to those of the large internationally active firms, others are still at an early stage and have only implemented some very basic performance adjustment mechanisms. Some firms have made good progress incorporating policies and procedures in their remuneration systems that in principle ensure that poor performance at firm or business level is also accompanied by reduced compensation, but they still lack a consistent framework for performance adjustments. More work is needed to appropriately link individual performance with the performance of the firm and the specific business unit(s), as well as to incorporate risk-adjusted performance measures in the award process and to the conduct of performance adjustment of deferred compensation. Many of the firms in this group are currently in the process of reworking or further amending their remuneration systems in order to fully comply with the P&S.

Notwithstanding the progress made by firms, there are still uncertainties in the effectiveness of the policies implemented to align compensation with performance, as they are still untested. Most firms did not experience poor overall financial performance in 2010 and reported that performance improved compared to the prior year. Performance adjustments (reduction in bonus pools and variable pay of individuals) have been made for specific business units, but they were commonly due to non-fulfilment of performance targets or a decrease in performance relative to 2009 rather than an overall negative performance. From the few that reported numerical examples, it was observed that decreased performance was generally accompanied by a similar level of reduction in compensation, though decreases were in most cases modest – usually in the range of 10-30 percent. A few firms reported significant reductions or cancellation of the pay awards for certain senior employees due to poor financial results or individual performance. Against this background, the practical question remains as to whether firms are prepared to operate a fully flexible bonus policy and make deep cuts to variable pay in the event of poor performance. A couple of firms raised the issue that such action might cause key individuals to leave the firm and would generally decrease firm's competitiveness at attracting and retaining staff.

4.1 *Use of measures for adjusting bonus pools and annual pay awards*

With the exception of one firm that is currently implementing a firm-wide bonus pool model, the 20 large internationally active firms have in place a performance measurement framework to assess the achievements of the firm as a whole, its business lines as well as individual employees. Therefore, performance measures tailored to the various levels (mostly at the firm and business level) are used to determine bonus pools and/ or allocations to the individual employees. At most of the large internationally active firms, the award process is structured as a combination of a top-down and a bottom-up approach (see section 4 for further details).

For the adjustment of the bonus pools a combination of quantitative and qualitative performance metrics and indicators is used. Performance is usually measured relative to the previous year's performance as well as a set of pre-defined performance targets. The use of a balanced scorecard approach is also common. In addition to a year-to-year view, some of the large internationally active firms also use metrics and indicators that are based on a multi-year accrual period for performance measurement.

The determination of individual employees' performance and compensation at large internationally active firms is largely a discretionary process, although the level of discretion varies significantly. At one end exists a quantitative system supplemented by triggers that if breached would result in reduced or even cancelled compensation (used by some firms in France, Italy and Germany). But, discretionary flexibility and override is still allowed under this quantitative system. At the other end is a process that leaves the determination of the bonus pools primarily to the discretion of the management or the remuneration committee, although their decisions are still supported by quantitative and qualitative measures. Some firms from the UK and the U.S. highlighted the necessity for a relatively high level of discretion when calculating and determining the bonus pools, to make sure that individuals are paid "fairly" in order to ensure that shareholder interests are not damaged as a result of staff retention, recruitment or motivation issues. Discretion is also needed in exceptional circumstances.

Overall, the practices of the 20 large internationally active firms for aligning compensation with performance and risk outcomes can be considered as generally consistent with Principle 5 and Standard 5. However, few details were provided in respect of the decision-making process and the exact linkage between the performance results of the firm, the different business units and the pay awards for the individual employees. The firms' policies remain largely untested and the practical effectiveness of the implemented methodologies and procedures is still an open issue.

For the other firms, most have already achieved good progress toward putting in place appropriate policies and procedures and the practices of some of these firms resemble those of the large internationally active firms. However, many firms are still not fully compliant with all of the relevant requirements, but they are in the process of amending or reworking their remuneration systems, targeting to complete their work by the end of the year. Areas where further progress is needed usually include one or more of the following points:

- Implementing a clearly defined and transparent award decision process, at both the firm-wide and individual levels.
- Ensuring consistency between the pay awarded to employees and business performance.
- Using an appropriate mix of quantitative and qualitative performance metrics and indicators. In some cases, their use of quantitative risk-adjusted performance measures is less developed than at the 20 large internationally active firms. A few

firms also rely on a single performance metric, which is unlikely to cover all relevant risk and performance factors.

There are also a number of firms that, up to now, have only partially implemented policies and procedures in line with the requirements of Principle 5 and Standard 5. The delays are commonly explained by still incomplete or only recently completed national regulation. Some firms also accorded less priority to compensation issues as they assessed their business models to be conservative, and the levels of variable compensation are relatively low.

4.2 *Challenges and impediments to implementation*

A number of firms reported challenges and impediments to the implementation of Principle 5 and Standard 5; these are mostly consistent with the gaps noted, and include the following:

- Challenge in ensuring the transparency of the process for determining compensation of employees, including documentation of the discretionary incentive compensation decisions and showing the linkage between performance and final incentive compensation decisions.
- There may be a business need not to restrict bonus payments despite short-term poor performance to avoid creating staff retention, recruitment or motivation issues, in order to protect shareholders' interests.[22]
- Practices in both ex-ante and ex-post risk and performance adjustment are still evolving. This relates especially to the use of performance-related malus and clawback arrangements (see section 5 below).

5. Pay structure and alignment of compensation with performance

For purpose of this review, *compensation structure* refers to the manner in which incentive pay is delivered (fixed versus variable, paid-upfront versus deferred, and the nature of the instruments, such as cash versus shares). *Ex post performance adjustment* refers to variation in the value of deferred pay between the date of the award and the vesting or payout date, especially downward adjustment of the value if performance is poor during the deferral period. Ex post adjustments can be implicit, for example due to variation in the firm's share price, or explicit, such as reductions in the number of units of deferred pay received due to application of a malus or clawback.[23] Maluses usually operate by affecting the quantity of deferred compensation at vesting, for example by reducing the number of shares received on the vesting date. Clawbacks operate by requiring the employee to return to the firm a specified amount of money already in the employee's possession. Maluses might be more feasible to implement or enforce in many jurisdictions, but do not operate after the end of the

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[22] Within this context, a few firms also raised the issue of the extent to which a firm should be permitted to cross-subsidise any business even if it is not in a separate legal entity. It is stated that subsidisation thereby may take place through the remuneration process resulting in a situation where a business unit with poor performance not suffering any material reduction in compensation.

[23] See "Range of Methodologies for Risk and Performance Alignment of Remuneration" by the BCBS (May 2011, available at http://www.bis.org/publ/bcbs194.pdf).

deferral period. Clawbacks can apply to both deferred and upfront payments and can be applied beyond deferral or retention periods, but collecting the money sometimes is difficult.

Stronger evolution of practices is observed at the large internationally active firms, most of whose practices are consistent with Standards 6 to 9. Fractions of pay that are variable and that are deferred are substantial for many employees of the large internationally active firms, and pay arrangements include ex post performance adjustment features, with however substantial variation in the details of ex post adjustments, especially maluses and clawbacks, and in the identification of material risk takers. The extent of progress at the other firms shows more dispersion – some have practices that resemble those of the large internationally active firms, others defer payout of only small fractions of bonuses, even for senior executives, or defer substantial fractions of bonuses only for senior executives.

Firms tend to organise pay structures by compensation plan rather than directly by material risk taker status, with top executives and other key employees having a plan with greater variable pay and more deferral, often via a Long Term Incentive Pay (LTIP) program that is typically delivered in stock or stock options (more common in North America). A deferral period of 4 to 5 years for the LTIPs is common. In most cases, the awards from the LTIPs are subject to meeting specific performance targets. It is also fairly common to have different plans for different business lines, and sometimes for different levels of personnel within a business. For some business lines, such as retail banking, deferral and pay structure is focused on the business line leaders and senior employees. For investment banking activities many firms go farther down the hierarchy, though this is not universal.

5.1 *Set of employees that are represented*

At all firms, pay structures and ex post performance adjustments vary across employees. For example, many low level employees receive no variable pay, whereas the majority of pay is variable for senior executives of many firms. Numbers of material risk takers (MRTs) tend to be lower at firms other than the large internationally active firms, and some of them appear not yet to have identified MRTs.[24]

Large internationally active firms differ in the methods they use to identify MRTs. Some use quantitative measures such as Value at-Risk (VaR) or economic capital criteria for inclusion as a risk taker, while for others the definition is based more on judgement and takes into account factors such as hierarchy and responsibilities; some firms use a combination of quantitative and qualitative methods. Most of the large internationally active firms outside the EU use compensation structures and ex post adjustments that are similar for MRTs and other senior or highly paid employees who are not designated as MRTs. In the EU, which has mandated a particular pay structure for MRTs, the difference between MRTs and other employees can be greater, though implementation differs even within the EU, especially if firms other than the large internationally active firms are taken into account. Many global

[24] Some jurisdictions, especially France and the U.S., have chosen to make a further distinction between individual MRTs (their individual decisions are material to the bank as a whole) and "groups" of risk takers whose individual decisions are generally not material but whose activities as a group are material. Especially where the groups are large and include low-level employees, pay structures for groups may differ from those of the individual MRTs, if only because the amounts of their variable pay may be small in absolute and proportional terms.

firms, including EU firms, have group-wide deferral policies in addition to the pay structures required for MRTs, in which the level of deferral increases with greater compensation.

5.2 *Fraction of total pay that is variable*

At the large internationally active firms, variable pay for the most senior executives and for MRTs forms a large or high proportion of total pay – above 60 percent in most such firms, and up to 75-90 percent. The fraction of variable pay is much smaller at some of the other firms, even for senior executives, but more specifically for other material risk takers

Approximately half the large internationally active firms reported reviews or changes to pay mix. A trend of increasing the fixed component relative to variable appears to have taken place as a result of rebalancing exercises. However such changes have typically focused on certain individuals, particularly those in control functions, senior staff and risk takers. Moreover, for most such individuals, variable pay continues to be a large component of total pay, often the majority or great majority.

5.3 *Fraction of variable pay that is deferred*

Substantial fractions deferred are common at the large internationally active firms. At the senior executive level of the hierarchy, 60 percent or more deferred and 40 percent or more for MRTs are common. These fractions are not strongly related to nationality or region, and it is unusual for fractions to fall below 60 percent and 40 percent on average at individual firms. In those cases, the bank appears to have changes in progress that are likely to raise fractions for the 2011 performance year.

The fraction deferred varies more across other firms. At some firms the fraction is much smaller on average and is associated with small fractions of variable pay in total pay and applied to a small numbers of employees; a few firms, especially in nations still in process of implementing the P&S, do not defer payouts at all. Smaller deferral fractions are seen mainly outside Europe and North America.

5.4 *Deferral periods, vesting and retention requirements*

Three year deferral with pro rata vesting appears to be the most common arrangement at the large internationally active firms.[25] There are a small number of firms with four or five year deferral periods and/or back-loading of payment, resulting in less rapid than pro rata vesting. Some firms have different deferral periods for different compensation plans, for example long-term incentive plans appear more likely to have periods longer than three years.

In cases where the instrument is stock, retention periods are also common, especially for senior executives. The duration varies from six months to until-retirement, though in the latter case a portion of the vested stock is excused from the retention period (at least enough to enable the employee to pay taxes). Some also require minimum stock holdings for senior executives.

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[25] A substantial fraction of firms apply a three year deferral despite the fact that the standard says that it should be for ‘at least’ that period of time. It may be that setting a minimum period makes it more difficult for firms to have a policy of a longer period, either for competitive reasons or because firms face pressure from employees.

At firms other than the large internationally active firms, a number either provided no information about deferral periods or indicated that they make no use of deferred compensation. The information obtained indicated greater variation than that for the large internationally active firms.[26]

5.5 *Use of performance linked instruments*

At the large internationally active firms, deferred pay is delivered in a variety of forms, but substantial fractions are structured to make the value at vesting sensitive to performance between the award date and the vesting date. In the EU, typically half or more of deferred pay is in equity or other performance-linked instruments, with the other half in cash or cash-like instruments that are also subject to a malus. EU firms also issue 50 percent of upfront variable compensation in shares or other performance linked instruments which are subject to a retention period. Outside the EU, the most common award structures all of deferred pay in equity linked instruments. At most large internationally active firms these are also subject to performance-based maluses or clawbacks, so that the performance adjustment can occur not only through variation in the stock price, but also by reducing the number of shares to be vested. However, both within and outside the EU, substantial variations can be found in the details. Such variation includes differences in circumstances under which maluses affect vesting, but also different methods, such as performance units that vest immediately but that have values which vary with performance. At the other firms, deferred pay is also often in equity linked instruments, especially in the case of senior executives.

5.6 *Use of maluses and clawbacks*

Maluses or clawbacks for malfeasance, misstatement, or other violations of internal policy (referred to as "conduct-based" below) are in place at all the large internationally active firms. Conduct based arrangements are in most cases related to financial restatements at the firm or business line level and for cases of serious misconduct. Therefore, these conduct-based measures provide only a limited linkage of compensation with performance and risk outcomes.

There is much more variation in the details of maluses and clawbacks tied to poor performance during the deferral period ("performance-based"). These usually apply to all components of deferred compensation, and often require a significant downturn in financial performance, such as the realisation of material losses at the firm, business, or individual level, in order to be activated. Overall, responses give the impression that some large internationally active firms have yet to implement or are still in the process of implementing performance-based malus for deferred pay delivered in equity-linked instruments. Many have only recently implemented malus or clawback schemes, so it is too early to tell how well or how consistently firms will apply them, especially in case of discretionary schemes (see below).

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[26] Three or four year deferral periods and pro rata vesting schedules are the most common, but a few report average deferral rates of less than three years for some categories of employees, and a number report average deferral periods of five years or more.

The details of performance-based ex post adjustments also vary a great deal, with most falling into one of four broad categories. Some firms use formulaic maluses, which reduce or eliminate vesting if a specified indicator falls below a threshold. An example would be losses (negative net income) for the firm as a whole or for the employee's business line. Other firms have maluses that are applied on a discretionary basis, often by the remuneration committee. A third group of firms use a hybrid approach in which final decisions about whose unvested pay is adjusted, and by how much, are made judgmentally according to well developed policies and procedures, but a performance indicator is used to set the process of deciding about forfeiture in motion. A fourth category included long-term incentive plans that include performance conditions that reduce the number of units vested in the event of poor performance but increase them in the event of high performance. These are qualitatively different than the other three categories in that they resemble performance target associated with the bonus process and may not act to limit risk-taking incentives.

Performance-related malus arrangements are more common at EU and North American firms than elsewhere in the world.

For firms other than the large internationally active ones, maluses and clawbacks for malfeasance, misreporting, etc. as well as performance-based maluses and clawbacks, are less common. This is especially the case at firms with low deferral fractions.

5.7 *Challenges and potential impediments to full implementation*

Some firms stated that differences across jurisdictions in the interpretation of certain Standards were a source of competitive disadvantage in the market for financial employees.[27] Most such comments seemed to be focused on pay structure, especially deferral rates, as well as guarantees (Standard 11) and hedging of deferred compensation (Standard 14) (see section 8). It is possible that the competitive concerns reported by some firms may arise in circumstances where firms in other jurisdictions are requested to comply with specific pay structures and other requirements, while other firms from other jurisdictions are not required to use the same pay structure. Average deferral rates reported by individual firms might conceal different degrees of internal variation, so that some firms might be flexible in setting individuals' deferral rates, or other elements such as retention periods or guarantees. Because the details of competitive bidding for key employees are rarely revealed, the extent of differences in practice and the main cause of firms' concerns remains difficult to assess.

The details of the transposition of the text and terminology of the P&S vary. Those following a regulatory approach may feel that the problem lies with jurisdictions that have adopted a more flexible interpretation of the Standards. This has had the effect of creating inconsistencies in implementation across the FSB membership. However, those following the supervisory approach may feel that the problem lies with jurisdictions which have inserted particular interpretations of some Standards in binding regulation, leaving less room for flexibility. The issue remains that some firms have expressed concerns of a lack of a level

[27] In their responses, half the large internationally active banks mentioned inconsistencies in regulatory requirements across jurisdictions as a problem. These were evenly divided between those concerned about competitiveness and level playing field and those concerned about the impact of satisfying multiple regulators on their ability to structure their pay system in an efficient and effective way. A variety of Standards were mentioned as the main cause of concerns.

playing field in the implementation of certain of the Standards and see lack of consistency across jurisdictions as a major obstacle to full implementation.

The issue of different degrees of flexibility in the interpretation and implementation of the Standards remain central to the concerns about competitiveness within the banking sector. It is important to note that competitive disadvantages may also arise when firms have to compete with those from unregulated sectors that have done little to implement the P&S.

Some firms also raised impediments to full implementation of the Standards on ex post performance adjustment arising from local labour laws or practices. In some jurisdictions, the ability to use variable pay is limited. In some, the ability to implement maluses and clawback, or even to defer pay or use performance-sensitive instruments, is limited.

There is still much room for improvement in firms that are further from having fully implemented Standards 6 to 9. Some of these firms believe that a form of proportionality applies to them, as reportedly their employees have little ability to take risk and/or they make little use of variable pay so that incentives to take risk are not provided.

As noted in section II, nations have used different (regulatory or supervisory) approaches to implementing the P&S. Deferral fractions and use of shares and ex post adjustments are roughly similar for the two groups of firms, with modestly higher deferral fractions on average at firms in nations following the regulatory approach but modestly lower use of equity and ex post adjustments in such nations. Also looking at the other firms, the criterion “regulatory versus supervisory” does not appear to be decisive in explaining differing degrees of implementation. This appears to support the conclusion in section II, that the terms regulatory approach and supervisory approach are too broad in their definition to fully capture differences in jurisdictions' application of the P&S.

6. Disclosure

Most firms choose to disclose their compensation practices as part of their Annual Reports, which cover the governance of the remuneration systems, remuneration polices, key features of the remuneration structures and quantitative information of the remuneration outcomes. In general, such disclosures were made within a period of not more than six months from the end of the reference year and are accessible through the firms’ websites.

Some best practices were demonstrated by a few firms which emphasised a high level of transparency with respect to the qualitative aspects of their remuneration systems. For instance, their disclosures included supplemental information on their approach to align with the key elements of the P&S, an explanation of the role of the risk and compliance functions in the compensation governance framework, a brief account of the methodologies of risk adjustments to performance measurements and bonus pool determination, and a description of the criteria such as the employees’ functional responsibilities, authorities and remuneration levels for the identification of material risk takers.

To maintain confidentiality, some firms choose to report directly to the national regulators information on compensation granted to a small number of employees within the firm in a reference year, such as severance payments, instead of disclosing such information publicly.

6.1 *Challenges and potential impediments to full implementation*

Some implementation issues were noted as follows:

- the disclosures were focused on the remuneration awarded to directors and senior management and lacked of information on the remuneration awarded to material risk takers, partly due to the absence of a robust framework for identifying this category of employees;
- insufficient information was disclosed in the area of ex ante risk adjustments, largely because methodologies are still evolving;
- the disclosures in some jurisdictions were largely based on the existing accounting standards, as well as the rules and regulations under the company laws and /or listing rules which may not cover certain elements of Standard 15 such as compensation granted to material risk takers, new sign-on and severance payments; and
- implementation gaps also existed in meeting the quantitative disclosure requirement as the information disclosed might not match with every element of Standard 15 for certain reasons, such as recourse to the principle of proportionality in making the disclosures.

7. Other features of compensation systems

7.1 *Compensation and capital*

The majority of firms reportedly have adequate policies in place to meet Standard 3 and supervisors believe firms would take action to reduce variable compensation for capital purposes if necessary. The majority of firms' responses imply that capital adequacy is considered in compensation decisions either explicitly or implicitly. There have been no reported instances of firms explicitly reducing variable compensation due to current or future capital concerns to date; all firms reported sufficient current capital adequacy with no currently anticipated short falls.

In general, the large internationally active firms appear further advanced in their consideration of the link between capital and remuneration. Of these firms, some explicitly consider capital as part of the process of determining bonus pools; others rely on compensation being captured in capital, budget/financial planning and/or stress testing processes. There are three ways that capital considerations are typically included as an input into the bonus pool decision process:

- through a balanced risk metric, in which capital is a component of a scorecard which provides a basis for determining the bonus pool amount;
- through the link between variable compensation and ex ante performance measures such as EP, which take account the cost of capital;
- through input to the compensation decision making body for consideration on a discretionary basis e.g. KPIs, assessment/attestation by the finance function/CFO.

The alternative reported approach of reliance on existing budgeting and capital planning processes has also been handled in a number of ways, including through stress testing and

ICAAP. For instance, some firms consider compensation to be sufficiently accounted for in the capital forecasting process through inclusion in income forecasts.

Outside the 20 large internationally active firms, a wider range of answers were provided on capital. A number of firms considered their level of variable compensation to be sufficiently low, particularly relative to capital levels, that its impact on capital would be negligible. Some firms appeared to place reliance on the link to performance and the operation of a fully flexible/discretionary bonus policy (which allows variable compensation to be decreased or eliminated in the case of poor financial results, increasing a firm's ability to preserve capital). Asian Emerging Market firms in particular appear to place more emphasis on the link to performance and low compensation levels in their approach to capital.

7.2 *Guaranteed bonuses*

Guaranteed bonuses (Standard 11) are awards which guarantee a minimum bonus payment without performance measures attached. There are a number of situations in which firms typically offer guaranteed minimum bonuses to employees: for hiring (both as an enticement for attracting talent and to "make whole" awards forfeited on joining from a previous employer) and for retention purposes.

The responses from firms can be generally split along two lines: those that state that guarantees are not a part of their compensation structures (therefore Standard 11 was deemed to be not applicable or fully met)[28]; and those that have policies setting out circumstances under which guarantees can or cannot be awarded.

All firms which implied that guarantees did not apply were outside the 20 large internationally active firms (this was a comment made by approximately 20 percent of these firms). Although difficult to tell conclusively from the responses, this appears most commonly due to the non prevalence of guarantees as a practice.

Almost all other firms, including those that are internationally active, stated that guarantees are issued exceptionally and/or that they have policies restricting awards to certain situations. Most guarantees are limited to new hires in their first year, with multi-year guarantees rarely permitted by firm policies. Some firms stated that their policies only allow guarantees to be awarded to new hires for one year. Other firms left open the possibility of applying more flexible arrangements in certain circumstances. Most firms indicated that such awards are limited to exceptional cases, for example retention in the event of restructuring or only against certain competitive offers for key individuals. Some EU firms also require guarantees to be subject to deferral and malus. "Make whole" awards appear to be treated separately from sign on bonuses in a number of firms, and are typically subject to deferral in order to prevent acceleration of payment.

Although the above describe policies as indicated in firms' responses, there was insufficient information to determine the extent to which differences in approach is actually prevalent across firms and jurisdictions. An additional important limitation of the analysis is that it is difficult to tell the extent to which the policies reported are applied in practice i.e.

[28] It is not clear whether these responses dispute that guarantees should be considered as part of compensation structures or (as seems more likely) whether banks state that guarantees are not used.

whether/when divergences from firm policy occur. Furthermore, many responses implied that exceptions to best practice/firm policy may be permitted. This can be a particularly sensitive issue where firms are competing to attract or to retain key individuals, especially in international financial markets.

7.3 *Golden Parachutes*

A significant number of firms reported that "golden parachute" contracts (Standard 12) had not been used in their organisation or had not been issued recently e.g. any such contracts that existed were made prior to 2009. For those firms with pre-existing contracts, policies that prohibit "golden parachute" severance payments have now been established in line with supervisory or regulatory expectations.

In addition, most firms stated that unvested and deferred payments would generally be forfeited in event of termination due to misconduct and serious failures. However, none had provided accounts where these forfeitures had been exercised.

Overall, the responses indicate that most firms have achieved a significant level of compliance with Standard 12, in particular among the 20 firms considered large and internationally active for the purposes of this review. For the remaining firms with implementation gaps, nearly all national authorities have committed initiatives to ensure implementation. In instances where firms awarded discretionary severance payments, these are generally limited to a small group of senior executives. In the responses provided, it was not always clear that firms had established clear internal criteria to assess the award of severance payments and if supervisors had reviewed and assessed awards granted. However, as approvals for such payments have to be escalated to senior management or board-level remuneration committees, the appropriateness of such decisions would be subjected to the firm's internal governance frameworks. Consequently, implementation of Standard 12 in such instances would then be dependent on the effectiveness of the firm's governance framework.

7.4 *No hedging by employees*

To implement Standard 14, most firms have formalised the relevant requirements in the employee code of conduct, staff trading policies or as part of the terms and conditions of specific remuneration schemes. However, the extent of communication to employees differed significantly.

Some firms, in particular the internationally active firms, require employees to explicitly undertake that they have understood the requirements as part of an annual declaration process or as a condition to receive the applicable compensation or awards. Other firms took a more passive approach by informing staff of the firms' policies and requirements. Almost all firms stated that any breach of requirements would clearly be considered an act of misconduct and lead to subsequent loss of awards.

There was also a range of practices observed in monitoring staff compliance with internal policies on Standard 14. Some firms achieve this through a self-declaration approach and pre-clearance requirements for trades. In some firms, particularly those with investment banking arms, more active monitoring is performed. For instance, all staff trades have to clear through the firm or designated broker accounts which would be monitored by independent functions.

Responses did not always clearly indicate if the implementation extended fully and retrospectively to include all past awards and all staff.

Although a majority of the firms had reported to adopt this Standard fully, there were some firms with remaining gaps and several others which adopted this Standard to a more limited extent. A few firms that did not consider this Standard applicable due to the absence of deferred compensation in their organisations or some firms commented that hedging tools were not available in their jurisdiction. Almost all large internationally active firms were broadly in compliance with this Standard.

IV. Assessment of firms' implementation status

1. National authorities' assessment of firms' progress

Most national authorities are broadly satisfied with firms' progress toward implementing the P&S. A summary of national authorities' assessment of firms' progress follows for each area, which closely aligns with the information provided by firms:

- *Effective governance of compensation*. Firms have made significant progress in implementing the applicable P&S, however, a few jurisdictions (Australia, Italy, Russia, Spain) identified the need for more progress in establishing compensation committees and improving their effectiveness through increased scrutiny and challenge. The Netherlands and Singapore identified a need for better engagement between the compensation committee and the committee responsible for risk.
- *Effective alignment of compensation with prudent risk-taking*. Implementation of the P&S poses the greatest challenge for firms, in particular the measurement of risk for ex ante risk adjustment and the strengthening of the relationship between risk and remuneration. The capacity of financial institutions to develop and implement appropriate ex ante and ex post risk adjustment instruments was identified as a difficult technical issue due to:
  - risk adjustment occurring only at the enterprise-wide level, with difficulties to develop ex ante and ex post risk adjustments for lower-level employees;
  - the need for a longer-term perspective in performance indicators and the development of risk adjusted performance parameters in a fully "risk-adequate" way, especially at the single-entity level and for smaller institutions;
  - the lack of objective and reliable criteria upon which to base risk adjustment, in particular for liquidity risk, especially among small institutions; and
  - malus and claw-back provisions with very high barriers (which meant they were considered unlikely ever to be used) or little evidence of any ex post risk adjustment at all.

  On some of these issues, authorities indicated that more progress could be expected in the future following the May 2011 BCBS report on the *Range of Methodologies for Risk and Performance Alignment of Remuneration*. On others, developments in risk management systems to a higher level of sophistication are needed in order to achieve full implementation.

- *Effective supervisory oversight and engagement by stakeholders*. While reasonable progress has been made, Australia and France identified the need for better disclosure by firms in relation to compensation arrangements, especially below the level of board members and senior management. In this area more progress can be expected after the implementation of the BCBS proposal on Pillar 3 disclosure requirements for remuneration which was released in July 2011.

2. The review's assessment of firms' progress

To assess effective progress in implementing the P&S by firms, assessment criteria were developed by a working group of the FSB as mandated by the first peer review (see Annex R). No criteria were provided on Standards 6 to 9 due to their different interpretation (numerical guidelines or examples of implementation) and to the fact that there was insufficient information on the range of firms' practices (particularly in identifying material risk takers) to be able to develop criteria that could support consistent judgement across all jurisdictions. For Standards 6 to 9, quantitative information has therefore been collected from the firms on various features of pay structure, separately for different levels of authority of employees and their total remuneration.

The assessments reflect quantitative and qualitative information provided by firms and national supervisors and make reference to the high level assessment criteria, to the assessments that national authorities have given based on those criteria, and to the views of the peer review team to ensure consistency across assessments.[29] Annexes F-K give an overview of the implementation progress by the firms across the different peer groups in four broad areas (effective governance, ex ante risk adjustment, alignment of compensation and performance, and disclosure) as well as two specific areas (golden parachutes and hedging by employees). It is important to note that the assessments represent a subjective interpretation of the information provided to the peer review team, and that assessment standards were the same for large internationally active firms and other firms, with no consideration of application of proportionality, which may be appropriate for some of the firms outside the large internationally active set. Annexes L-R provide the detailed information on pay structure and ex post performance adjustment features.

2.1 *Firms' implementation assessment tables*

In general, firms have made better progress in implementing and strengthening their governance structure to oversee the compensation system's design and operation than in other areas: of the total of 66 institutions surveyed, 62 percent have broadly implemented the P&S

[29] In particular, national authorities have provided their assessments based on the four – grades scale described in Annex A (Implemented, Mostly Implemented, Partly Implemented, Not Implemented). To ensure consistency across different assessments given by national authorities, the supervisors in the peer review team have followed a judgemental process in which they used the grades assigned by national supervisors as well as other information on firm's responses to determine progress using a less granular scale of only three categories (broadly implemented, good progress but still having some small gaps, still at a relatively early stage of implementation).

(see Annex F).[30] Also good progress has been achieved in the areas of no hedging and golden parachutes (see Annexes J and K), whereas more gaps to full implementation are observed in the area of alignment of compensation with performance, with only half of the firms in the sample having broadly implemented the related P&S (see Annex H). Disclosure is the area where most progress is needed; 26 percent broadly implemented the P&S (see Annex I).

By types of firms, large internationally active firms have generally made better progress than the other firms, with most of them assessed to be broadly in compliance with the relevant requirements, partly because of receiving more supervisory attention and partly because national actions to implement the P&S were taken at early dates in their jurisdictions. Large internationally active firms also show some degree of consistency in their practices. It is interesting to note that the progress of different types of firms tends to differ even within individual jurisdictions, consistent with the observation in Section II that many national authorities have prioritised their efforts towards the large internationally active firms, and that jurisdictions have firms with different characteristics.

"Other firms" consist of a wide variety of firms ranging from some big firms in advanced economies which are early-movers to smaller firms in emerging markets including late-movers. Progress therefore varies across the other firms included in the review. The divergence among "other firms" in implementation may simply be the result of the fact that the different firms are included in "other firms". Some of these firms are further behind, although there is also a large degree of variation in the progress among these firms. Many of the firms that still have some small gaps are already in the process of reworking or further amending their remuneration systems in order to fully comply with the P&S.

Firms in jurisdictions that have moved earlier in the implementation of the P&S show more progress; of the institutions based in jurisdictions that are still in the process of introduction of their regulatory frameworks (Argentina, India, Indonesia, Russia, South Africa) the vast majority are at an early stage of implementation. Some of these firms also explained that implementation of some parts of the P&S was not as important for them as for other firms because of their conservative business model, the relatively low amount of variable compensation paid for employees, and the fact that their remuneration system doesn't generally encourage excessive risk-taking.

There are also significant differences across geographic regions. The vast majority of firms in Europe, North America, and Asian Advanced Economies have reached a more advanced stage. This result can be explained by Europe and North America having a greater number of large internationally active firms in the sample (which have been the primary object of regulatory and supervisory initiatives so far) and also by the national actions on compensation in Europe, North America, and Asian Advanced Economies being adopted earlier than in other regions. Latin American firms are not far behind, as most of them are assessed to have made good progress but still has some small gaps remaining. In contrast, Asian Emerging Markets and Other jurisdictions are further behind.

[30] 21 percent still have some small gaps, including an insufficient level of independence of the remuneration committee and little involvement of risk and compliance functions in the process, and the remaining 16 percent are still at a relatively early stage of implementation.

The distinction between "regulatory approach" and "supervisory approach" is often blurred in reality since national authorities usually use laws, regulations, and supervisory guidance in combination and the degree of enforceability of these regulations and guidance and choice of formulating prescriptive rules or high-level principles vary across jurisdictions. Consequently, there are no material differences in firms' progress in implementing the Standards whether they are in jurisdictions with a regulatory approach or supervisory approach.

Nevertheless differences in the application of the P&S exist and do give rise to concerns amongst some of the large internationally active firms about the lack of a level playing field. There are two possible reasons for this paradox. First, the level of transparency of requirements varies across jurisdictions, which may contribute to heighten firms' concerns. Secondly, the averages reported by firms may conceal different degrees of internal variation.

2.2 *Implementation of pay structure and ex post adjustment*

The peer review collected quantitative information from firms about their pay structure. Each firm completed a table similar to Table 2 below, which reports (simple) average figures on pay structure and ex-post performance adjustment from the tables provided by all firms.[31]

Table 2: All banks – Averages

	Number of employees	Variable Compensation				
		% of total compensation	% that is deferred	Deferral period (number of years)	% awarded in shares or share-linked instruments	% subject to ex post risk adjustment
A. Most senior members of the executive board	14	67	58	3	49	44
B. Other members of the executive board	12	62	54	3	50	42
C. Other senior executives	55	64	51	3	43	41
D. Other employees whose individual actions have a material impact on the risk exposure of the firm	480	61	43	3	37	36
E. The most highly paid employees not covered above	40	76	47	3	42	36

The average value for each of several element of pay structure (the columns) was reported for each of several groups of employees (the rows). Employee groupings include: senior executives split into the most senior members of the executive board, other members of the executive board, and other senior executives (rows A, B and C, respectively); other material risk takers (row D); and employees paid as much or more than the average for senior

[31] Of the 66 banks reporting for their consolidated organisation, seven did not provide a table, or provided one that was unusable, or had pay structures for 2010 that were so constrained by national law or by omission of bonuses that the tables were not informative. This left a total sample of 59 banks, which are included in Table 8.1.

executives but not included in other rows (row E). On average, for all firms, variable pay constitutes 61-76 percent for the different groups of employees, while the fraction of variable pay that is deferred is 43-58 percent. The average time until all of a deferred award vests is 3 years and the fraction awarded in shares ranges from 37 to 50 percent; 36-44 percent of employee groups is subject to ex post risk adjustment.[32]

The single most important pattern in explaining the different results is the distinction between large internationally active firms and other firms. The divergence among "other firms" in the implementation may simply be the result of the fact that the different firms are included in "other firms" from some big firms in advanced economies which are early movers to smaller firms in emerging markets including late movers. As shown in Tables M.2 and M.3, on average, the firms outside the large internationally active set make somewhat less use of variable pay, defer somewhat smaller fractions for a somewhat smaller number of years, and make somewhat less use of share-linked instruments and ex post adjustments, with more variation in practice across the firms.

Values reported by individual firms vary moderately around the averages at the large internationally active firms. Values at the 20th and 80th percentiles were identified for each cell of the table, and these were within 15 to 25 percentage points of the mean (and always 3 years or more for the vesting period). Somewhat more variation exists in values reported by firms other than large internationally active firms, mainly because some such firms report zeros in some cells, reflecting the fact that they are at an early stage of implementation. The tables in Annex N show groupings of firms by geographic location, including for jurisdictions that provided usable data for three or more firms (9 jurisdictions). Averages are similar for large internationally active firms headquartered in Europe and North America and Europe (Tables N.1 and N.2). Using a regional breakdown for all firms (Tables N.1 – N.5), averages are again similar for North America and Europe, but are somewhat smaller in Asia and Other regions. However, as noted previously, the concentration of large internationally active firms in North America and Europe likely accounts for at least some of the difference. In Asia, ex post adjustments play a smaller role in the emerging markets. Deferral fractions and percentages for equity-linked instruments and ex post adjustment are smallest on average in the Other regions, but these also harbour a sizable number of nations in which implementation of the P&S is still in progress.

By time since incorporation into national codes (Annex O), averages are generally higher for firms headquartered in nations that had mostly or fully implemented the P&S by the time of the first peer review ("early movers") than for firms in nations still in process of implementation. By business model (Annex Q), which were produced only for the subset of large internationally active firms, averages are similar for wholesale and mixed wholesale-retail business models, but somewhat smaller for mainly retail firms. Finally, as shown in Annex P, averages are similar across the two methods of implementation (regulatory or supervisory).[33]

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[32] For large internationally active firms (see Annex M), the respective numbers are: variable pay constitutes 76-89 percent for the different groups of employees, while the fraction of variable pay that is deferred ranges is 57-74 percent. The average time until all of a deferred award vests is 3-4 years, and the fraction awarded in shares ranges from 52 to 68 percent; 54-68 percent of employee groups is subject to ex post risk adjustment.

[33] There is a significant difference in average deferral percentage for other-members-of-the-executive-board, but this row was reported by only a few banks in the supervisory category, two of which reported unusually low percentages in that

V. Conclusions and recommendations

1. Full implementation by national authorities

The findings of the review show that differences in implementing the P&S by FSB member jurisdictions is an important contributing factor to the differences on the degree of implementation across firms.

Although many jurisdictions and firms have made good progress in implementing the P&S, the responses from some national authorities revealed some constraints (primarily of a legal nature) on their ability to fully implement the FSB P&S. The most common constraint relates to labour laws, which in a few jurisdictions appear to limit the capacity of regulators to apply some of the P&S; in other cases, national authorities have noted that government-owned financial institutions may lie beyond direct supervisory oversight.

FSB member jurisdictions have committed to full implementation of the P&S, and it is important to continue their efforts in this area. In those few cases where there are significant impediments, jurisdictions should identify ways to overcome them in order to ensure an outcome that is fully consistent with the objectives of the P&S. The nature of the impediments, as well as the actions to address them, should be reported to the FSB and will be included in its ongoing monitoring and public reporting of the implementation of the P&S.

National responses also highlighted the importance of proportionality in the application of the P&S, particularly in jurisdictions whose framework covers smaller institutions for whom the implementation costs might be proportionally higher or whose impact on financial stability is not significant. In some jurisdictions, the issue of proportionality is linked to existing compensation practices - for example, where compensation is overwhelmingly fixed (no variable component) or paid in cash, or where shares and share-like instruments cannot be used as an instrument of variable remuneration (e.g. for unlisted financial institutions such as cooperatives, for privately-owned or state-owned companies, and for firms in jurisdictions where the domestic equity market is less developed). Some of the surveyed banks have also asserted that limited implementation of the P&S, particularly for Standards 6 to 9, is justified because of the specific features of their business models (e.g. local, retail-oriented etc.).

The above circumstances might justify proportionality in the implementation of the P&S as long as they reflect substantive differences in the business model and risk profile of the relevant institutions; are based on clearly defined criteria in national regulations or supervisory guidance, which should be reviewed periodically to ensure that they do not give rise to regulatory arbitrage; and are reported to the FSB as part of its ongoing monitoring of the implementation of the P&S.

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cell. Supervisory and regulatory approaches lead to similar percentages if similar tables are produced only for the large internationally active banks (not shown).

Recommendation 1 - Full implementation by national authorities

(a) All FSB member jurisdictions should finalise the implementation of the P&S. Jurisdictions should undertake actions, including legislation where needed, to eliminate any impediments to full implementation.

(b) Proportionality in the implementation of the P&S may be justified by the business model and risk profile of the institution. FSB member jurisdictions should clearly define in national regulations or supervisory guidance the specific criteria supporting the application of the principle of proportionality. In addition, jurisdictions should proactively ensure that proportionality remains appropriate and does not give rise to regulatory arbitrage as a result of market developments and emerging risks.

(c) National authorities should periodically report to the FSB on the nature of any significant impediments and proposed actions to address them as well as on the specific criteria supporting the application of proportionality in their jurisdiction. This reporting will form part of the FSB's ongoing monitoring of the implementation of the P&S.

2. Addressing level playing field concerns

International consistency in the implementation of the P&S remains an issue as indicated by the findings of this peer review. Inconsistent requirements can make it more costly and difficult for firms to operate across jurisdictions (especially during the transition period to full implementation), and may also cause an unlevel playing field (although some banks may raise such concerns solely as a way to avoid taking action to implement the P&S). Most level playing field concerns, which are particularly relevant for large internationally active banks, appear to be related to pay structure (Standards 6 to 9), guarantees (Standard 11), and the hedging of deferred compensation (Standard 14).

Because the details of competitive bidding for key employees are rarely revealed, the extent of differences in practice and the main cause of firms' concerns remain difficult to assess. The information collected by the peer review is not sufficient to allow a clear identification of the extent, severity, and causes of level playing field concerns on the part of firms and supervisors. Potential causes of these concerns are differences in the level of implementation across firms, in the degree of transparency of national requirements across jurisdictions, as well as in the interpretation and details of the requirements for some P&S.

More detailed information on the specific sources of firms' concerns is needed to verify their validity and to assess the effects of any inconsistencies in the implementation of the P&S. This will require FSB member jurisdictions to foster a bilateral consultation process among their supervisors in order to substantiate and address specific level playing field concerns raised by their respective institutions, particularly with regard to Standards 6-9, 11 and 14. The FSB should review this information periodically (at least annually), appraise whether the processes are working effectively, and identify any issues where coordinated multilateral action might be helpful. The findings from this exercise should inform the scope and intensity of the FSB's ongoing monitoring of the implementation of the P&S. Over time, the analysis of firm-specific cases via bilateral consultations and the FSB monitoring process should provide more clarity on the appropriate flexibility and transparency in the application of the P&S across firms and jurisdictions.

Recommendation 2 – Addressing level playing field concerns

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. The nature of the concerns, the actions taken to address them via supervisory cooperation and the outcomes should be reported at least annually to the FSB and should inform the scope and intensity of its ongoing monitoring of the implementation of the P&S.

3. Ongoing implementation monitoring

Compensation practices remain a priority area on the international reform agenda. As part of its coordinated framework for monitoring the implementation of agreed G20/FSB financial reforms, the FSB should undertake ongoing monitoring and public reporting on the implementation of the P&S. The objectives of this monitoring will be to ensure that the FSB P&S are fully implemented in member jurisdictions and by relevant firms, that implementation effectively aligns compensation practices to prudent risk-taking behaviour, and that the recommendations of this peer review are appropriately followed up. Based on the findings from the ongoing monitoring, the FSB should consider the scope and appropriate timing for a follow-up review on compensation practices as well as any decision to issue additional FSB guidance on the interpretation of the definition of material risk takers.

Recommendation 3 – Ongoing implementation monitoring

The FSB should undertake ongoing monitoring and public reporting on the implementation of the P&S as part of its coordinated framework for monitoring the implementation of agreed G20/FSB financial reforms. This monitoring should focus on remaining gaps and impediments to full implementation by member jurisdictions as well as on the actions taken by relevant parties in response to this report's recommendations. 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.

4. Supervisory cooperation

As practices are still evolving, the effectiveness of compensation policies should be closely monitored by supervisors. Implementation and supervisory review should move from a compliance exercise to a focus on effective outcomes with regard to risk-taking incentives. As supervision of remuneration policies and practices involves a high degree of judgement, home-host supervisory cooperation and coordination for significant, cross-border financial institutions should be enhanced. This would also involve the exchange of information between supervisors on industry best practices and on implementation challenges.

Risk and performance alignment, in particular, is an area in which only a small proportion of firms have achieved a high degree of implementation, and further improvement needs to be made. This is also the area identified as more technically challenging by surveyed firms, especially with regard to difficult-to-measure risks and longer time horizons.

Another area that would benefit from enhanced supervisory dialogue is the identification of the precise set of employees in each firm to which the P&S apply ("material risk takers" or MRTs). There appear to be some differences with regard to the criteria used to identify relevant employees across jurisdictions as well as across firms within the same jurisdiction. Most jurisdictions have already adopted a way to identify individual MRTs, but the methods and sets of employees tend to differ, especially for lower-level employees that can have a significant collective influence on a firm's performance.

Recommendation 4 – Supervisory cooperation

Supervisory cooperation in the area of compensation practices should be stepped up. Greater efforts need to be made to include remuneration on the agenda of supervisory colleges and to enhance home-host supervisory cooperation and coordination for significant, cross-border financial institutions. In order to enhance the effectiveness and consistency of implementation of the P&S, supervisors should use appropriate supervisory networks to exchange information on the interpretation and technical implementation of the P&S in their jurisdiction, including with respect to the definition of material risk takers. They should also discuss evolving firm practices, especially in the areas of risk adjustment and performance alignment.

5. Corporate governance

Despite progress in the area of effective governance, there is still work to be done, particularly among institutions located in jurisdictions where implementation of the P&S is not yet advanced or still has gaps. Moreover, even though almost all large internationally active banks have set up a remuneration committee as part of their governance structure, there remains room for improvement in the expertise and experience of the remuneration committee members, in their ability and willingness to challenge the executive members as necessary, and in the independence and status of the risk and compliance functions.

The urgency to make progress is motivated by the fact that effective governance is a necessary precondition for the resilience and integrity of other parts of the compensation system and process. Furthermore, implementing the P&S requirements with respect to governance typically requires organisational and procedural changes that can be implemented fairly quickly without regard to existing contractual arrangements and commitments. The FSB P&S on effective governance are considered a "low hanging fruit", and there should be no exception to full and timely progress in implementation.

Effective corporate governance ultimately requires material cultural changes within firms. Relevant industry bodies and international standard-setters – such as the BCBS and the OECD – should continue to support the implementation of the P&S in this area via the collection and dissemination of good practices on the effective governance of compensation.

Recommendation 5 – Effective governance of compensation

Supervisors should ensure that all financial institutions deemed significant for the purposes of the P&S take immediate steps to align their practices with the key requirements in the area of effective governance of compensation. Particular attention should be given to the independence and expertise of the institution's remuneration committee, to the independence of risk and compliance functions in the compensation process, and to evidence of real cultural change within the institution.

6. Disclosure

Additional disclosures on compensation practices by firms across all jurisdictions would help increase the effectiveness of market discipline and provide clarity on issues and concerns about a level playing field. It is expected that the Pillar 3 disclosure requirements for remuneration, issued by the BCBS in July 2011, will further promote international consistency in this area, thereby allowing market participants to assess the quality of banks' remuneration practices.

Recommendation 6 – Disclosure

Supervisors should ensure that all financial institutions deemed significant for the purposes of the P&S comply with the Basel Committee's Pillar 3 disclosure requirements for remuneration from 1 January 2012.

Annex A: Status of national implementation

The table below provides a preliminary snapshot of implementation initiatives in FSB member jurisdictions. The table does not provide an assessment of the degree of compliance with the particular Principle or Standard, rather an indication of whether regulatory or supervisory initiatives are underway to implement a Principle or Standard (or elements thereof);[34] initiatives are at the preparatory stage (i.e., regulation or supervisory guidance being drafted or under consultation); under consideration; or not currently underway. The table was developed by the FSB Secretariat based on the responses to the template provided by member jurisdictions, and national entries have been checked for accuracy by the relevant authorities.

For a summary of the Principles and Standards, see Annex C.

	AR	**AU**	**BR**	**CA**	**CN**	**FR**	**DE**	**HK**	**IN**	**ID**	**IT**	**JP**	**KR**	**MX**	**NL**	**RU**	**SA**	**SG**	**ZA**	**ES**	**CH**	**TR**[35]	**UK**	**US**
Effective governance of compensation																								
P1	R	R	R	S	S	R	R	S	R	R	R	S	S	R	R	S	R	R	IP	R	R	S	R	R
P2	R	R	R	S	S	R	R	S	R	R	R	S	S	R	R	S	R	R	IP	R	R	S	R	S
S1	R	R	R	S	S	R	R	S	IP	S	R	S	S	R	R	S	R	R	IP	R	R	S	R	R
P3	R	R	R	S	S	R	R	S	IP	S	R	S	S	R	R	R	R	R	IP	R	R	S	R	S
S2	R	R	R	S	S	R	R	S	IP	S	R	S	S	R	R	S	R	R	IP	R	R	S	R	S
Effective alignment of compensation with prudent risk taking																								
P4	R	R	R	S	S	R	R	S	IP	IP	R	S	S	R	R	IP	R	R	IP	R	R	S	R	S
S3	R	R	R	S	S	R	R	S	UC	R	R	S	S	R	S	IP	R	R	IP	R	R	S	R	R
S4	R	R	R	S	S	R	R	S	UC	IP	R	S	S	R	R	IP	R	S	IP	R	R	S	R	S
P5	R	R	R	S	S	R	R	S	IP	IP	R	S	S	R	R	IP	R	R	IP	R	R	S	R	S

[34] As stated elsewhere in this report, effective implementation of the Principles and Standards can be achieved through a variety of approaches, including different mixes of regulation and supervisory oversight.

[35] In Turkey, the national supervisory authority (BRSA) published supervisory guidance on compensation in June 2011; the column for Turkey in the table reflects this new guidance. However, since the peer review has examined the status of firms' implementation before the actual passage of the supervisory guidance, Turkey has been considered among the "late mover" countries for the purposes of results on firm level implementation.

	AR	AU	BR	CA	CN	FR	DE	HK	IN	ID	IT	JP	KR	MX	NL	RU	SA	SG	ZA	ES	CH	TR[35]	UK	US
S5	NA	R	R	S	S	R	R	S	IP	IP	R	S	S	R	R	IP	R	S	IP	R	R	S	R	S
P6	R	R	R	S	S	R	R	S	IP	IP	R	S	S	R	R	IP	R	R	IP	R	R	S	R	S
S6	NA	S	R	S	S	R	R	S	IP	IP	R	S	S	R	R	IP	R	S	IP	R	R	S	R	S
S7	NA	S	R	S	S	R	R	S	IP	IP	R	S	S	R	R	IP	R	S	IP	R	R	S	R	S
P7	R	S	R	S	IP	R	R	S	IP	IP	R	S	S	R	R	IP	R	R	IP	R	R	S	R	S
S8	NA	S	R	S	IP	R	R	S	IP	IP	R	S	S	R	R	IP	R	S	IP	R	R	S	R	S
S9	NA	S	R	S	S	R	R	S	IP	IP	R	S	S	R	R	IP	R	S	IP	R	R	S	R	S
S11	R	S	R	S	S	R	R	S	IP	IP	R	S	S	R	R	IP	R	S	IP	R	R	S	R	S
S12	NA	S	R	S	S	R	R	S	UC	IP	R	S	S	R	R	IP	R	S	IP	R	R	S	R	S
S14	NA	S	NA	S	S	R	R	S	IP	IP	R	S	S	R	R	IP	S	S	IP	R	UC	NA	R	S
Effective supervisory oversight and engagement by shareholders																								
P8	R/IP	S	R	S	S	R	S	S	IP	S	S	S	S	R	R	S	S	S	IP	R	R	S	R	S
S10	NA	NA	NA	S	S	R	R	R	UC	R	R	R	S	R	R	R	R	R	NA	R	R	R	R	R
S13	IP	S	R	S	S	R	R	S	UC	IP	R	S	S	R	R	S	S	S	IP	R	S	S	R	S
S16	IP	S	R	S	S	R	S	S	IP	S	S	S	S	R	R	S	S	S	IP	R	S	S	R	S
S17	IP	R	R	S	S	R	R	S	UC	IP	S	S	S	R	R	S	S	S	IP	R	R	S	R	S
S18	IP	S	R	S	S	R	R	S	UC	IP	S	S	S	R	R	S	R	S	IP	R	R	S	R	S
P9	R	R	R	S	S	R	R	S	IP	R	R	R	S	R	R	R	R	S	IP	R	R	S	R	R
S15	R	R	R	S	S	R	R	S	IP	IP	R	S	S	R	R	R	R	S	IP	R	R	S	R	R

Legend: R – regulatory approach (including applicable laws, regulations, and a mix of both regulation and supervisory oversight); S – supervisory approach (including supervisory guidance and/or oversight); IP – initiatives under preparation; UC – initiatives under consideration; NA – not addressed or not relevant. (S19 not included.)

Acronyms: AR – Argentina; AU – Australia; BR – Brazil; Ca – Canada; CN – China; FR – France; DE – Germany; HK – Hong Kong; IN – India; ID – Indonesia; IT – Italy; JP – Japan; KR – Korea; MX – Mexico; NL – Netherlands; RU – Russia; SA – Saudi Arabia; SG – Singapore; ZA – South Africa; ES – Spain; CH – Switzerland; TR –Turkey; UK – United Kingdom; US – United States.

Annex B: Remaining gaps in national implementation

Country	Gaps in governance, effective alignment with risk taking, or disclosure	Principle not yet implemented	Standard not yet implemented	Reason / additional information
Argentina	Effective alignment with risk taking Disclosure		5-10, 12-14, 16-18 (13 and 16-18 in process of implementation)	No current plans to implement Standards 5-10, 12 and 14 on effective alignment of compensation with prudent risk-taking and government intervention. It does not consider there are currently any significant problems with compensation and risk-taking in its domestic banking system. It also states that domestic labour laws limit its capacity to act in this area.
Australia	Effective alignment with risk-taking		10	This Standard is not applicable as Australia has not bailed-out any financial institutions.
Brazil	Effective alignment with risk-taking		10 and 14	Standard 10 is not applicable as Brazil has not bailed-out any financial institutions.
China	Effective alignment with risk-taking	7	8	Currently, compensation is overwhelmingly paid in cash. China is considering to increase the use of long-term incentive plans with stock-linked instruments.
India	All	3-9	All	In the process of implementing the remaining 7 Principles as well as 12 of the 19 Standards (the Standards on the alignment of risk and compensation are still under consideration). Governance requirements are expected to be issued in the second half of 2011. Implementation is expected to be completed by 2012-13 (although banks have been asked to begin preparatory work in anticipation of commencement).
Indonesia	Effective alignment with risk-taking Disclosure	9	4-14	These Standards are still under consideration.

Country	Gaps in governance, effective alignment with risk taking, or disclosure	Principle not yet implemented	Standard not yet implemented	Reason / additional information
Russia	Effective alignment with risk-taking		4-14	These Standards are still under consideration.
South Africa	All	All	All	Is in the process of developing a new domestic framework, which will exclude Standard 10 (relating to institutions that have received extraordinary government support). South Africa expects to issue governance requirements, placing statutory obligations on the board with respect to the oversight of compensation schemes, in the second half of 2011.
Switzerland	Effective alignment with risk-taking		14	Switzerland awaits more information on how the Standard on the use of hedging strategies has been implemented in other jurisdictions to avoid 'misalignment or disproportionate impact'.
Turkey	Effective alignment with risk-taking		14	On June 9, 2011, standards were adopted into the domestic framework with some flexibility in implementation.
US	Disclosure		15	US waited for the finalisation of forthcoming Pillar 3 compensation guidance from the BCBS before beginning rulemaking on disclosure in relation to compensation of some elements of Standard 15, though other elements are disclosed.

Annex C: Summary of FSB Principles and Standards

a. Effective governance of compensation

<table>
<tr><td>Principle 1.</td><td>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.</td></tr>
<tr><td>Principle 2.</td><td>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.</td></tr>
<tr><td>Standard 1.</td><td>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.</td></tr>
<tr><td>Principle 3.</td><td>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.</td></tr>
<tr><td>Standard 2.</td><td>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.</td></tr>
</table>

b. Effective alignment of compensation with prudent risk-taking

<table>
<tr><td>Principle 4.</td><td>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.</td></tr>
<tr><td>Standard 3.</td><td>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.</td></tr>
<tr><td>Standard 4.</td><td>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.</td></tr>
<tr><td>Principle 5.</td><td>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.</td></tr>
<tr><td>Standard 5.</td><td>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.</td></tr>
<tr><td>Principle 6.</td><td>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.</td></tr>
<tr><td>Standard 6.</td><td>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.</td></tr>
<tr><td>Standard 7.</td><td>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.</td></tr>
</table>

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.
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.
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.
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.
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.
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.

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.
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.
Standard 13.	Significant financial institutions should take the steps necessary to ensure immediate, prospective compliance with the FSB Standards and relevant supervisory measures.
Standard 16.	Supervisors should ensure the effective implementation of the FSB Principles and Standards in their respective jurisdiction.
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.

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.
Standard 19.	Supervisors need to coordinate internationally to ensure that these standards are implemented consistently across jurisdictions.
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.
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.

Annex D: Firms surveyed for this peer review

Country	Firms
Argentina	1. Banco Santander Rio 2. Banco Galicia
Australia	3. Commonwealth Bank of Australia 4. National Australia Bank 5. Australia and New Zealand Banking Group 6. Westpac Banking Corporation 7. Macquarie Bank Limited
Brazil	8. Itaú 9. Bradesco
Canada	10. Royal Bank of Canada 11. Toronto-Dominion Bank 12. Scotiabank 13. Canadian Imperial Bank of Commerce 14. Bank of Montreal
China	15. Industrial and Commercial Bank of China 16. Bank of China 17. China Construction Bank
France	18. BNP Paribas 19. Société Générale 20. Crédit Agricole 21. BPCE
Germany	22. Deutsche Bank 23. Commerzbank 24. Landesbank Baden Württemberg
Hong Kong	25. The Hongkong and Shanghai Banking Corp. 26. Standard Chartered Bank (HK)
India	27. ICICI Bank 28. HDFC Bank 29. Kotak Mahindra Bank 30. Axis Bank
Indonesia	31. Bank Mandiri 32. Bank Central Asia 33. Bank Danamon
Italy	34. Unicredit 35. Intesa San Paolo 36. Monte dei Paschi di Siena
Japan	37. Mizuho Financial Group 38. Mitsubishi UFJ Financial Group 39. Sumitomo Mitsui Financial Group
Korea	40. Kookmin Bank 41. Shinhan Bank

Country	Firms
Mexico	42. Banco Mercantil del Norte (Banorte)
Netherlands	43. ING Group 44. Rabobank
Russia	45. Sberbank 46. VTB 47. Gazprombank
Saudi Arabia	48. National Commercial Bank 49. SAMBA Financial Group
Singapore	50. DBS Bank 51. Overseas-Chinese Banking Corporation 52. United Overseas Bank
South Africa	53. Nedbank 54. Standard Bank
Spain	55. Santander 56. BBVA
Switzerland	57. Credit Suisse 58. UBS
Turkey	59. Isbank 60. Akbank
UK	61. Barclays 62. HSBC Holdings 63. Lloyds Banking Group 64. The Royal Bank of Scotland Group 65. Standard Chartered
USA	66. Citi 67. Goldman Sachs 68. Morgan Stanley 69. JP Morgan Chase 70. Bank of America

Annex E: Groupings of firms

Peer Group		Firms / Jurisdictions		Number of firms
Firm type	**All firms**			66
	Large internationally active firms (*The concept of a "large internationally active firm" is different to that of a "global systemically important bank" developed by the BCBS, and is intended to be used purely for analytical purposes in this report.*)	Bank of America Barclays BBVA BNP Paribas Citi Credit Suisse Deutsche Bank Goldman Sachs HSBC Holdings ING	JP Morgan Chase Macquarie Morgan Stanley RBS Group Santander Scotiabank Societé Générale Standard Chartered Unicredit UBS	20
	• *Retail*			*2*
	• *Mix*			*13*
	• *Wholesale*			*5*
	Other firms			46
Geographic region[36]	**North America**	Canada USA		10
	Latin America	Argentina Brazil Mexico		4
	Western Europe	France Germany Italy Netherlands	Spain Switzerland UK	21
	Asia Advanced Economies	Australia Japan	Korea Singapore	15
	Asia Emerging Markets	China India Indonesia		10

36 Hong Kong is excluded because subsidiaries of other banks are included in the sample.

Peer Group		Firms / Jurisdictions		Number of firms
	Others	Russia Saudi Arabia	South Africa Turkey	8
Stage of implementation	**Early movers jurisdictions**	Australia Canada China France Germany Hong Kong Italy Korea	Japan Netherlands Saudi Arabia Singapore Spain Switzerland UK US	49
	Late movers jurisdictions	Brazil Mexico		3
	Jurisdictions with implementation gaps	Argentina India Indonesia	Russia South Africa Turkey	14
Implementation approach	**Regulatory approach**	Argentina Australia Brazil France Germany Italy Mexico	Netherlands Saudi Arabia Singapore Spain Switzerland UK	35
	Supervisory approach	Canada China Hong Kong Japan	Korea US	20
	No specific approach	India Indonesia Russia	South Africa Turkey[37]	13

[37] Turkey has introduced the Principles and Standards in its national framework in June 2011, adopting a supervisory approach. Since this review has examined data as at the end of 2010, Turkey is considered as still not having implemented the Principles and Standards, and therefore having no specific implementation approach.

Annex F: Firms' implementation assessment tables – Effective governance

Peer Group		Broadly implemented (%)	Good progress but still having some small gaps (%)	Still at a relatively early stage of implementation (%)
Firm type	**All firms**	62	21	17
	Large internationally active firms	100	–	–
	• *Retail*	*100*	–	–
	• *Mix*	*100*	–	–
	• *Wholesale*	*100*	–	–
	Other firms	46	30	24
Geographic region	**North America**	100	–	–
	Latin America	–	75	25
	Western Europe	86	14	0
	Asia AE	77	23	0
	Asia EM	10	20	70
	Other	26	37	37
Stage of implementation	**Early movers jurisdictions**	84	16	–
	Late movers jurisdictions	–	100	–
	Jurisdictions with implementation gaps	–	21	79
Implementation approach	**Regulatory approach**	74	23	3
	Supervisory approach	83	17	0
	No specific approach	0	13	77

Annex G: Firms' implementation assessment tables – Ex ante risk adjustment

	Peer Group	Broadly implemented (%)	Good progress but still having some small gaps (%)	Still at a relatively early stage of implementation (%)
Firm type	**All firms**	67	13	20
	Large internationally active firms	95	5	–
	• *Retail*	*5*	*5*	–
	• *Mix*	*65*	–	–
	• *Wholesale*	*25*	–	–
	Other firms	54	26	20
Geographic region	**North America**	100	–	–
	Latin America	25	25	50
	Western Europe	76	24	–
	Asia AE	92	8	–
	Asia EM	20	20	60
	Other	38	50	12
Stage of implementation	**Early movers jurisdictions**	84	14	2
	Late movers jurisdictions	33	33	33
	Jurisdictions with implementation gaps	21	29	50
Implementation approach	**Regulatory approach**	74	20	6
	Supervisory approach	88	6	6
	No specific approach	23	31	46

Annex H: Firms' implementation assessment tables – Alignment with performance

Peer Group		Broadly implemented (%)	Good progress but still having some small gaps (%)	Still at a relatively early stage of implementation (%)
Firm type	**All firms**	48	33	19
	Large internationally active firms	90	10	–
	• *Retail*	*50*	*50*	–
	• *Mix*	*93*	*7*	–
	• *Wholesale*	*100*	–	–
	Other firms	27	45	28
Geographic region	**North America**	80	20	–
	Latin America	–	50	50
	Western Europe	81	19	–
	Asia AE	40	53	7
	Asia EM	0	30	70
	Other	14	43	43
Stage of implementation	**Early movers jurisdictions**	63	31	6
	Late movers jurisdictions	–	67	33
	Jurisdictions with implementation gaps	8	23	69
Implementation approach	**Regulatory approach**	63	31	6
	Supervisory approach	50	35	15
	No specific approach	8	25	67

Annex I: Firms' implementation assessment tables – Disclosure

Peer Group		Broadly implemented (%)	Good progress but still having some small gaps (%)	Still at a relatively early stage of implementation (%)
Firm type	**All firms**	26	48	26
	Large internationally active firms	55	45	–
	• *Retail*	–	*100*	–
	• *Mix*	*75*	*25*	–
	• *Wholesale*	*40*	*60*	–
	Other firms	13	50	37
Geographic region	**North America**	50	50	–
	Latin America	–	–	100
	Western Europe	57	43	–
	Asia AE	–	85	15
	Asia EM	–	30	70
	Other	–	50	50
Stage of implementation	**Early movers jurisdictions**	35	61	4
	Late movers jurisdictions	–	–	100
	Jurisdictions with implementation gaps	–	15	85
Implementation approach	**Regulatory approach**	34	49	17
	Supervisory approach	28	72	–
	No specific approach	–	15	85

Annex J: Firms' implementation assessment tables – Golden parachutes

Peer Group		Broadly implemented (%)	Good progress but still having some small gaps (%)	Still at a relatively early stage of implementation (%)	No data provided (%)
Firm type	**All firms**	70	24	4	2
	Large internationally active firms	80	15	5	–
	• *Retail*	*33*	*33*	*33*	–
	• *Mix*	*77*	*15*	*8*	–
	• *Wholesale*	*100*	–	–	–
	Other firms	67	27	4	2
Geographic region	**North America**	80	20	–	-
	Latin America	75	–	–	25
	Western Europe	62	29	9	–
	Asia AE	93	7	–	–
	Asia EM	40	60	–	–
	Other	76	12	12	–
Stage of implementation	**Early movers jurisdictions**	76	20	4	–
	Late movers jurisdictions	100	–	–	–
	Jurisdictions with implementation gaps	43	43	7	7
Implementation approach	**Regulatory approach**	71	20	6	3
	Supervisory approach	83	17	–	–
	No specific approach	46	46	8	–

Annex K: Firms' implementation assessment tables – No hedging

Peer Group		Broadly implemented (%)	Good progress but still having some small gaps (%)	Still at a relatively early stage of implementation (%)	No data provided (%)
Firm type	**All firms**	67	14	17	2
	Large internationally active firms	90	10	–	–
	• *Retail*	*33*	*67*	–	–
	• *Mix*	*100*	*0*	–	–
	• *Wholesale*	*100*	-	–	–
	Other firms	57	15	26	2
Geographic region	**North America**	100	–	–	–
	Latin America	50	25	0	25
	Western Europe	76	19	5	–
	Asia AE	80	20	–	–
	Asia EM	10	–	90	–
	Other	50	12	38	–
Stage of implementation	**Early movers jurisdictions**	80	14	6	–
	Late movers jurisdictions	33	33	–	33
	Jurisdictions with implementation gaps	21	8	71	–
Implementation approach	**Regulatory approach**	80	14	3	3
	Supervisory approach	72	17	11	–
	No specific approach	15	8	77	–

Annex L: Data qualifications for tables on pay structure and ex post performance

Note: firms did not always interpret instructions for completing the table in a uniform way, so some provided answers that pose problems of comparability. In particular:

- Firms reported average figures, but variations within the averages were not requested.
- Firms differed in the definition of "senior executive" and "material risk taker" that they used, which affects the number and nature of employees reflected in each row. For example, some firms included control and risk management personnel, and some did not. Thus, the averages provide only a rough characterisation of practice for different types of employee, especially for those below the executive committee level.
- Many firms did not split members of their Executive Board into the most-senior and others (Blank rows are treated as having no impact on the average.)
- Many firms had multiple incentive compensation plans with different plans having different deferral periods. Where firms provided a range of deferral periods, the midpoint of the range was used in coding the information for inclusion in averages. However, at the large internationally active firms, the ranges were such that all such firms defer for three years or more. A handful of such firms reported a range for the fraction deferred, but in almost all such cases the bottom of the range was 40 (60) percent or larger.
- Many firms reported the last two columns as a percentage of deferred compensation rather than as a percentage of variable compensation as instructed. Averages may in some cases overstate the true percentages. In cases where either the text of the firm's response or the reported value (such as 100 percent) identified such reporting, the values were adjusted to be a fraction of variable pay.
- Some firms use deferred performance units tied to accounting results rather than the bank's stock price, which are recognised in Standard 8 as sometimes an appropriate substitute for share-linked instruments. However, such firms did not always include such instruments in their percentages of share-linked instruments, so the averages may understate the use of performance-sensitive instruments.
- Some firms included clawbacks or maluses for malfeasance, misreporting, or similar forms of misbehaviour in the percentages for the last column, so averages in that column probably overstate the use of performance-based ex post risk adjustments somewhat.

Annex M: Pay structure and ex post adjustment – Type of firms

Table M.1: All firms – Averages

	Number of employees	Variable Compensation				
		% of total compensation	% that is deferred	Deferral period (number of years)	% awarded in shares or share-linked instruments	% subject to ex post risk adjustment
A. Most senior members of the executive board	14	67	58	3	49	44
B. Other members of the executive board	12	62	54	3	50	42
C. Other senior executives	55	64	51	3	43	41
D. Other employees whose individual actions have a material impact on the risk exposure of the firm	480	61	43	3	37	36
E. The most highly paid employees not covered above	40	76	47	3	42	36

Table M.2: Large internationally active firms – Averages

	Number of employees	Variable Compensation				
		% of total compensation	% that is deferred	Deferral period (number of years)	% awarded in shares or share-linked instruments	% subject to ex post risk adjustment
A. Most senior members of the executive board	10	81	74	4	68	64
B. Other members of the executive board	7	78	67	4	61	62
C. Other senior executives	50	80	63	3	58	55
D. Other employees whose individual actions have a material impact on the risk exposure of the firm	704	76	59	3	52	48
E. The most highly paid employees not covered above	37	89	57	3	54	51

Table M.3: Other firms (i.e. not large internationally active firms) – Averages

	Number of employees	Variable Compensation				
		% of total compensation	% that is deferred	Deferral period (number of years)	% awarded in shares or share-linked instruments	% subject to ex post risk adjustment
A. Most senior members of the executive board	16	61	50	3	40	33
B. Other members of the executive board	14	54	48	3	44	33
C. Other senior executives	59	54	44	3	32	31
D. Other employees whose individual actions have a material impact on the risk exposure of the firm	333	50	32	3	27	28
E. The most highly paid employees not covered above	42	63	37	3	31	23

Table M.4: Large internationally active firms headquartered in Europe – Averages

	Number of employees	Variable Compensation				
		% of total compensation	% that is deferred	Deferral period (number of years)	% awarded in shares or share-linked instruments	% subject to ex post risk adjustment
A. Most senior members of the executive board	7	77	74	4	63	63
B. Other members of the executive board	7	75	68	4	59	63
C. Other senior executives	45	77	64	3	55	56
D. Other employees whose individual actions have a material impact on the risk exposure of the firm	203	75	62	3	51	49
E. The most highly paid employees not covered above	56	84	58	3	47	55

Table M.5: Large internationally active firms headquartered outside Europe – Averages

	Number of employees	Variable Compensation				
		% of total compensation	% that is deferred	Deferral period (number of years)	% awarded in shares or share-linked instruments	% subject to ex post risk adjustment
A. Most senior members of the executive board	14	87	75	4	77	65
B. Other members of the executive board	8	86	66	5	66	58
C. Other senior executives	59	86	60	4	64	54
D. Other employees whose individual actions have a material impact on the risk exposure of the firm	1562	78	54	3	55	45
E. The most highly paid employees not covered above	11	96	56	4	63	47

Annex N: Pay structure and ex post adjustment – Geographic location

Table N.1: Europe – Averages

	Number of employees	Variable Compensation				
		% of total compensation	% that is deferred	Deferral period (number of years)	% awarded in shares or share-linked instruments	% subject to ex post risk adjustment
A. Most senior members of the executive board	20	71	70	3	61	59
B. Other members of the executive board	7	71	70	3	65	62
C. Other senior executives	38	71	63	3	54	55
D. Other employees whose individual actions have a material impact on the risk exposure of the firm	261	66	59	3	51	49
E. The most highly paid employees not covered above	46	85	60	3	50	57

Table N.2: North America – Averages

	Number of employees	Variable Compensation				
		% of total compensation	% that is deferred	Deferral period (number of years)	% awarded in shares or share-linked instruments	% subject to ex post risk adjustment
A. Most senior members of the executive board	14	81	73	4	66	59
B. Other members of the executive board	5	83	66	4	66	50
C. Other senior executives	51	86	60	3	58	53
D. Other employees whose individual actions have a material impact on the risk exposure of the firm	1138	81	51	3	47	43
E. The most highly paid employees not covered above	11	96	56	3	56	53
F. All other employees	20734	52	32	3	27	30

Table N.3: Asia – Emerging Markets – Averages

	Number of employees	Variable Compensation				
		% of total compensation	% that is deferred	Deferral period (number of years)	% awarded in shares or share-linked instruments	% subject to ex post risk adjustment
A. Most senior members of the executive board	6	56	45	3	19	7
B. Other members of the executive board	3	38	62	3	37	0
C. Other senior executives	42	48	42	3	15	7
D. Other employees whose individual actions have a material impact on the risk exposure of the firm	48	46	32	3	12	10
E. The most highly paid employees not covered above	10	55	60	4	60	0

Table N.4: Asia – Advanced Economies – Averages

	Number of employees	Variable Compensation				
		% of total compensation	% that is deferred	Deferral period (number of years)	% awarded in shares or share-linked instruments	% subject to ex post risk adjustment
A. Most senior members of the executive board	11	64	56	3	54	50
B. Other members of the executive board	18	59	46	3	45	40
C. Other senior executives	96	51	41	3	31	42
D. Other employees whose individual actions have a material impact on the risk exposure of the firm	280	50	27	3	27	30
E. The most highly paid employees not covered above	12	63	29	2	20	10

Table N.5: Other Regions – Averages

	Number of employees	Variable Compensation				
		% of total compensation	% that is deferred	Deferral period (number of years)	% awarded in shares or share-linked instruments	% subject to ex post risk adjustment
A. Most senior members of the executive board	13	62	34	2	25	18
B. Other members of the executive board	11	58	0	0	0	0
C. Other senior executives	57	56	33	2	32	18
D. Other employees whose individual actions have a material impact on the risk exposure of the firm	533	43	20	2	14	22
E. The most highly paid employees not covered above	104	54	30	2	30	20

Table N.6: Australia – Averages

	Number of employees	Variable Compensation				
		% of total compensation	% that is deferred	Deferral period (number of years)	% awarded in shares or share-linked instruments	% subject to ex post risk adjustment
A. Most senior members of the executive board	2	73	68	4	63	66
B. Other members of the executive board	10	70	65	4	60	60
C. Other senior executives	167	60	47	4	47	52
D. Other employees whose individual actions have a material impact on the risk exposure of the firm	360	53	34	3	34	38
E. The most highly paid employees not covered above	14	76	42	3	30	11

Table N.7: Canada – Averages

	Number of employees	Variable Compensation				
		% of total compensation	% that is deferred	Deferral period (number of years)	% awarded in shares or share-linked instruments	% subject to ex post risk adjustment
A. Most senior members of the executive board	9	76	70	4	61	51
B. Other members of the executive board	5	83	66	4	66	50
C. Other senior executives	24	86	56	4	56	51
D. Other employees whose individual actions have a material impact on the risk exposure of the firm	194	82	46	4	46	48
E. The most highly paid employees not covered above	2	96	34	4	34	70
F. All other employees	1586	60	29	4	29	39

Table N.8: China – Averages

	Number of employees	Variable Compensation				
		% of total compensation	% that is deferred	Deferral period (number of years)	% awarded in shares or share-linked instruments	% subject to ex post risk adjustment
A. Most senior members of the executive board	3	47	50	3	0	17
B. Other members of the executive board	3	0	50	3	0	0
C. Other senior executives	9	46	50	3	0	17
D. Other employees whose individual actions have a material impact on the risk exposure of the firm	95	60	40	3	0	40
E. The most highly paid employees not covered above						

Table N.9: France – Averages

	Number of employees	Variable Compensation				
		% of total compensation	% that is deferred	Deferral period (number of years)	% awarded in shares or share-linked instruments	% subject to ex post risk adjustment
A. Most senior members of the executive board	61	57	64	3	58	54
B. Other members of the executive board	10	64	69	3	65	47
C. Other senior executives	53	70	68	3	53	54
D. Other employees whose individual actions have a material impact on the risk exposure of the firm	555	66	66	3	51	54
E. The most highly paid employees not covered above	70	88	61	3	37	51

Table N.10: Italy – Averages

	Number of employees	Variable Compensation				
		% of total compensation	% that is deferred	Deferral period (number of years)	% awarded in shares or share-linked instruments	% subject to ex post risk adjustment
A. Most senior members of the executive board	1	64	47	4	30	57
B. Other members of the executive board	3	80	60	5	60	80
C. Other senior executives	14	61	51	4	40	58
D. Other employees whose individual actions have a material impact on the risk exposure of the firm	92	50	39	4	39	45
E. The most highly paid employees not covered above	63	64	50	4	50	75

Table N.11: Japan – Averages

	Number of employees	Variable Compensation				
		% of total compensation	% that is deferred	Deferral period (number of years)	% awarded in shares or share-linked instruments	% subject to ex post risk adjustment
A. Most senior members of the executive board	23	32	45	1	44	43
B. Other members of the executive board	16	36	4	1	2	1
C. Other senior executives	74	46	48	2	17	47
D. Other employees whose individual actions have a material impact on the risk exposure of the firm	2	40	5	2	0	5
E. The most highly paid employees not covered above	14	37	4	1	0	4

Table N.12: Singapore – Averages

	Number of employees	Variable Compensation				
		% of total compensation	% that is deferred	Deferral period (number of years)	% awarded in shares or share-linked instruments	% subject to ex post risk adjustment
A. Most senior members of the executive board	11	78	51	3	43	43
B. Other members of the executive board	5	45	36	3	36	36
C. Other senior executives	36	60	37	3	34	34
D. Other employees whose individual actions have a material impact on the risk exposure of the firm	220	47	21	4	21	21
E. The most highly paid employees not covered above	4	69	27	3	18	18

Table N.13: United Kingdom – Averages

	Number of employees	Variable Compensation				
		% of total compensation	% that is deferred	Deferral period (number of years)	% awarded in shares or share-linked instruments	% subject to ex post risk adjustment
A. Most senior members of the executive board	6	80	84	3	81	81
B. Other members of the executive board	8	78	67	3	60	67
C. Other senior executives	37	80	69	3	60	61
D. Other employees whose individual actions have a material impact on the risk exposure of the firm	240	82	61	3	51	59
E. The most highly paid employees not covered above	12	93	55	3	42	55

Table N.14: USA – Averages

	Number of employees	Variable Compensation				
		% of total compensation	% that is deferred	Deferral period (number of years)	% awarded in shares or share-linked instruments	% subject to ex post risk adjustment
A. Most senior members of the executive board	18	86	76	3	79	67
B. Other members of the executive board						
C. Other senior executives	72	86	63	3	69	54
D. Other employees whose individual actions have a material impact on the risk exposure of the firm	2083	80	56	3	57	37
E. The most highly paid employees not covered above	16	96	67	3	78	45

Annex O: Pay structure and ex post adjustment – Implementation stage

Table O.1: Firms in nations still in progress of implementation – Averages

	Number of employees	Variable Compensation				
		% of total compensation	% that is deferred	Deferral period (number of years)	% awarded in shares or share-linked instruments	% subject to ex post risk adjustment
A. Most senior members of the executive board	10	61	33	2	29	10
B. Other members of the executive board	7	67	37	2	37	0
C. Other senior executives	51	50	33	2	28	10
D. Other employees whose individual actions have a material impact on the risk exposure of the firm	520	43	24	2	19	8
E. The most highly paid employees not covered above	106	46	34	2	34	17

Table O.2: Firms in "early movers" jurisdictions – Averages

	Number of employees	Variable Compensation				
		% of total compensation	% that is deferred	Deferral period (number of years)	% awarded in shares or share-linked instruments	% subject to ex post risk adjustment
A. Most senior members of the executive board	14	69	64	3	54	52
B. Other members of the executive board	12	62	56	3	51	47
C. Other senior executives	54	67	56	3	46	48
D. Other employees whose individual actions have a material impact on the risk exposure of the firm	494	64	48	3	42	42
E. The most highly paid employees not covered above	27	81	50	3	44	42

Annex P: Pay structure and ex post adjustment – Implementation approach

Table P.1: Supervisory Approach (All firms) – Averages

	Number of employees	Variable Compensation				
		% of total compensation	% that is deferred	Deferral period (number of years)	% awarded in shares or share-linked instruments	% subject to ex post risk adjustment
A. Most senior members of the executive board	13	67	62	3	54	48
B. Other members of the executive board	20	52	41	3	36	26
C. Other senior executives	43	67	52	4	39	42
D. Other employees whose individual actions have a material impact on the risk exposure of the firm	907	75	47	4	44	40
E. The most highly paid employees not covered above	11	83	43	3	46	36

Table P.2: Regulatory Approach (All firms) – Averages

	Number of employees	Variable Compensation				
		% of total compensation	% that is deferred	Deferral period (number of years)	% awarded in shares or share-linked instruments	% subject to ex post risk adjustment
A. Most senior members of the executive board	15	70	64	3	53	51
B. Other members of the executive board	8	67	65	3	61	59
C. Other senior executives	66	68	58	3	51	51
D. Other employees whose individual actions have a material impact on the risk exposure of the firm	263	58	46	3	38	43
E. The most highly paid employees not covered above	35	81	53	3	43	43

Annex Q: Pay structure and ex post adjustment – Firm business model

Table Q.1: Large internationally active firms employing a wholesale business model – Averages

	Number of employees	Variable Compensation				
		% of total compensation	% that is deferred	Deferral period (number of years)	% awarded in shares or share-linked instruments	% subject to ex post risk adjustment
A. Most senior members of the executive board	14	87	77	4	62	49
B. Other members of the executive board	10	88	66	6	66	66
C. Other senior executives	69	86	65	4	53	47
D. Other employees whose individual actions have a material impact on the risk exposure of the firm	1506	80	65	3	44	42
E. The most highly paid employees not covered above	4	95	63	4	52	39

Table Q.2: Large internationally active firms employing a mixed business model – Averages

	Number of employees	Variable Compensation				
		% of total compensation	% that is deferred	Deferral period (number of years)	% awarded in shares or share-linked instruments	% subject to ex post risk adjustment
A. Most senior members of the executive board	8	80	78	4	74	72
B. Other members of the executive board	6	78	69	4	62	61
C. Other senior executives	51	81	67	3	62	60
D. Other employees whose individual actions have a material impact on the risk exposure of the firm	497	78	62	3	57	53
E. The most highly paid employees not covered above	44	89	59	3	56	58

Table Q.3: Large internationally active firms employing a retail business model – Averages

	Number of employees	Variable Compensation				
		% of total compensation	% that is deferred	Deferral period (number of years)	% awarded in shares or share-linked instruments	% subject to ex post risk adjustment
A. Most senior members of the executive board	9	70	50	3	50	50
B. Other members of the executive board	6	68	60	3	50	60
C. Other senior executives	19	71	46	3	50	47
D. Other employees whose individual actions have a material impact on the risk exposure of the firm	127	61	40	3	47	40
E. The most highly paid employees not covered above	55	81	40	3	50	40

Annex R: Assessment criteria

1. Effective governance of compensation

Background	Corporate governance systems are markedly different across the world so that reviewers need to rely on *functional equivalence* in making a judgment about implementation. Thus, reference to the "board of directors" should be viewed as referring to the supervisory aspect of a board over management and not just to an executive body. In dual board systems it would refer to the "Board of Supervisors"; in a one-tier system it should refer to non-executive directors in the board of directors. There are also many equivalents to a remuneration committee: the key to assessing effective implementation is that there is a supervisory body that can establish and take responsibility in the first instance for the remuneration policy. Control organs also differ widely, so that reference to risk committees and audit committees must be seen as a broad term describing a function. This is consistent with the Basel Committee on Banking Supervision (BCBS) *Principles for Enhancing Corporate Governance* for firms.[38] Effective governance is a necessary precondition for compensation systems to be sound. This requires effective oversight by the boards of the design and operation of compensation practices for the whole firm and compensations systems that interact materially with other aspects of risk governance. The firm's risk management function must have appropriate authority and be effectively engaged in the design of compensation frameworks. Weaknesses in risk identification and risk measurement will materially affect the risk adjustments that influence compensation. It is also important that firms adopt risk and performance alignment practices that are commensurate with their business activities. Compensation systems should be subject to robust controls and periodic reviews to ensure integrity.
Criteria	***Implemented*:** • The supervisory body of the board of directors must actively oversee the remuneration policy, effectively taking overall responsibility for the design and operation of the remuneration system. Relevant board members and employees must have independence and expertise in risk management and compensation.[39] To this end, significant financial institutions

[38] http://www.bis.org/publ/bcbs176.pdf.

[39] There may be some variations in the way independence of the remuneration committee is ensured as well as some discussion on how to define competent members. For example, competence with respect to risk and risk management

	should have a remuneration committee or an equivalent structure that with adequate terms of reference can effectively exercise the oversight. The remuneration committee should: o 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; o review and approve the bonus pools including the outcome of risk adjustments in its determination of the annual bonus awards. It should receive reports from the risk function and work closely with the firm's risk committee in the evaluation of the incentives created by the compensation system, including whether the institution has met or exceeded its risk appetite in earning its profit and loss for the year; • The remuneration committee conducts an annual compensation review that identify material deviations of compensation outcomes from the intent of the compensation system, to ensure that the firm's compensation policy operates as intended, and that the system is in compliance with the FSB *Principles* and *Standards* and any other relevant international standards, and the respective rules by national supervisory authorities. • Compliance and risk control functions are independent, have appropriate authority and good interaction with the remuneration committee. For employees in the risk and compliance function: o Remuneration is determined independently of other business areas and is adequate to attract qualified and experienced staff and commensurate with their key role in the firm. Their remuneration is linked to the objective of their function so as to avoid conflict of interest o The risk and control functions are involved in the design and implementation of ex ante risk adjustments and have the ability to override decisions or pressure from

might be achieved if (i) a majority of non executive members are independent members of the board in the sense that they have no other vested interest and (ii) the committee has appropriate skills and access to advice to perform its function or does some activities jointly with the board's risk committee. Substantial expertise on the part of the most involved board members or of the remuneration committee members would require enough risk measurement expertise and a sense of history of the risk realisations.

	the revenue producing functions; ***Mostly implemented***: The firm has implemented most of the practices above and is in the process of addressing the remainder. ***Partly implemented*:** The firm fails to implement several of the practices above, and is not in the process of implementing them. ***Not implemented***: The firm does not have a remuneration committee, an equivalent body or a process for ensuring that the firm's compensation policy is in compliance with the FSB *Principles* and *Standards* as well as complementary guidance by national supervisors.

2. Pay structure and effective alignment of compensation with prudent risk taking ***Ex ante risk adjustment***	
Background	Principle 4 and Standard 4 state that 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. Therefore, awards of variable pay should depend not only on net revenue or accounting profit generated during the performance period, but also on the degree of risk taken in the course of business during the period. For a given degree of short-term profit and a given level of other elements of performance (such as teamwork at the individual employee level), increased risk should be associated with decreased awards of variable pay per unit of revenue. Ex ante risk adjustments are adjustments to the amount of variable pay per unit of revenue or short-term profit that attempt to offset increases in short-term performance that arise mainly due to greater risk-taking rather than greater long-run profitability. Such adjustments are not focused on achieving alignment of annual remuneration awards and annual performance. Ex ante risk adjustments are based on forward-looking assessments of risk on the books at the end of the performance year and tail risks embedded in businesses with exposures that appear to be short-term. They are focused largely on affecting employee risk-taking incentives. Since profit, other aspects of performance, and risk vary over time and across employees, no single correct approach to risk adjustment exists.[40] Firms satisfy Principle 4 and Standard 4 by incorporating risk into their decision-making about awards of variable pay. The baseline assessment is

[40] The BCBS consultative document *Range of Methodologies for Risk and Performance Alignment of Remuneration Banks* found at http://www.bis.org/publ/bcbs178.pdf analyses and discusses the methodologies used by institutions to adjust remuneration to risk and performance. The main objectives of this report are (i) to present the remuneration practices and methodologies that support sound incentives and (ii) the challenges or elements influencing the effectiveness of risk alignment that should be considered by banks, when developing their methodologies, and supervisors, when reviewing and assessing banks' practices.

2. Pay structure and effective alignment of compensation with prudent risk taking ***Ex ante risk adjustment***	
	to consider whether a bank's practices include effective risk adjustments and whether the adjustments have certain characteristics mentioned in the *Principles* or *Standards*. Principle 4 and Standard 4 say that risk adjustments should account for all types and severities of risk and that both quantitative measures of risk and human judgments about risk should play a role in making the adjustments. The difficulty of incorporating types of risk, for which measurement is at early stages, should not lead to ignoring such risks. Standard 4 specifically mentions liquidity risk, as well as "the cost and quantity of capital required to support the risks taken" but does not discuss the nature of the capital (actual capital, required minimum regulatory capital, or economic capital). Economic capital would be the preferred option, even though not dictated by the *Standards*. Standard 4 also states that revenues booked in advance of their actual receipt should be accompanied by risk adjustments that take into account the risk that the revenue will not be received. Such adjustment should ensure that uncertain revenue (in particular mark-to-model gains) is not rewarded at a higher rate per unit of long-term profit than the rate for revenues actually received. It is important to note that though accounting standards may require a bank to do so for purposes of financial statements, low-quality revenues do not need to be fully recognised for purposes of bonus decision-making. Principle 4 and Standard 4 are not specific about the nature of risk adjustments to be applied at different levels within the bank. They imply that risk adjustments should have an effect on variable pay at the individual-employee level, on the size of the firm-wide bonus pool, and on allocations of the firm-wide pool to units. In principle, such adjustments may be made to the firm-wide bonus pool based on firm-wide assessments of risk, but means of calibrating such adjustments to an absolute level of impact on pay are not well understood, and unless the allocation of the firm-wide pool includes consideration of the differences in contributions to firm-wide risk of different business units or employees, the firm-wide adjustment is likely to have little impact on incentives. Thus, ex ante risk adjustments should also be made in allocating the firm-wide pool to pools for units or employees. Alternatively, a bank may use a bottom-up approach in which adjusted pools are created for units, and the firm-wide pool is a by-product.

<table>
<tr><td colspan="2">2. Pay structure and effective alignment of compensation with prudent risk taking

Ex ante risk adjustment</td></tr>
<tr><td>Criteria</td><td>Implemented: A firm has fully implemented Principle 4 and Standard 4 if it has all of the practices listed below and the home country supervisor believes that the bank’s policies and procedures for carrying out risk adjustments are sound, that the risk adjustments are well-calibrated, and that the bank needs to do no further work in its risk adjustments at this time. Few firms are likely to be in such a position as of early 2011.
• Uses an appropriate mix of both quantitative and qualitative methods in making ex ante risk adjustments.
• Adjusts for all types of risks, including difficult-to-measure risks such as liquidity risk and reputation risk. Takes into account the amount and cost of capital required to support risks taken.
• Takes into account the timing and likelihood of receipt of revenues when deciding pool amounts and when making incentive pay awards, if the firm books as current revenues some revenues not actually received.
Mostly implemented: The bank implements most of the practices above and is in process of addressing the remainder.
Partly implemented: The bank does consider the degree of risks taken, but fails to implement several of the practices above and is not in process of correcting them.
Not implemented: The bank does not consider the degree of risks taken during the performance year in determining bonus pools or awards to individual employees.</td></tr>
</table>

3. Pay structure and effective alignment of compensation with prudent risk taking *Alignment of compensation with performance*	
Background	Principle 5 and Standard 5 state that poor financial performance of the bank as a whole, or at a particular business line or unit, should be accompanied by reduced compensation. This may be effected by a reduction in bonuses or by activation of maluses or clawbacks, or some combination of the two. The Principle and Standard do not specify how bad the performance must be for the symmetry principle to apply. Normal, modest variations in operating performance should not be expected to trigger maluses or proportional variations in bonuses.
Criteria	Whether effective implementation can be demonstrated by actions taken by the firm during 2010 depends on whether any business units, or the firm as a whole, experienced poor financial performance. ***Implemented:*** The firm has a policy of substantially reducing pay and the evidence that variable remuneration was decreased substantially as a result of some units, or the firm as a whole, experiencing poor financial performance leads supervisors to believe that the bank’s policy (as a combination of maluses, clawbacks, and variable pay award) and procedures are sound. ***Mostly implemented*:** No units experienced poor financial performance, but the firm has a policy of substantially reducing pay in such an event and the combination of maluses, clawbacks, and variable pay award policies make the policy credible in the judgment of their supervisors. ***Partly implemented*:** Although the firm has a policy for triggering clawbacks, maluses or reductions in variable pay the policy has not been activated recently and it is not considered credible by supervisors. ***Not implemented:*** Business units (or the bank as a whole) experienced poor financial performance during 2010, but total variable pay received by employees at the relevant units (or all employees if losses for the bank as a whole) did not shrink significantly and the firm cannot detail the consistency between the compensation mix and performance outcome.

3. Pay structure and effective alignment of compensation with prudent risk taking

Compensation structures and ex post performance adjustment

Background	Most of the FSB's *Principles* and *Standards* cover institution-wide compensation policies and practices. Principle 7 states that the mix of cash, equity and other forms of compensation must be consistent with risk alignment. The goal should be a mix that generates a close match between executives' incentives and the long term performance of the firm. However, Standards 6-9 and some of the disclosure requirements of Standard 15 are addressed to a limited group of employees within the institution. Standards 6-9 are concerned with remuneration structures – deferment, vesting periods, the allocation of the compensation into shares, and malus/clawback arrangements. Standard 6 defines the employees to be covered by these Standards as: '*senior executives as well as other employees whose actions have a material impact on the risk exposure of the firm*'. The latter group are described as '*material risk takers*' within this document. Standard 6 says 'For this group, a substantial portion of variable compensation, such as 40 to 60 percent, should be payable under deferral arrangements over a period of years.' The third bullet of Standard 6 has also a subcategory of employees: '*for the most senior management and the most highly paid employees*, the percentage…that is deferred…should be substantially higher, for example above 60%'. This section of the criteria addresses the question how to define these groups of employees. Depending on circumstances, including internal governance characteristics, the relevant population may differ; however, effective implementation requires that the population of material risk takers be large enough and covers all employees whose function in general are such that they may individually expose firms to material risk, unless otherwise demonstrated. Firms should identify their material risk takers. This task should fall within the responsibilities of senior management and the risk control function. Not enough is known at this stage on the range of firms' practices in identifying the material risk takers. While it is not possible therefore to detail a specific criteria for definition of material risk takers at this stage, as a guideline to this identification process, it can be broadly expected that, in all significant financial institutions, the following categories of employees with any authority over, or influence on, risk-taking decisions should be identified: A. The most senior members on the executive board. This category is relevant if the executive board is very large, otherwise, it should be

3. Pay structure and effective alignment of compensation with prudent risk taking *Compensation structures and ex post performance adjustment*	
	merged with category B. B. Other members of the executive board C. Other senior executives: At a minimum, heads of major business lines, heads of major geographic business regions, and heads of risk and control functions, should be included to the extent they are not already included in Groups A or B. If the firm has a firm-wide executive or operating committee that is one level below the Executive Board, its members should be included. D. Other employees whose individual actions have a material impact on the risk exposure of the firm: Individuals whose actions have a material impact on the risk exposure of the firm. This group should include employees not already in Groups A, B or C whose decisions can expose the firm to risks that are material to the firm as a whole. As illustrative examples, firms often include in this category those staff with an ability to commit a significant amount of the bank's risk capital, an ability to significantly influence the bank's overall liquidity position, an ability to significantly influence other material risks, and managers of significant business units. Among risk and control personnel, ordinarily at least those reporting directly to the heads of the risk and finance functions would be included, and perhaps more such personnel, unless the amount of incentive pay received by risk and control personnel is completely unaffected by firm-wide or business unit revenues or profits. E. The most highly paid employees not included in Groups A, B, C or D, with total remuneration awarded or paid for the last performance year that is greater than the mean for staff in Groups A and C. F. All other employees receiving any deferred variable pay and for whom the variable pay award is linked to personal or business unit performance (omit employees who participate only in profit-sharing plans, for example). If this is not a group of people significantly larger than the sum of A, C, D, and E, that can be because variable pay is not common in your organisation or because variable pay is common but often none is deferred. The purpose of the FSB *Standards* related to ex post performance adjustment is to ensure that variable remuneration systems link payouts over time to performance over time for senior executives and other employees whose actions have a material impact on the firm's risk profile. Standards 6-9 require significant financial institutions to make use of some method of delaying payment of variable remuneration and making the value ultimately paid sensitive to performance during the delay period. The methods specified include the deferral of payouts, the use of pay

3. Pay structure and effective alignment of compensation with prudent risk taking ***Compensation structures and ex post performance adjustment***	
	vehicles that expose employees to bad outcomes, (such as shares or share-linked instruments), and performance-dependent maluses or clawbacks. Information has been collected from the firms about each of the features of pay structure that are discussed in Standards 6-9, comparing them with features related to the level of authority of employees and to their total remuneration. The features include: fraction of total pay that is variable; fraction of variable pay that is deferred; deferral period and whether vesting occurs no faster than pro rata; and fraction of variable pay that is in performance-linked instruments.

4. Disclosure	
Background	Governance of compensation is more likely to be effective if the firm's stakeholders, particularly shareholders, are engaged with compensation. In order for them to be effectively engaged, they must be well-informed. They can only be well-informed if the firm makes timely, accurate and comprehensive disclosure about its compensation practices. Principle 9 and Standard 15 set out the information to be publicly disclosed. The first two main bullets of Standard 15 ask for information on the governance of the compensation system and its most important characteristics, whilst the third main bullet, broken down into six sub-bullets, ask for quantitative information. The quantitative information is to cover the compensation of the relevant employees, broken down as between senior executives and other employees whose actions have a material impact on the risk profile of the firm. When the firm does not disclose some information described in Principle 9 and Standard 15, the firm should explain clearly why such information should not be disclosed (i.e. legal impediments for the purpose of protection of personal information). The BCBS Consultative Documents on *Pillar 3 Disclosure Requirements for Remuneration* and *Range of Methodologies for Risk and Performance Alignment of Remuneration* provide some examples of the information to be disclosed that might be useful in interpreting the range of practice, but the BCBS documents are not likely to be finalised in time for its use as guidance in this peer review.
Criteria	***Implemented*:** There are two main criteria for full implementation: The information should be clear, readily available to members of the public, and published in a timely manner (not more than 6

4. Disclosure	
	months after the date to which the information refers). The firm will have made a clear commitment to publish information relating to 2010 not more than 6 months after the relevant date. The information should comply with all the requirements in Principle 9 and Standard 15 and has none of the deficiencies listed under "Partly implemented" (few, if any, firms are in such a position as of early 2011). ***Mostly implemented:*** The firm will disclose clear, readily available information, but is likely to take longer than six months to do so, or all the requirements in Principle 9 and Standard 15 are not met. However, the firm has plans to remedy the deficiencies. ***Partly implemented***: The firm will disclose some or most of the requirements in Principle 9 and Standard 15 but in the opinion of supervisors it is likely to do the bare minimum, and some disclosures will be less than fully satisfactory to those looking for a clear picture of the firm's compensation practices and policies. ***Not implemented*****:** The firm fails to disclose, or does not intend to disclose all or most of the requirements in Principle 9 and Standard 15.

5. Other features of compensation systems *Compensation and capital*	
Background	Standard 3 states that 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.
Criteria	***Implemented:*** A firm has a policy for reducing total variable compensation in order to preserve its capital base and supervisors believe the policy is sound. If such policies do not exist, a firm has taken action to limit its total variable compensation in order not to limit its ability to strengthen its capital base. ***Partly implemented:*** No evidence that a limitation on total variable compensation payouts in 2009 or 2010 was necessary in order not to limit its ability to strengthen its capital base, but supervisors believe that the firm would take such action if necessary. ***Not implemented:*** Evidence in 2009 or 2010 that a firm has weakened its capital base as a result of its total compensation payout, to a level which causes supervisory concern.

5. Other features of compensation systems ***Guaranteed bonuses***	
Background	Standard 11 prohibits the use of guaranteed bonuses of more than one year; other guaranteed bonuses are allowed under exceptional circumstances and only in the context of hiring,
Criteria	***Implemented*:** No guaranteed bonuses of more than one year, and only extended to new hires. The number of guarantees given should be small relative to the total number of new hires. ***Partly implemented*:** A small number of guarantees given outside the FSB Standard, but firms have supplied adequate reasons to supervisors for doing so. ***Not implemented*:** A large number of guarantees given.

5. Other features of compensation systems *Golden parachutes*	
Background	Standard 12 asks for a re-examination of contractual payments related to termination of employment and prohibits those that are not related to performance measures achieved overtime.
Criteria	***Implemented*:** Especially for material risk takers, the firm's policies and procedures do not support large severance payments that are made even in event of bad performance, taking into account restrictions imposed by local labour and other laws.

5. Other features of compensation systems *No hedging by employees*	
Background	Standard 14 asks that firm 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.
Criteria	***Implemented*:** Such arrangements exist for employees receiving deferred remuneration. ***Mostly implemented:*** Such arrangements exist only for senior executives and employees whose individual decisions can have a material impact on the risk exposure of the firm. ***Partly implemented*:** Such arrangements exist only for a subset of employees whose individual decisions can have a material impact on the risk exposure of the firm. ***Not implemented*:** No such arrangements.