

**Implementing the FSB Principles for Sound Compensation  
Practices and their Implementation Standards**

Progress Report

13 June 2012



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# **Implementing the FSB Principles for Sound Compensation Practices and their Implementation Standards - Progress Report**

## **Executive Summary**

The 2011 FSB peer review on compensation indicated that good progress had been made in implementing the FSB [Principles](#) and [Standards](#) on Sound Compensation Practices (“Principles and Standards”, P&S), but that more work was necessary to overcome constraints to full implementation by individual national authorities and to address concerns by firms of an uneven playing field. The review set out several recommendations to address these issues and to support the effective implementation of the P&S by both national authorities and firms. The need for additional work was also echoed by the Cannes Summit Declaration, in which G20 Leaders called on the FSB to “undertake an ongoing monitoring and public reporting on compensation practices focused on remaining gaps and impediments to full implementation of these standards and carry out an ongoing bilateral complaint handling process to address level playing field concerns of individual firms.”

The FSB launched the [Bilateral Complaint Handling Process](#) (BCHP) in early 2012. The BCHP establishes a mechanism for national supervisors from FSB member jurisdictions to bilaterally report, verify and, if necessary, address specific compensation-related complaints by financial institutions based on level playing field concerns. All FSB members have informed the relevant financial institutions operating in their jurisdiction of the main features of the BCHP.

To undertake the ongoing monitoring, the FSB has also established a Compensation Monitoring Contact Group (CMCG) comprising national experts from member jurisdictions with regulatory or supervisory responsibility on compensation practices. The CMCG is responsible for monitoring and reporting to the FSB on national implementation of the P&S. The ongoing monitoring exercise, which is not as in-depth as a peer review, is based on the input provided in a survey by CMCG members.

This first progress report describes the developments in implementing the P&S over the relatively short time period since the October 2011 thematic peer review. The main findings of the report are as follows:

First, almost all FSB member jurisdictions have now completed the implementation of the P&S in their national regulation or supervisory guidance. Those jurisdictions that, at the time of the 2011 peer review, still showed significant gaps (Argentina, India, Indonesia, Russia, and South Africa) have progressed in their implementation efforts. However, in the case of Indonesia and Russia, the relevant regulation is currently under review and it has not yet been issued. Moreover, some other jurisdictions (Argentina, Brazil, China, India, and Turkey) have elected not to implement one or more Standards related to the alignment of compensation with risk taking, either because they are not deemed applicable or because of domestic constraints (e.g. labour laws). These jurisdictions will need to continue their efforts to overcome impediments to full implementation in order to ensure an outcome that is fully consistent with the objectives of the P&S. The reasons for not implementing specific Principles or Standards, as well as the nature of the actions taken to address identified

impediments, will be reported to the FSB by the relevant jurisdictions and will be described in the next progress report.

Several other jurisdictions that had already implemented the P&S have issued additional regulation or supervisory guidance. For example, some European Union (EU) member states have issued regulation in relation to the implementation of the Capital Requirements Directive (CRD) III. A few jurisdictions (Italy, Spain, Netherlands) have also issued specific provisions for institutions applying for government support, with restrictions on compensation policies that in some cases go beyond the P&S.

Second, notable progress has been made in implementing the Basel Committee's Pillar 3 disclosure requirements issued in July 2011, but more needs to be done. Several jurisdictions have issued regulation or supervisory guidance to implement those requirements (Canada, Germany, Hong Kong, Italy, Japan, Saudi Arabia, Singapore, Spain, Switzerland, Turkey). In the case of EU members, consistency with the Pillar 3 requirements is required by the CRD III. In two jurisdictions, the new disclosure guidance is being finalised (United States) or is still under development (Australia). Other members indicated that the disclosure requirements are already included in existing regulation, although in some cases more work is necessary to confirm that their regulation is fully consistent with the Pillar 3 requirements.

Third, there remain important differences in terms of applying the P&S. In particular, implementation choices vary with respect to the application of the principle of proportionality and to the identification of employees as material risk takers (MRTs). Some jurisdictions have given detailed guidance on the application of the principle of proportionality (Brazil, Germany, Italy, Spain, United Kingdom), while others have made reference to general criteria supporting the principle or have not defined such criteria at all. As regards the identification of MRTs, several jurisdictions have provided detailed guidance (Australia, Brazil, France, Germany, Hong Kong, India, Italy, Japan, Netherlands, Spain, Switzerland, United Kingdom). Even without explicit criteria, firms in some other jurisdictions are required by supervisory guidance to have adequate processes in place to identify MRTs (e.g. Singapore, Saudi Arabia, United States).

Fourth, supervisory attention on compensation issues at the domestic level continues to increase. A number of supervisory actions have been taken since the 2011 peer review. These actions often include direct engagement with firms' remuneration committees, senior management as well as the heads of remuneration or control functions. Future supervisory plans continue to focus on compensation practices and indicate that supervisory attention is not fading – indeed, a high level of supervisory engagement is reported to contribute to greater attention to compensation issues by firms.

Most authorities report that firms in their jurisdiction have made good progress and that those firms – especially the ones deemed significant for the purposes of the P&S – do not show major implementation gaps. Firms are still experimenting with different approaches in their compensation practices on a number of issues covered by the P&S and so it is still difficult to identify best practices, although supervisory pressure and dialogue are encouraging firms to look for better solutions. While some member countries note improvements in firms' compensation practices (e.g. use of longer periods when evaluating employees' performance), others highlight practical implementation problems. In addition, there remain some challenging areas where more progress is needed, the most critical of which are the alignment

of compensation with ex-ante risk taking and ex-post performance, and the identification of material risk takers. These are also the areas identified by members where more supervisory cooperation would be beneficial.

Finally, cross-border supervisory cooperation on compensation issues is improving, but more progress can be made. Almost all respondents confirm their engagement in supervisory cooperation, both in networks and in supervisory colleges. Some host authorities note, however, that compensation issues have not yet been included in the agenda of some supervisory colleges. A few authorities note that bilateral exchanges among their national supervisors are proving effective to address compensation issues for cross-border groups (Mexico, United States).

The findings in this report confirm the 2011 peer review's conclusion that achieving lasting change in behaviour and culture within firms is a long-term challenge requiring a sustained commitment and that additional time is needed for a common supervisory understanding to evolve and for effective and consistent implementation of the P&S to take place. The FSB will continue to monitor and report on progress so as to generate substantive and relevant information that provides further impetus to aligning compensation practices to prudent risk taking behaviour.

In terms of next steps, and in order to promote the sharing of experiences across its membership, the FSB will organise a workshop of the CMCG and external, independent parties with expertise in firms' compensation practices. The workshop will focus on initial findings from the BCHP and on those areas where particular progress is still needed in light of the findings of this progress report, such as better risk alignment. The discussions from such a workshop will provide useful information for FSB members and will be included in the next progress report, which will continue to follow up on remaining gaps and impediments to full implementation as well as the actions taken by relevant parties.

## I. Introduction

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 employees' risk taking incentives with the long-term profitability of the firm, particularly at significant financial institutions.

The 2011 follow-up peer review<sup>1</sup> on compensation practices found that relevant authorities and firms in FSB member jurisdictions had made good progress in implementing the P&S, but that more work is necessary 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. The review set out several recommendations to address these issues, including:

- that the FSB should undertake ongoing monitoring and public reporting on the implementation of the P&S, focusing on remaining gaps and impediments to full implementation by member jurisdictions as well as on the actions taken by relevant parties in response to the report's recommendations; and
- that the nature of level playing field concerns (particularly with regard to the implementation of Standards 6-9, 11 and 14), 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.

The G20 Leaders Cannes Summit Declaration<sup>2</sup> reaffirmed “the commitment to discourage compensation practices that lead to excessive risk taking by implementing the agreed FSB principles and standards on compensation” and called on the FSB to “undertake an ongoing monitoring and public reporting on compensation practices focused on remaining gaps and impediments to full implementation of these standards and carry out an ongoing bilateral complaint handling process to address level playing field concerns of individual firms. Based on the findings of this ongoing monitoring, we call on the FSB to consider any additional guidance on the definition of material risk takers and the scope and timing of peer review process”.

In response to the call by the G20, the FSB has created a Compensation Monitoring Contact Group (CMCG) under the Standing Committee on Standards Implementation, comprising national experts from member jurisdictions with regulatory or supervisory responsibility on compensation practices. The CMCG is responsible for monitoring and reporting on national implementation of the P&S. Compensation practices has also been designated as a priority area under the FSB Coordination Framework for Implementation Monitoring, and will therefore undergo intensive monitoring and detailed reporting.<sup>3</sup> This progress report follows

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<sup>1</sup> See [http://www.financialstabilityboard.org/publications/r\\_111011a.pdf](http://www.financialstabilityboard.org/publications/r_111011a.pdf).

<sup>2</sup> See <http://www.g20-g8.com/g8-g20/g20/english/for-the-press/news-releases/cannes-summit-final-declaration.1557.html>.

<sup>3</sup> See [http://www.financialstabilityboard.org/publications/r\\_111017.pdf](http://www.financialstabilityboard.org/publications/r_111017.pdf). More information on the FSB's implementation monitoring activities in this area is available on a dedicated page of the FSB website (<http://www.financialstabilityboard.org/activities/compensation/cm.htm>).

the first and second thematic peer reviews on compensation practices and provides an update on the implementation of the FSB P&S over the relatively short time period since the October 2011 peer review. The report has been prepared in consultation with the CMCG, based on the responses to a questionnaire circulated to its members (see Annex E).

The report is structured as follows: Section II describes the overall progress made by national authorities in implementing the P&S since the 2011 peer review. Part of this section focuses on the implementation of the new Basel Committee Pillar 3 disclosure requirements on compensation, and on the implementation choices made by national authorities with respect to the application of the principle of proportionality and the definition of material risk takers (MRTs), since recommendations on these two topics were included in the 2011 peer review. Section III describes recent developments in supervisory monitoring and cooperation in this area, with specific focus on effective governance and appropriate disclosure practices, which were highlighted in the 2011 peer review as needing particular supervisory attention. Section IV describes the national authorities' assessment of the progress in implementation by firms operating in their jurisdiction, including some of the main challenges that firms are facing in implementing the P&S. Section V outlines the preparations by national authorities for the establishment of a bilateral complaints handling process, a mechanism for national supervisors to address compensation-related complaints by firms that are related to level playing field concerns. Finally, Section VI identifies next steps to further promote the sharing of experiences in the area of compensation practices.

## **II. Implementation by national authorities**

### **1. Overall progress and priorities**

Almost all FSB member jurisdictions have now completed the implementation of the P&S in their national regulation or supervisory guidance. Those jurisdictions found to have significant implementation gaps at the time of the 2011 peer review (Argentina, India, Indonesia, Russia, South Africa) have since made progress in their implementation efforts. However, in the case of Indonesia and Russia, the relevant regulation is currently under review and it has not yet been issued. Moreover, some other jurisdictions (Argentina, Brazil, China, India, Turkey) have elected not to implement one or more Standards related to the alignment of compensation with risk-taking, either because they are not deemed applicable or because of domestic constraints (e.g. labour laws). This is particularly the case for Argentina, which has not implemented at this stage several Standards (see below). According to the authorities, there are currently no significant problems with compensation and risk-taking in the domestic banking system. The authorities also state that domestic labour laws limit their capacity to act in this area. Annex B provides an update on the status of national implementation since the 2011 peer review, while Annex C describes the remaining gaps in national implementation. More specifically:

- In Argentina, a proposal has been drafted to amend the Supervisory Handbook in order to align supervisory practices with the regulation issued to implement the P&S. Several meetings have been held with executive officers of major financial institutions, discussing their self-assessments with respect to the new corporate

governance rules. While Standards 13 and 16-18 are in the process of being implemented, there are at present no plans to implement Standards 5-10, 12 and 14 relative to effective alignment of compensation with prudent risk-taking and to government intervention. This is because, in the Argentinean authorities' judgment, there are currently no significant problems with compensation and risk-taking in the domestic banking system and because domestic labour laws limit the authorities' capacity to act in this area.

- India has issued final guidelines on compensation applicable to all private sector banks and foreign banks operating in India. The guidelines implement all Principles and Standards, except Standard 12 regarding re-examination of contractual payments related to termination of employment.<sup>4</sup> The guidelines will be implemented from the financial year 2012-13 and will be followed by supervisory review to ensure continuous compliance.
- Indonesia has incorporated several remuneration issues in the regulation on Good Corporate Governance that is currently under review; the review might allow more FSB P&S to be addressed in that regulation. Indonesia is adopting a supervisory approach to compensation practices as part of enhancing banks' corporate governance. Dialogue with the banking industry has also taken place as part of the consultation process on the regulation on Good Corporate Governance.
- Russia has issued draft amendments to the Bank of Russia Regulation "On Bank Economic Position Assessment" (under review), including a special section on the assessment of remuneration systems of credit institutions. This regulation is complemented by a Letter on the "Range of Methodologies for Risk and Performance Alignment of Remuneration".<sup>5</sup> In order to provide additional powers for the regulation of credit institutions' remuneration systems, draft amendments to the Law "On the Central Bank of the Russian Federation (Bank of Russia)" are currently under consideration.
- South Africa, which at the time of the 2011 review was in the process of developing a new domestic framework, has issued two regulations in December 2011 implementing the P&S.<sup>6</sup> In the bilateral annual discussions with the firms' board of directors, the prudential authority has emphasised the importance of ensuring the full implementation of the P&S.

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<sup>4</sup> As per the banking statutes in India, any payment of compensation to whole-time directors and Chief Executive Officers (CEOs) during and after employment requires the approval of the Reserve Bank of India (RBI) on a case-by-case basis. Accordingly, banks obtain RBI's approval on a case-by-case basis (usually multiple times in a year) for the payment of salary, bonus and other benefits to their whole-time directors and CEOs. While granting approval, the RBI takes into account all relevant factors, including the financial position of the concerned bank as well as industry practice. Therefore, when implementing the P&S into national regulation, it was considered by the Indian authorities that banks should not be instructed to re-examine existing contractual payments as stipulated in Standard 12.

<sup>5</sup> In addition, the regulation "On organization of internal control in credit organisations and banking groups" is currently being revised, which will stipulate the role of the compliance function in monitoring remuneration process.

<sup>6</sup> Standard 10, related to government intervention, has not been implemented. Legislation is currently being developed in South Africa to adopt a twin-peaks approach to its supervisory structure, and Standard 10 could possibly be addressed in that legislation.

Other jurisdictions, which had already implemented the P&S, have issued new regulation in the course of 2011. For example, Italy, Spain and the Netherlands have issued regulation in relation to the adoption of European Union (EU) Directive 2010/76 (the so-called CRD III) and the related 2010 Committee of European Banking Supervisors (CEBS) Guidelines on Remuneration Policies and Practices<sup>7</sup> as follows:

- in Italy, specific amendments to the Italian Banking Law and to the banks' supervisory provisions have been made in order to: i) explicitly entrust the Bank of Italy with the power to limit variable remuneration where necessary to strengthen the capital basis; ii) require banks to disclose to the public (in accordance with the Pillar 3 requirements) their remuneration policies and practices;
- in Spain, recent legislation has focused on improving disclosure, improving the link between risk analysis, remuneration policies and long term outcomes, and increasing supervisory controls; and
- in the Netherlands, further supervisory guidance is being elaborated on specific paragraphs of the CEBS Guidelines on the CRD III (e.g. length of the deferral and retention period in case of multi-year accrual; prohibition to pay dividend on deferred shares) as well as on other issues (proportionality in the application of ex post risk alignment requirements).

Some countries have issued specific laws, regulation or supervisory guidance to introduce additional and more restrictive compensation rules on financial institutions that receive public support (see section III for additional supervisory actions). In Spain, two Royal Decree Laws were enacted in February 2012 imposing strict limits to the remuneration and the redundancy payments for those institutions that have received or apply for public financial support. In the Netherlands, regulation is being finalised on additional requirements for compensation in financial institutions in case of request for state support, which go beyond those mentioned by Standard 10 of the P&S (for example, all rights of the management board to variable remuneration must be annulled).

Other jurisdictions have also published additional guidance documents to provide more clarity on existing rules and requirements (United Kingdom), while some other jurisdictions are already foreseeing the need to adjust some dispositions in the regulation. Mexico is currently drafting a proposal to modify some of its dispositions that relate to the composition of the compensation committee and to measures regarding the payment of bonuses and employment termination payments. The Netherlands is elaborating further supervisory guidance on specific questions that were raised during the supervisory process – for example, in relation to the possibility to apply ex-post risk alignment in a proportionate way to MRTs. Spain is planning to issue further supervisory guidance, in order to clarify those aspects in which shortcomings were found during the supervisory process.

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<sup>7</sup> <http://www.eba.europa.eu/cebs/media/Publications/Standards%20and%20Guidelines/2010/Remuneration/Guidelines.pdf>

## **2. Basel Committee Pillar 3 disclosure requirements for remuneration**

Most jurisdictions have taken additional regulatory steps to introduce in their respective frameworks the Basel Committee's Pillar 3 disclosure requirements for remuneration that were issued in July 2011.<sup>8</sup> In several jurisdictions, disclosure requirements for remuneration were already in place (Argentina, Brazil, China, France, India, Korea, Mexico, Netherlands, Russia, United Kingdom) – sometimes in connection with securities laws applicable to publicly listed companies (e.g. Brazil, Russia<sup>9</sup>). In some of these cases, more work is necessary to confirm that the regulation is fully consistent with the Pillar 3 disclosure requirements for remuneration. In the case of European Union members, consistency with the Pillar 3 requirements is required by the EU's CRD III, and some of these jurisdictions have issued new specific regulation in order to implement the European directive into their national frameworks, including with respect to the new disclosure requirements (Germany, Italy, Spain). Other jurisdictions have also issued new regulation (Japan, Singapore, Turkey<sup>10</sup>) or supervisory guidance (Canada, Hong Kong, Saudi Arabia, Switzerland) to apply them.

Two jurisdictions have not yet issued new regulation related to the Basel Committee's Pillar 3 disclosure requirements for remuneration (Australia, United States). In the United States, the regulation is being finalised and, according to the supervisory authority, much of the required information is already disclosed in practice by major banks. In Australia, the supervisory authority (APRA) has been consulting with banks on the form of remuneration disclosures and, while standards and guidelines have not yet been issued, locally incorporated firms are encouraged to report on remuneration practices in a manner consistent with the Basel Committee's document.

## **3. Proportionality and identification of Material Risk Takers**

FSB member jurisdictions have made different choices regarding the institutions and employees that are covered by the P&S. One of the recommendations of the 2011 peer review was that, while 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, and should proactively ensure that proportionality remains appropriate and does not give rise to regulatory arbitrage as a result of market developments and emerging risks.

The responses indicate that there is a wide variation among member jurisdictions as to the use of the principle of proportionality as well as on the criteria used to support the principle. In some cases, the criteria are not clearly defined. Annex A reports the various choices and criteria used to support the principle of proportionality as well as the identification of

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<sup>8</sup> See <http://www.bis.org/publ/bcbs197.pdf>.

<sup>9</sup> In Russia, the disclosure requirements on the annual reports of credit institutions and quarterly securities issuers are deemed by the authorities to be already mostly in line with Pillar 3. The full range of Pillar 3 remuneration disclosures will be subject to supervisory assessment, as provided for by draft amendments to relevant Bank of Russia regulations.

<sup>10</sup> Turkey has issued in June 2011 amendments to the "Regulation on Banks Corporate Governance Principles", which also cover some of the BCBS disclosure requirements for remuneration.

employees that come under the scope of the P&S. Some jurisdictions provide for clearly specified – and in some cases very detailed – criteria related to the proportional application of the P&S (Brazil, Germany, Italy, Spain, United Kingdom). In some cases (e.g. Canada), while the Principles apply to all firms, certain Standards apply only to the largest institutions. In Switzerland, the Remuneration Circular applies directly for banks and insurers with regulatory capital exceeding CHF 2 billion, whereas for other institutions the Circular applies only indirectly as best practice guidance. In Spain the supervisory authority can exempt institutions below a certain threshold of total assets from complying with particular requirements (e.g. deferred remuneration, compensation by shares, ex-post adjustments).

In those cases where the criteria are explicitly specified, Annex A also includes criteria used for the definition of MRTs to which Standards 6-9 apply. A slight majority of FSB jurisdictions have explicitly defined some criteria for the identification of MRTs (Australia, Brazil, France, Germany, Hong Kong, India, Italy, Japan, the Netherlands, Spain, Switzerland, United Kingdom). A variety of approaches is observed, potentially resulting in a wide variation in the number of employees identified as MRTs.<sup>11</sup> In Brazil, for example, only members of the board of directors and executive officers are identified as MRTs, while in Australia the criteria are broader and include all employees for whom a significant portion of total remuneration is based on performance and whose activities (individually or collectively) may affect the financial soundness of the institution. In Japan, institutions are required to single out “identified employees” – based on whether an employee is highly remunerated and whether his action has a material impact on the risk profile of the firm – for the purpose of the compensation disclosure requirements. In Mexico, where no criteria have been explicitly defined, on-site inspections have shown that very few employees are classified as MRTs because some firms are considering only the senior management as employees in scope.

In some jurisdictions even without explicit criteria, firms are still required by supervisory guidance to have adequate processes in place to identify MRTs (e.g. Saudi Arabia, Singapore, United States). In Saudi Arabia, banks are required to identify and disclose MRTs based on their internal policies and supervisory guidance provided by the prudential authority; the firm’s approaches are then reviewed to ensure adequacy and consistency. In the United States, banks are required to identify on an ongoing basis “covered employees”, i.e. those employees receiving incentive-based compensation and having an ability, either alone or as a member of a group, to take or influence risk that is material to the bank or a business within the bank.

More uniformity is observed at the European level on both proportionality and the identification of MRTs due to the CEBS Guidelines on remuneration policies and practices that provide guidance on CRD III. The Guidelines indicate that proportionality should be defined by taking into account size and internal organization as well as the nature, scope and complexity of banking activities of an institution. As regards MRTs, the CEBS Guidelines specify that institutions are required to identify staff in the categories executive board, senior management, control staff, staff “in the same remuneration bracket” and “other risk takers”.<sup>12</sup>

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<sup>11</sup> Those responses that provide numbers for MRTs identified by the institutions indicate a broad range (i.e. between the tens and the thousands of employees per firm).

<sup>12</sup> To select the other risk takers, institutions have to identify which activities materially affect the risk profile of the institution. The guidance provides for criteria for financial risks; for other financial risks and non-financial risks, institutions are required to develop their own criteria or identification method. After the relevant activities are selected, the institution will need to identify the risk takers within these activities.

However, even in the presence of common EU regulation and guidelines, the implementation choices by different EU member countries have differed, resulting in some variation in the criteria applied both in relation to the proportionality principle and to the definition of MRTs.

### **III. Supervisory monitoring and cooperation**

#### **1. Overall developments**

Supervisory attention on compensation issues at the domestic level continues to increase. Since the 2011 peer review, a number of authorities in FSB member jurisdictions have strengthened their supervisory review of remuneration policies by conducting bank-specific assessments. Dedicated meetings have been organised to identify the areas where further work is needed, often with direct engagement with the chair of the firm's remuneration committee and senior management as well as with the head of remuneration and/or of control functions. Some authorities have integrated compensation assessments into their risk assessment processes (Canada, Argentina).

Several supervisors have just completed, or are currently conducting, in-depth offsite (Australia, France, United Kingdom) or on-site remuneration inspections (Germany, Hong Kong, Mexico, Saudi Arabia, Spain, United States), usually of their largest institutions.<sup>13</sup> On-site inspections are considered by national authorities as particularly effective for exerting pressure for reform on institutions.

The UK is in the third year of an annual supervisory process in which a remuneration Policy Statement questionnaire is submitted by firms, followed up with specific information requests on payout proposals for "code" staff<sup>14</sup> as well as details on remuneration structures and deferrals. The information is reviewed by the Financial Services Authority (FSA) and meetings are held at the most senior level; firms are prohibited from making variable remuneration awards to "code" staff until the supervisor has verified that they comply with the Remuneration Code. The letters containing the FSA's approval also specify any further action that firms are expected to undertake during the following year.

In several other jurisdictions, firms are requested to provide a yearly report with a description of compensation policies (Brazil, Saudi Arabia<sup>15</sup>, Spain). In Brazil, firms also have to highlight changes implemented during the year, together with quantitative information on compensation. In Spain, all institutions with total assets above €10 billion were required in the last quarter of 2011 to submit an independent expert report, assessing progress in the implementation of the P&S, with specific focus on identified staff at the level of group, parent company and subsidiaries. Firms were also required to submit information on senior management's contracts and compensation arrangements, and the Bank of Spain required the institutions to rapidly adjust those contracts to the new regulation on compensation practices.

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<sup>13</sup> Compensation practices have also been dealt with in more general reviews: the Canadian prudential authority (OSFI) has conducted a thematic review on corporate governance, which included the governance of compensation.

<sup>14</sup> Code staff is identified according to the FSA's "Remuneration Code" (SYSC 19A of the FSA Handbook); see <http://fsahandbook.info/FSA/html/handbook/SYSC/19A> for details.

<sup>15</sup> The reports are required on a half-yearly basis in Saudi Arabia.

Some jurisdictions continue to give priority to larger and more complex institutions (for example, Switzerland), while other authorities are expanding their horizontal review programs to a second tier of medium-sized banks and insurers. In the Netherlands, the supervisory authority has assessed the remuneration policy of 33 medium-sized banks and insurers in 2011 via a self-assessment process, followed by a supervisory letter to each institution; the US has recently intensified the supervisory review of medium-sized banks, operating mainly domestically.

Some authorities have issued specific supervisory guidance on compensation practices in light of current economic developments – for example, in relation to the European crisis. The French Prudential Authority has strengthened its “ex-ante” supervisory action, reviewing for approval the provision of variable compensation to be awarded by large banks to identified staff and members of the board. The prudential authority also has the power to require a reduction of the awards given to staff, taking into consideration the relationship between compensation awards and the availability of resources to support the safety and soundness of the institutions, particularly in a period of weak financial results. In Italy, the Bank of Italy issued in early 2012 a formal letter requesting banks – particularly those in the need of strengthening their capital base – to devote specific attention to the cost stemming from variable remuneration and to ensure the proper functioning of ex-ante and ex-post risk adjustment, which should take into account financial results as well as the institution’s specific capital and liquidity situation. Furthermore, banks were asked to adopt a prudent approach in determining the overall amount of the bonus pool related to the 2012 performance year, and not to circumvent the contraction of variable remuneration through inappropriate increases in the fixed part in the following years. In Spain, institutions with public financial support were required to communicate their variable remuneration proposal relating to year 2011 performance, which was subject to approval by the Bank of Spain. In February 2012, institutions with public financial support were required to report on the actions taken to adapt the compensation packages to the new regulation, requiring restrictions on the remuneration for senior managers and members of the board.

All FSB jurisdictions have indicated that they will continue to monitor compensation practices of firms through both off-site and on-site supervision, taking supervisory actions where needed. Future plans include analysis of the 2011 payout round and of self-assessment reports by financial institutions; ongoing meetings with the management and remuneration committees of major banking groups; horizontal reviews (in some cases with specific focus on disclosure practices: Canada, Hong Kong, Italy, Saudi Arabia); and the review of independent reports. In several countries, compensation policies and practices are also being reviewed as part of full-scope inspections. Canada will review a selection of conglomerate institutions’ compensation practices in conjunction with risk appetite statements to determine whether appropriate alignment exists. Spain has planned a broad on-site revision of compensation schemes for most financial firms, with special focus on the new entities that have emerged as a result of the consolidation process of the Spanish financial system.

## **2. Ensuring effective governance and appropriate disclosure of compensation**

The 2011 peer review recommended that supervisors 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 and that they comply with the Basel Committee's Pillar 3 disclosure requirements for remuneration from 1 January 2012.

While several jurisdictions have noted that the effective governance of compensation is being dealt with in the context of the ongoing and longstanding regulatory and supervisory efforts on effective risk governance and internal control frameworks, a few authorities have indicated that they have taken specific actions in 2011 to strengthen the governance of compensation by their supervised firms. Switzerland completed a review of institutions' self-assessments to determine areas of progress or requiring further focus (including with respect to board of directors oversight of remuneration). In Canada, the supervisory authority has issued recommendations on the need for directors with financial industry expertise, and has identified areas for improvement with respect to the independence of risk and compliance functions and their compensation processes (i.e. objective setting and performance appraisals). In the Netherlands, the "Points for attention for self assessment" recently published by the supervisory authority specifically addresses the required expertise of supervisory board members with respect to risk management, performance management and remuneration; institutions are also required to provide for specific training and the possibility to ask external advice.

While most jurisdictions have updated the national regulation or supervisory guidance to include the Basel Committee's Pillar 3 disclosure requirements for remuneration, only a few of them have engaged in supervisory actions to ensure appropriate disclosure by firms. In Singapore, the supervisory authority has engaged the locally incorporated banks on their quantitative disclosures to be published in their 2012 annual reports in order to enhance those disclosures so that they conform to the Pillar 3 requirements. Following this focused action, improvements in disclosures have been noted, particularly on the definition and remuneration structures (breakdown of long term awards) of MRTs.

As for future plans, Brazil has scheduled on-site inspections to verify the effectiveness of compensation governance. In Australia, the supervisory activity on effective governance of compensation will include a review of the effectiveness of the processes for risk alignment; the role of the firms' board remuneration committee; and the process adopted by that committee to make recommendations on the individual remuneration of Responsible Persons. In the Netherlands, supervision will focus on the effective application of the remuneration policies of banks and insurers, i.e. on whether the institutions act in compliance with their defined policy. In Hong Kong, supervisory efforts will focus on issues such as the identification of MRTs, comprehensiveness of risk capture, and risk adjustment of the remuneration processes.

### **3. Supervisory cooperation**

Cross-border supervisory cooperation on compensation issues is improving, but more progress can be made. Almost all FSB jurisdictions are engaging in supervisory cooperation efforts, both in the policy development efforts at the international level (for example, by the FSB) and in the context of supervisory colleges. In Singapore, for example, alignment of the banks' compensation practices with the P&S was indicated as one of the areas of supervisory focus of the colleges of local banking groups, in order to ensure consistent application on a

group-wide basis. The work within supervisory colleges is particularly important to ensure that the P&S are applied consistently on a group-wide basis by firms. Many colleges, according to the responses of home supervisors, have put compensation issues in the agenda; however, some host supervisors have noted that remuneration issues have not been thoroughly revised by the colleges in which they participate.

Some supervisory authorities note that they engage in bilateral contacts with other supervisors to align the supervision of cross-border institutions and to discuss best practices, and that these bilateral exchanges have been open and effective (Netherlands, United States). The United States notes that any formal or organised action on supervisory colleges in this area would not be advisable due to the large current demands on supervisory personnel. Mexico reports a close and ongoing relationship with foreign counterparts, which enables the supervisory authority (CNBV) to obtain information from home supervisors and also to exchange information on the way they are implementing the P&S and promoting industry's adherence.

At the European level, a network of supervisors – the European Banking Authority (EBA) Task Force on Remuneration – is in place to respond to questions raised by member states on CRD III implementation. The EBA, which has recently published a survey on the implementation of the CEBS Guidelines on remuneration policies and guidelines<sup>16</sup>, is also expected to issue guidelines (as called for by CRD III) to benchmark remuneration trends and monitor the compensation of “high earners” (i.e. individuals paid more than €1 million).

Other regional cooperation efforts have also begun to address compensation-related issues, such as the Arab and the Gulf Cooperation Council Committees of Banking Supervisors, in which Saudi Arabia participates. Finally, Switzerland and the Netherlands have co-founded a cooperation group (ISPER) to promote exchange of best practices among supervisors.

#### **IV. Assessment of implementation by firms**

Many jurisdictions note that firms have made further material progress in complying with the FSB P&S, especially on those matters raised to their attention by supervisors.<sup>17</sup> A number of countries characterise firms' compensation practices, especially those of firms deemed significant for the purposes of the P&S, as already consistent with the P&S, whilst noting that work to develop and improve industry practices continues (e.g. France, Japan, Netherlands, Saudi Arabia, United Kingdom, and the United States). Importantly, most FSB member authorities have not observed unintended consequences from the implementation of the P&S in their jurisdiction. One exception is Spain, which has identified reactions by some firms such as the shifting of variable payments to fixed payments; changing multi-year performance schemes to annual variable compensation; and shifting from redundancy remuneration to pension benefits so as to avoid restrictions on the redundancy payments, since beneficiaries

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<sup>16</sup> See <http://eba.europa.eu/cebs/media/Publications/Standards%20and%20Guidelines/2010/Remuneration/Implementation-survey-on-CEBS--Guidelines-on-Remuneration--final-.pdf>.

<sup>17</sup> Switzerland, for example, indicates progress in eliminating inappropriate instruments, increasing the amount of variable pay, raising the proportion of deferred compensation, reducing leverage and lengthening deferral, as well as adjusting performance metrics and improvements in other areas.

can take accrued pension funds when leaving the company without any further restriction not specified in their contracts.

Other jurisdictions see remaining gaps, albeit with various degrees of importance in different areas of compensation. Although most jurisdictions describe the effective governance of compensation as an area that is already covered by existing regulation, some gaps are still observed. For example, Germany notes that members of the compensation committee are often of high seniority and cannot dedicate enough time to in-depth analysis, and that human resources departments in firms still dominate the awards process with lesser involvement of the risk management function. Canada notes that there remains room for improvement in the independence or risk and compliance functions, while Switzerland notes the need for improvement in terms of ensuring effective board of directors' oversight on sign-on and severance payments.

Some examples of areas in which work is in progress and where some difficulties are still encountered include the alignment of compensation with ex-ante risk taking and ex-post performance, and the identification of MRTs.<sup>18</sup> Several jurisdictions identify appropriate risk adjustment as a challenging area, as currently adjustments are mainly qualitative or subjective in nature (Australia, Spain, Singapore, United Kingdom). Australia focuses on performance measures since it is concerned that some firms place too much reliance on generic measures (such as earnings-per-share) that are too high level to provide a reliable measure of individual performance and risk-taking. Some authorities also indicate that the measurement of some types of risk, such as reputation risk, is challenging for their supervised firms (e.g. China). Other jurisdictions note that best practice methodologies continue to evolve and supervisors have witnessed substantive progress by firms (Canada, Italy, France); for example, incentive compensation awards in Italy now include a charge for capital and liquidity risk in stressed conditions and are using longer periods when evaluating employees performance.

The alignment of compensation with performance is highlighted as a continuing challenge for institutions, since they do not want to lose key personnel and struggle to align compensation payouts with the financial performance of the company. Some countries (for example, Germany) note that malus criteria are not sensitive enough and are only triggered in exceptional cases. Other FSB members (Italy, Spain) note that non-cash instruments equivalent to shares for variable remuneration purposes have not been defined yet by non-publicly listed firms. As indicated in the 2011 peer review, Argentina notes that restrictions imposed by the national labour law create difficulty in ex-post performance adjustment. The alignment of compensation with performance is an area where, according to many responses, greater international information sharing on firms' practices and more supervisory review and analysis would be beneficial.

Almost all member jurisdictions have identified the criteria used for the identification of MRTs as an area needing improvements, since the relevant criteria are based mainly on qualitative factors (employment status, hierarchical level, activity, operational authority). Spain has noted that criteria to identify the relevant staff below senior managers differ among institutions with similar risk profiles. Germany suggested that there should be clear

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<sup>18</sup> These have also been identified as problematic at the EU level in the recently published EBA implementation survey.

quantitative criteria defined for the identification of MRTs, and that the level of pay should be considered.

On the other hand, many jurisdictions believe that uniform quantitative criteria for the identification of MRTs are not a panacea as financial firms differ in goals, activities, culture, and in the type of employment they offer. Moreover, even in those cases where quantitative criteria are available, supervisory pressure over a period of time is needed for firms to identify an appropriate group of employees.

Some jurisdictions have identified disclosure as a challenging area, given the trade-off between providing enough transparency for market participants and privacy for firm executives as well as the level of detail needed to allow an evaluation of the quality of the remuneration systems in specific areas.

Some authorities that have reviewed also medium-sized banks identify further challenges for these institutions such as, for example, in the application of the proportionality principle (Netherlands). Spain has noted challenges relating to the implementation of the P&S by firms' subsidiaries, especially those that are based in foreign countries or that are not fully owned.

## **V. Establishment of a Bilateral Complaint Handling Process**

In response to the call by the G20 Leaders, the FSB has recently established a mechanism for national supervisors from FSB member jurisdictions to bilaterally report, verify and, if necessary, address specific compensation-related complaints by financial institutions that are related to level playing field concerns. The objectives of the Bilateral Complaint Handling Process (BCHP)<sup>19</sup> are to:

- Address evidence-based complaints raised by financial institutions to their home supervisors that document a competitive disadvantage as a result of the inconsistent implementation of the P&S, particularly with regard to Standards 6-9, 11 and 14, by firms headquartered in other jurisdictions.
- Produce and report information to the FSB on the nature and outcomes of such complaints so as to inform the scope and intensity of the ongoing monitoring.

The BCHP is intended to complement and reinforce normal bilateral or multilateral supervisory channels that may be used by supervisors to address compensation issues. In particular, the BCHP is expected to generate evidence-based information on specific cases of inconsistent implementation of the P&S that have been brought to the attention of national supervisors and to encourage supervisory dialogue on these issues. Specific sources of concern relating to the application of the P&S will be verified and addressed as needed via bilateral exchanges among national supervisory authorities. Over time, the analysis of firm-specific cases is expected to provide more clarity on the application of the P&S across firms and jurisdictions. The outcomes of the BCHP will be reported by the CMCG to the FSB as part of the ongoing monitoring process, and will be included in future progress reports.

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<sup>19</sup> See [http://www.financialstabilityboard.org/publications/r\\_120427b.pdf](http://www.financialstabilityboard.org/publications/r_120427b.pdf).

All FSB member jurisdictions have undertaken steps to prepare for the BCHP. In particular, most jurisdictions have communicated the establishment and main features of the BCHP to the relevant firms in writing, as well as to industry associations and other parties; others have either informed the relevant firms in presentations and conference calls or by posting the information on official websites.

While it is difficult to judge a priori the volume of complaints that will be received, the establishment of such a process is designed to pre-empt any concerns on the part of firms relating to lack of information or adequate processes to address level playing field issues. The process is seen as contributing to a higher degree of attention by firms across FSB member jurisdictions to the P&S as well as to the domestic regulations on remuneration.

## **VI. Next steps**

The findings in this report confirm the 2011 peer review's conclusion that achieving lasting change in behaviour and culture within firms is a long-term challenge requiring a sustained commitment and that additional time is needed for a common supervisory understanding to evolve and for effective and consistent implementation of the P&S to take place.

As indicated by their responses to the questionnaire, continued attention by national authorities on sound compensation practices is necessary to enhance firms' behaviour and to align employees' risk-taking incentives with the long-term profitability of the firm. While progress has been made since the 2011 peer review, there remain some areas of difficulty for the full and effective implementation of the P&S, such as risk alignment methodologies and the identification of MRTs. In these areas, the importance of sharing experiences and discussing options between supervisors is seen as particularly useful.

The FSB will continue to monitor and report on progress so as to generate substantive and relevant information that provides further impetus to aligning compensation practices to prudent risk taking behaviour.

In terms of next steps, and in order to promote the sharing of such experiences across its membership, the FSB will organise a workshop of the CMCG and external, independent parties with expertise in firms' compensation practices. The workshop will focus on initial findings from the BCHP and on those areas where particular progress is still needed in light of the findings of this progress report, such as better risk alignment. The discussions from such a workshop will provide useful information for FSB members and will be included in the next implementation progress report on compensation practices. The next progress report will follow up on remaining gaps and impediments to full implementation as well as the action taken by relevant parties.

## Annex A: Proportionality and identification of Material Risk Takers

Country	Scope of application of the FSB Principles and Standards (P&S) and Proportionality	Identification of Material Risk Takers (MRTs) – Regulatory or supervisory guidelines	Firms' approaches to identification of MRTs
Argentina	The P&S are applied to all financial institutions, following the principle of proportionality. For example, a financial institution is required to set up a Staff Incentive Committee only if appropriate according to its size, complexity or economic importance.		
Australia	<p>All deposit taking institutions and insurers (life insurers and general insurance institutions). Governance standards apply equally to locally-incorporated entities, foreign owned subsidiaries and foreign branches.</p> <p>All institutions are expected to comply in full with all requirements</p> <p>Basel Committee (BCBS) Pillar 3 disclosure requirements will be applied with a proportionate approach to the implementation that reflects the nature, size and complexity of the firm.</p>	Material risk-takers are defined in supervisory guidance as all other persons for whom a significant portion of total remuneration is based on performance and whose activities, individually or collectively, may affect the financial soundness of the institution. Australian Prudential Regulation Authority's (APRA) focus is on employees who receive substantial variable pay linked to volume or other non risk-based metrics. APRA's Prudential Practice Guide 511 on Remuneration sets out expectations in this regard, typically captures financial market traders, other transaction-oriented staff, commissioned sales personnel and intermediaries such as agents and brokers.	The definition adopted by most entities largely follows the wording in APRA's prudential standard.

Country	Scope of application of the FSB Principles and Standards (P&S) and Proportionality	Identification of Material Risk Takers (MRTs) – Regulatory or supervisory guidelines	Firms' approaches to identification of MRTs
Brazil	<p>All financial institutions that are supervised by the Banco Central do Brasil (BCB) except for credit cooperatives and microcredit institutions (insurers are not under the supervision of the BCB).</p> <p>For the purposes of applying the P&amp;S, financial institutions are therefore classified into three different categories:</p> <p>a) Credit cooperatives and microcredit institutions, which are not bound to obey Resolution 3921/2010;</p> <p>b) Significant financial institutions, which are required to observe all of the provisions of Resolution 3921/2010, such as the requirement of constitution of the remuneration committee;</p> <p>A financial institution is considered significant if:</p> <ul style="list-style-type: none"> <li>(i) it is publicly traded;</li> <li>(ii) holds regulatory capital in excess of R\$ 1 billion;</li> <li>(iii) administrates third parties assets in excess of R\$ 1 billion;</li> <li>(iv) holds more than R\$ 5 billion in deposits and third parties assets</li> </ul> <p>c) Other institutions, which are bound to comply with Resolution 3921/2010, except for some provisions such as the requirement of constitution of the remuneration committee and some disclosure requirements.</p>	<p>Only administrators (board of directors and executive officers) are subject to the provisions of the Resolution 3921/2010.</p>	

Country	Scope of application of the FSB Principles and Standards (P&S) and Proportionality	Identification of Material Risk Takers (MRTs) – Regulatory or supervisory guidelines	Firms' approaches to identification of MRTs
Canada	<p>FSB Principles: All federally regulated financial institutions</p> <p>FSB P&amp;S: 6 largest banks and 3 largest life insurance companies (<i>Conglomerate Canadian financial institutions</i>)</p>	<p>No definition explicitly communicated. Onus is on firms to have a process to identify MRTs.</p> <p>Firms are expected to have in place sufficient processes to identify MRTs in order to comply with FSB P&amp;S.</p>	<p>Firms established criteria to identify MRTs within their organization and assessed all employees to determine if they fit the criteria. Key control function personnel provided input or reviewed the list of MRTs.</p> <p>Examples of criteria used by firms: position and title within the organization, risk in their business unit, responsibilities; dollar value of compensation</p>
China	All commercial banks, excluding non bank financial institutions	No explicit definition	Firms normally regard as MRTs group level executives, head of domestic first tier branches, heads of major departments within the group
France	All banks and investment firms	Reference to Committee of European Banking Supervisors (CEBS – now European Banking Authority or EBA) Guidelines on remuneration	Firms identify typically senior management, heads of units/desks, individuals with large delegation of power. MRTs considered both on an individual and collective basis, determining a broad notion of MRTs (in the thousands from major banks)

<b>Country</b>	<b>Scope of application of the FSB Principles and Standards (P&amp;S) and Proportionality</b>	<b>Identification of Material Risk Takers (MRTs) – Regulatory or supervisory guidelines</b>	<b>Firms’ approaches to identification of MRTs</b>
Germany	<p>All banks</p> <ul style="list-style-type: none"> <li>- Major banks (Total assets &gt; €40 billion, or based on self risk analysis, taking into account size, remuneration structure, nature, scope, complexity risk content and international scale of business activities conducted): More demanding requirements applying to remuneration schemes of management board and other material risk takers</li> <li>- Other institutions: general requirements applying to institutions and employees; institutions that are not “major” may not apply Standards 6-8.</li> </ul>	Reference to CEBS Guidelines on remuneration	Institutions generally adopt a function specific approach in which only management levels are identified.

Country	Scope of application of the FSB Principles and Standards (P&S) and Proportionality	Identification of Material Risk Takers (MRTs) – Regulatory or supervisory guidelines	Firms’ approaches to identification of MRTs
Hong Kong	<p>All Authorised Institutions (AIs), including, in the case of locally incorporated AIs, their overseas branches and subsidiaries subject to the Hong Kong Monetary Authority’s (HKMA) consolidated supervision (paragraph 1.3.1 of the Remuneration Guideline).</p> <p>Licensed banks and authorized institutions incorporated in Hong Kong are subject to higher requirements (e.g. mandatory remuneration committee).</p> <p>An institution with a large, complex, multifaceted business which employs large numbers of employees engaged in diverse risk-taking activities would be regarded as significant institutions for the purpose of thematic examination on compliance with the Remuneration Guideline. In general, the HKMA expects large and complex AIs that make extensive use of variable incentive compensation arrangements to have more formalised, systematic and detailed policies, procedures, and systems and to undertake more extensive monitoring and review</p> <p>The Remuneration Guideline requires all AIs to make adequate disclosure on remuneration, but allows overseas-incorporated AIs not to make separate disclosure in respect of the remuneration system applicable to their Hong Kong operations, if the information required to be disclosed forms part of the disclosures made by the institutions’ head offices.</p> <p>The HKMA expects that the provisions in the Remuneration Guideline concerning the balance of fixed and variable incentives-based remuneration, the mix of instruments used for the payment of variable remuneration, the measurement of long-term performance, and the arrangements for deferral of variable remuneration are to be applied in a manner commensurate with the seniority, responsibilities, role and activities of the relevant employees.</p>	<p>AIs’ remuneration principles should apply to the employees whose activities during the course of their employment (individually or collectively) could have a material impact on the institution’s risk profile and financial soundness. In this regard, the policy should have specific regard to the remuneration of the following personnel:</p> <p>(a) senior management who are responsible for oversight of the AI’s firm-wide strategy or activities or those of the AI’s material business lines (including, but not limited to, executive directors, the chief executive, and other senior executives);</p> <p>(b) individual employees (“Key personnel” for the purposes of this module) whose duties or activities in the course of their employment involve the assumption of material risk or the taking on of material exposures on behalf of the AI (for example, proprietary traders and dealers who are in a position to take on material exposures);</p> <p>(c) groups of employees whose activities in the aggregate may expose the AI to material amounts of risk and who are subject to the same or similar incentive arrangements (including, but not limited to, employees who are incentivised to meet certain quotas or targets by payment of variable remuneration for example, personnel in marketing, sales and distribution functions and loan officers); and</p> <p>(d) employees within risk control functions (including, but not limited to, risk management, financial control, compliance, legal and internal audit functions).</p>	<p>In general, AIs have classified their employees as material risk takers with specific reference to the criteria prescribed in the Remuneration Guideline.</p>

Country	Scope of application of the FSB Principles and Standards (P&S) and Proportionality	Identification of Material Risk Takers (MRTs) – Regulatory or supervisory guidelines	Firms’ approaches to identification of MRTs
India	All banks in private sector and foreign banks operating in India, with effect from the financial year 2012-13.	The guidelines issued are applicable to the Whole Time Directors of banks. Banks will have to ensure that the remuneration packages of other employees are also aligned with the FSB P&S, given that the full set of these requirements have been incorporated into the Guidelines.	
Indonesia	The relevant regulation has not yet been issued	The relevant regulation has not yet been issued	
Italy	<p>All banks</p> <p>1) “Major” banking groups (total assets &gt; €40 billion) are required to adopt all the provisions on compensation (corresponding to the whole set of the FSB P&amp;S): currently 11 banking groups</p> <p>2) “Medium” banks and banking groups (€3.5 billion &gt; total assets &gt; €40 billion) are required to apply all the general provisions on compensation and to consider (on a case-by-case analysis) to what extent Standards no. 6-9 may be applied to their identified staff.</p> <p>3) “Minor” banks (total assets &lt; €3.5 billion), may not adopt Standards 6-9, but have to comply with all the other FSB P&amp;S on compensation policies and practices.</p>	<ul style="list-style-type: none"> <li>• “Identified staff” as per CEBS Guidelines: Executive directors, senior executives, top managers (people responsible for the main business lines, corporate functions and geographical areas) and those directly reporting to the governing bodies, as well as people responsible for the internal control functions (including the higher staff within those control functions) have to be considered “identified staff” (unless a bank proves the contrary).</li> <li>• Self evaluation on other employees with total remuneration higher than €200.000 and variable part of compensation &gt; 20% of total annual compensation.</li> <li>• Employees whose total remuneration is in the same pay bracket as that of executive directors and /or other risk takers.</li> </ul>	<p>Mainly based on qualitative factors: employment status, hierarchical level, activity, operational authority</p> <p>Currently focus of supervisory attention.</p>

Country	Scope of application of the FSB Principles and Standards (P&S) and Proportionality	Identification of Material Risk Takers (MRTs) – Regulatory or supervisory guidelines	Firms' approaches to identification of MRTs
Japan	<p>- The supervisory guidelines revised in March 2010 that implement the P&amp;S apply to all banks and branches of foreign banks; large and internationally-active securities companies, foreign securities companies, and branches of foreign securities companies; internationally-active insurance companies; and Norinchukin Bank.</p> <p>- The regulations and guidelines revised in March 2012 in line with BCBS disclosure requirements for remuneration apply to all deposit-taking institutions, including all banks and cooperative credit institutions, and large and internationally-active securities companies designated by the Japanese Financial Services Agency (JFSA).</p> <p>- The JFSA clarifies the supervisory viewpoints in implementing the P&amp;S and the BCBS disclosure requirements for remuneration for each type of firms in the respective guidelines.</p>	<p>With regards to the BCBS disclosure requirements for remuneration, Japanese financial firms are required to identify a group of employees (Identified Employees) who satisfy both the following two conditions:</p> <ul style="list-style-type: none"> <li>- whether an employee is highly remunerated;</li> <li>- whether the employee's action has a material impact on the risk profile of the firm.</li> </ul> <p>The JFSA states in the supervisory guidelines that employees remunerated more than the senior management at headquarters in Japan can be Identified Employees if their actions have material impact on the risk profile of the firm.</p>	<p>Firms are required to adopt the provisions in the regulations and supervisory guidelines.</p>
Korea	<p>Financial holding companies, financial investment business entities, banks and insurance companies. (financial investment with total asset of KRW five trillion or more; insurance companies with total asset of KRW ten trillion or more).</p> <p>The scope of application is currently being expanded to smaller insurance companies and financial investment institutions.</p>	<p>No explicit guidance</p>	<p>Management and executive or directors who make material decisions on the bank's operation or who execute work that can impose material risks to the financial companies. Staff who can impose serious risks to the financial institution including the heads of departments in charge of Investment banking, financial investment business, foreign exchange dealing, securities management, design, sales and dealing of derivatives; as well as specialist staff under a separate contract who get a bonus that is in proportion of profits made by their business line.</p>

Country	Scope of application of the FSB Principles and Standards (P&S) and Proportionality	Identification of Material Risk Takers (MRTs) – Regulatory or supervisory guidelines	Firms’ approaches to identification of MRTs
Mexico	All institutions in the Mexican banking system (including regulated non-bank banks and all brokerage houses)	No explicit guidance	Generally only senior management
Netherlands	<p>All banks, investment firms, insurers and other financial institutions.</p> <p>Based on CEBS Guidelines, proportionality defined according to size, internal organization and nature, scope and complexity of the activities. Institutions have to motivate the proportionate application of each article of the Regulation on sound remuneration policy.</p>	<p>Based on CEBS Guidelines, De Nederlandsche Bank (DNB) has published a Question &amp; Answer (Q&amp;A) note on how institutions should identify the MRTs or “Identified staff”. CEBS Guidelines include the categories of executive board, senior management, control staff, staff in the “same remuneration bucket” and other risk takers. For the latter, DNB distinguishes three categories: decision takers, staff who execute activities within the risk profile and monitoring functions.</p>	<p>Institutions (have to) make use of the Q&amp;A note of DNB when selecting their MRTs.</p>
Russia	<p>Banks (credit organizations) and State controlled institutions.</p> <p>Proportionality is subject to professional supervisory judgement.</p>	<p>Currently no definition. But it is provided in draft law and regulatory amendments.</p>	<p>Some advanced banks use a concept similar to MRT based on their capital allocation process.</p>
Saudi Arabia	<p>All banks including their non-banking subsidiaries and branches of foreign banks operating in Saudi Arabia.</p>	<p>There is no specific definition of MRTs.</p> <p>Banks are required to determine the proportion of fixed and variable components of compensation by taking into account the nature and level of responsibilities of an employee, business area in which he is working, and the overall compensation philosophy of the bank.</p> <p>Banks are required to take into account the guidance provided in the BCBS document on “Range of Methodologies for Risk and Performance Alignment of Remuneration”. Banks are also required to publicly disclose the number of employees engaged in material risk taking activities and the compensation paid to them. These disclosures are reviewed by SAMA (Saudi Arabian Monetary Agency) to ensure consistency across the industry.</p>	<p>Banks identify and disclose MRTs based on their internal policies and supervisory guidance provided by SAMA. Their approaches to identification of MRTs are reviewed by SAMA to ensure adequacy and consistency of such approaches.</p>

<b>Country</b>	<b>Scope of application of the FSB Principles and Standards (P&amp;S) and Proportionality</b>	<b>Identification of Material Risk Takers (MRTs) – Regulatory or supervisory guidelines</b>	<b>Firms’ approaches to identification of MRTs</b>
Singapore	<p>All banks, financial holding companies and significant insurers incorporated in Singapore</p> <p>The high-level principles incorporated in Standards 6 to 9 are hard-coded in the Regulations (which have the force of law) and apply to each “executive officer”, defined as any employee who is principally responsible for the management and conduct of the business of the company (expected to cover at least management staff who are division or department heads).</p>	No specific definition of MRTs. The remuneration packages of all employees are expected to be aligned with the FSB P&S, as the full set of these requirements are incorporated into the Guidelines.	The locally incorporated banks use employees’ seniority in rank as the key criterion to determine whether they should be deemed as material risk takers, supplemented by the employees’ job functions (e.g. employees in front office/ trading roles would be included) and the composition of remuneration (e.g. high-earning employees whose compensation or whose bonus to salary ratio exceed certain pre-determined thresholds would be included).
South Africa	All banks	No explicit guidance	

Country	Scope of application of the FSB Principles and Standards (P&S) and Proportionality	Identification of Material Risk Takers (MRTs) – Regulatory or supervisory guidelines	Firms' approaches to identification of MRTs
Spain	<p>All financial institutions, including insurance and financial services companies</p> <p>Institutions with total assets &lt; €10 billion are exempted from complying with some requirements (e.g. Remuneration Committee); the Bank of Spain (BoS) can require any of these institutions to comply.</p> <p>Relevant regulation states two levels of requirements:</p> <ul style="list-style-type: none"> <li>- Global requirements: apply to the entire organization</li> <li>- Specific requirements: Those related to performance assessment and ex-ante risk adjustments apply to all groups for which there is variable remuneration.</li> <li>- Additionally, ex-post adjustments on the variable remunerations should be applied to the identified staff (material risk takers).</li> </ul> <p>The BoS can exempt institutions with total assets &lt; €10 billion or officers with variable remuneration below €100.000 from complying with certain requirements (i.e. deferred remuneration; compensation by shares; ex-post adjustments etc.).</p>	<p>Based on CEBS guidelines: the BoS expects that the identified staff include executive members; senior management; staff responsible for independent control functions; other risk takers; other employees whose total remuneration takes them into the same remuneration bracket as senior managers and risk takers.</p> <p>National supervisory guidance includes as identified staff at least the following: executive members of the board; members of the management committee; any other top officer (general managers; officers with a salary similar to the former; any employee with a special high management contract –different from general labour contract); managers of control functions (internal control; internal audit; compliance function; legal department; risks control; financial control); managers of the different business lines (commercial banking; capital markets; treasury activities; wholesale banking etc.); and in general, members of any other committee entitled to take on relevant decisions.</p> <p>Officers with variable remuneration higher than €100.000 or above 30% of fixed remuneration should be considered as identified staff.</p> <p>BoS can release institutions with total assets &lt; € 10 billion or officers with variable remuneration below €100.000 from complying with certain requirements (i.e. deferred remuneration; compensation by shares; ex-post adjustments etc.).</p>	<p>Financial entities must submit to the BoS a list of the categories of employees whose professional activities have an impact on the risk profile of the entity; the BoS holds the power to specify which categories should be included in the scope of application.</p>

Country	Scope of application of the FSB Principles and Standards (P&S) and Proportionality	Identification of Material Risk Takers (MRTs) – Regulatory or supervisory guidelines	Firms' approaches to identification of MRTs
Switzerland	<ul style="list-style-type: none"> <li>- Direct application of the Remuneration circular for institutions with regulatory capital exceeding CHF 2 billion.</li> <li>- For other institutions, Remuneration circular applies indirectly as best practice guidance.</li> <li>- Proportionality also applies taking into account the overall remuneration risk of an institution and its total risk profile, which includes among other things size and complexity.</li> </ul>	<p>- The Swiss Financial Market Supervisory Authority (FINMA) has adopted the notion of “Key Risk Takers”: the Management Board and CEO as well as key decisions makers across the institution, including for example heads of divisions, heads of control functions, individuals having the ability to make or influence major financial or risk decisions or making major commitments on behalf of the company. The remuneration arrangements for this group are subject to higher conditions and expected to receive greater oversight by the Board of Directors.</p>	<p>- The number of Key Risk Takers in larger institutions is generally well over 100 individuals and in some cases several hundred individuals.</p>
Turkey	<p>Investment firms (which operate as capital markets institutions).</p> <p>The regulation on corporate governance is applied to all banks and there is no discrimination depending on their size or complexity.</p>	<p>No specific definition of MRTs; some rules and policies are in place concerning the compensation of senior management of the firms. Investment firms are required to determine the proportion of fixed and variable components of compensation and a maximum ratio (variable/total) has to be defined for each department of the firm. The greater the responsibility and authority of an employee in the firm, the greater that ratio should be.</p>	

Country	Scope of application of the FSB Principles and Standards (P&S) and Proportionality	Identification of Material Risk Takers (MRTs) – Regulatory or supervisory guidelines	Firms’ approaches to identification of MRTs
United Kingdom	<p>The UK Financial Services Authority (FSA) Remuneration Code covers approximately 2,700 banks, building societies and investment firms.</p> <p>Based on CEBS Guidelines, proportionality defined according to size, internal organization and nature, scope and complexity of the activities</p> <p>Four tiered proportionality framework, providing indication of which of the rules certain firms may be allowed to neutralise, based on key metrics:</p> <ul style="list-style-type: none"> <li>- Business model type</li> <li>- Regulatory permissions/activities</li> <li>- Size (capital for UK firms; total assets for non-EEA branches)</li> </ul> <p>Tier 1 and 2: large and medium-sized banks, building societies and broker dealers - <i>Apply all the remuneration rules</i></p> <p>Tier 3: small banks and building societies and firms that may occasionally take short term risk on their balance sheet. – <i>May not apply certain rules, if prescribed within Annex 2 of the CEBS Guidelines.</i></p> <p>Tier four: firms that generate income from agency business that does not put their balance sheets at risk. – <i>Same as Tier 3</i></p> <p>Firms may apply for individual guidance to UK FSA.</p>	<p>Based on CRD III and CEBS Guidelines, the FSA Remuneration Code applies to a certain category of staff, referred to as “Code staff”.</p> <p><i>“Remuneration Code staff comprises categories of staff including senior management, risk takers, staff engaged in control functions and any employee receiving total remuneration that takes them into the same remuneration bracket as senior management and risk takers, whose professional activities have a material impact on the firm’s risk profile”.</i></p> <p>A proportionate approach is also applied at the individual level: certain Remuneration Code staff, who satisfy both the following conditions:</p> <p>(a) variable remuneration of the individual is no more than 33% of total remuneration; and</p> <p>(b) total remuneration of the individual is no more than £500,000.</p> <p>can neutralise certain CRD requirements on remuneration structures (e.g. minimum levels of deferral, minimum proportion in shares)</p> <p>Further supervisory guidance to firms to include as Code Staff a person: who performs a “significant influence function”; or is a “senior manager”; or a head of a significant business line; or a head of a support and control function..</p>	<p>Practices for identification in firms vary, in general consider staff who hold "significant influence functions", other senior managers and heads of key business units or control functions. Firms then consider other staff they deem to be material risk takers (e.g. some firms use threshold metrics such as amounts of revenue or assets under management or value-at-risk); and individuals in the same remuneration bracket as senior management and risk takers, to assess whether their professional activities have a material impact on the firm’s risk profile.</p>

<b>Country</b>	<b>Scope of application of the FSB Principles and Standards (P&amp;S) and Proportionality</b>	<b>Identification of Material Risk Takers (MRTs) – Regulatory or supervisory guidelines</b>	<b>Firms’ approaches to identification of MRTs</b>
United States	<p>Supervisory guidance applies to global consolidated operations of all US-headquartered banking organizations and to the US operations of foreign banking organizations.</p> <p>Supervisory action prioritized on large banks, including all US-headquartered banks that are internationally active</p>	<p>Supervisory guidance requires banks to have an adequate process for identifying on an ongoing basis “covered employees”: those receiving incentive compensation who have an ability, either alone or as a member of a group, to take or influence risk that is material to the bank or a business within the bank.</p> <p>Banks are expected to have features in their incentive compensation arrangements to promote balanced risk taking incentives, but the details of such features differ across roles and businesses.</p>	<p>De facto, largest banks have thousands of covered employees who are in many different roles and businesses.</p>

## Annex B: Status of national implementation

The table below provides a snapshot of the status of implementation 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 have been taken to implement the Principles and Standards (or elements thereof);<sup>20</sup> 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. The cells highlighted in grey indicate those areas where there have been updates since the 2011 peer review report.

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

	AR	AU	BR	CA	CN	FR	DE	HK	IN	ID	IT	JP	KR	MX	NL	RU	SA	SG	ZA	ES	CH	TR	UK	US
<i>Effective governance of compensation</i>																								
<b>P1</b>	R	R	R	S	S	R	R	S	R	R	R	S	S	R	R	S	R	R	R	R	R	S	R	R
<b>P2</b>	R	R	R	S	S	R	R	S	R	R	R	S	S	R	R	S	R	R	R	R	R	S	R	S
<b>S1</b>	R	R	R	S	S	R	R	S	R	S	R	S	S	R	R	S	R	R	R	R	R	S	R	R
<b>P3</b>	R	R	R	S	S	R	R	S	R	S	R	S	S	R	R	R	R	R	R	R	R	S	R	S
<b>S2</b>	R	R	R	S	S	R	R	S	R	S	R	S	S	R	R	S	R	R	R	R	R	S	R	S
<i>Effective alignment of compensation with prudent risk taking</i>																								
<b>P4</b>	R	R	R	S	S	R	R	S	R	IP	R	S	S	R	R	IP	R	R	R	R	R	S	R	S
<b>S3</b>	R	R	R	S	S	R	R	S	R	R	R	S	S	R	S	IP	R	R	R	R	R	S	R	R
<b>S4</b>	R	R	R	S	S	R	R	S	R	IP	R	S	S	R	R	IP	R	S	R	R	R	S	R	S
<b>P5</b>	R	R	R	S	S	R	R	S	R	IP	R	S	S	R	R	IP	R	R	R	R	R	S	R	S
<b>S5</b>	NA	R	R	S	S	R	R	S	R	IP	R	S	S	R	R	IP	R	S	R	R	R	S	R	S
<b>P6</b>	R	R	R	S	S	R	R	S	R	IP	R	S	S	R	R	IP	R	R	R	R	R	S	R	S

<sup>20</sup> 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.

	AR	AU	BR	CA	CN	FR	DE	HK	IN	ID	IT	JP	KR	MX	NL	RU	SA	SG	ZA	ES	CH	TR	UK	US	
S6	NA	S	R	S	S	R	R	S	R	IP	R	S	S	R	R	IP	R	S	R	R	R	S	R	S	
S7	NA	S	R	S	S	R	R	S	R	IP	R	S	S	R	R	IP	R	S	R	R	R	S	R	S	
P7	R	S	R	S	IP	R	R	S	R	IP	R	S	S	R	R	IP	R	R	R	R	R	S	R	S	
S8	NA	S	R	S	IP	R	R	S	R	IP	R	S	S	R	R	IP	R	S	R	R	R	S	R	S	
S9	NA	S	R	S	S	R	R	S	R	IP	R	S	S	R	R	IP	R	S	R	R	R	S	R	S	
S11	R	S	R	S	S	R	R	S	R	IP	R	S	S	R	R	IP	R	S	R	R	R	S	R	S	
S12	NA	S	R	S	S	R	R	S	NA	IP	R	S	S	R	R	IP	R	S	R	R	R	S	R	S	
S14	NA	S	NA	S	S	R	R	S	R	IP	R	S	S	R	R	IP	S	S	R	R	S	NA	R	S	
<b>Effective supervisory oversight and engagement by shareholders</b>																									
P8	R/IP	S	R	S	S	R	S	S	S	S	S	S	S	R	R	S	S	S	R	R	R	S	R	S	
S10	NA	NA	NA	S	S	R	R	R	R	R	R	R	S	R	R	R	R	R	UC	R	R	R	R	R	
S13	IP	S	R	S	S	R	R	S	R	IP	R	S	S	R	R	S	S	S	R	R	S	S	R	S	
S16	IP	S	R	S	S	R	S	S	S	S	S	S	S	R	R	S	S	S	R	R	S	S	R	S	
S17	IP	R	R	S	S	R	R	S	R	IP	S	S	S	R	R	S	S	S	R	R	R	S	R	S	
S18	IP	S	R	S	S	R	R	S	R	IP	S	S	S	R	R	S	R	S	S	R	R	S	R	S	
P9	R	R	R	S	S	R	R	S	R	R	R	R	S	R	R	R	R	R	R	R	R	R	S	R	R
S15	R	R	R	S	S	R	R	S	R	IP	R	R	S	R	R	R	R	R	R	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 C: 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
<b>Argentina</b>	Effective alignment with risk taking  Disclosure		5-10, 12-14, 16-18  (13 and 16-18 in process of implementation)	There is at present no implementation of Standards 5-10, 12 and 14 on effective alignment of compensation with prudent risk-taking and government intervention. According to the authorities, there are currently no significant problems with compensation and risk-taking in its domestic banking system. The authorities also state that domestic labour laws limit their capacity to act in this area.
<b>Australia</b>	Effective alignment with risk-taking		10	To date, Standard 10 has not been applicable as Australia has not bailed-out any financial institutions.  Australia's prudential standards on remuneration require that boards of regulated financial institutions retain the ability to adjust performance-based remuneration downwards (if necessary, to zero) to protect the financial soundness of the institution or to respond to unexpected circumstances. In addition, in case government intervention becomes necessary, APRA has the power to compel boards to take action to implement the requirements of the prudential standard.
<b>Brazil</b>	Effective alignment with risk-taking		10 and 14	To date, Standard 10 is not applicable as Brazil has not bailed-out any financial institutions.
<b>China</b>	Effective alignment with risk-taking	7	8	Currently, compensation is overwhelmingly paid in cash. China is considering increasing the use of long-term incentive plans with stock-linked instruments.

<b>Country</b>	<b>Gaps in governance, effective alignment with risk taking, or disclosure</b>	<b>Principle not yet implemented</b>	<b>Standard not yet implemented</b>	<b>Reason / additional information</b>
<b>India</b>	Effective alignment with risk taking		12	Final guidelines have already been issued, which are applicable to banks in the private sector and foreign banks operating in India from the financial year 2012-13. Standard 12 has not been implemented as any payment of compensation to whole-time directors and Chief Executive Officers during and after employment requires RBI approval on a case-by-case basis.
<b>Indonesia</b>	Effective alignment with risk-taking  Disclosure	9	4-14	These Standards are still under consideration.
<b>Russia</b>	Effective alignment with risk-taking		4-14	Law and regulation drafts on these Standards are under preparation.
<b>South Africa</b>			10 (under consideration)	South Africa is currently in the process of adopting a twin-peaks approach to its supervisory structure. Legislation is currently being developed to accommodate the above. Principle 10 could possibly be addressed in the above legislation.
<b>Switzerland</b>	Effective alignment with risk-taking		14	Even though there is no formal guidance, the Standard concerning no hedging in respect of remuneration is addressed by larger institutions through internal compliance processes. Adherence by larger institutions to this Standard can now be confirmed.
<b>Turkey</b>	Effective alignment with risk-taking		14	On June 9, 2011, Standards were adopted into the domestic framework with some flexibility in implementation.
<b>US</b>	Disclosure		15	US is in the process of preparing a rule related to Pillar 3 compensation disclosure guidance. Much of the information required by the BCBS guidance is already disclosed by major banks.

## Annex D: Summary of FSB Principles and Standards for Sound Compensation Practices

### a. Effective governance of compensation

<b>Principle 1.</b>	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.
<b>Principle 2.</b>	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.
<b>Standard 1.</b>	<p>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:</p> <ul style="list-style-type: none"> <li>▪ 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;</li> <li>▪ to that end, work closely with the firm's risk committee in the evaluation of the incentives created by the compensation system;</li> <li>▪ 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</li> <li>▪ 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.</li> </ul>
<b>Principle 3.</b>	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.
<b>Standard 2.</b>	<p>For employees in the risk and compliance function:</p> <ul style="list-style-type: none"> <li>▪ remuneration should be determined independently of other business areas and be adequate to attract qualified and experienced staff;</li> <li>▪ performance measures should be based principally on the achievement of the objectives of their functions.</li> </ul>

**b. Effective alignment of compensation with prudent risk-taking**

<b>Principle 4.</b>	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.
<b>Standard 3.</b>	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.
<b>Standard 4.</b>	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: <ul style="list-style-type: none"> <li>▪ the cost and quantity of capital required to support the risks taken;</li> <li>▪ the cost and quantity of the liquidity risk assumed in the conduct of business; and</li> <li>▪ consistency with the timing and likelihood of potential future revenues incorporated into current earnings.</li> </ul>
<b>Principle 5.</b>	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.
<b>Standard 5.</b>	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.
<b>Principle 6.</b>	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.
<b>Standard 6.</b>	For senior executives as well as other employees whose actions have a material impact on the risk exposure of the firm: <ul style="list-style-type: none"> <li>▪ 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;</li> <li>▪ a substantial portion of variable compensation, such as 40 to 60 percent, should be payable under deferral arrangements over a period of years; and</li> <li>▪ 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.</li> </ul>

<b>Standard 7.</b>	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.
<b>Principle 7.</b>	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.
<b>Standard 8.</b>	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.
<b>Standard 9.</b>	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.
<b>Standard 11.</b>	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.
<b>Standard 12.</b>	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.
<b>Standard 14.</b>	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**

<b>Principle 8.</b>	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.
<b>Standard 10.</b>	In the event of exceptional government intervention to stabilise or rescue the firm: <ul style="list-style-type: none"> <li>▪ supervisors should have the ability to restructure compensation in a manner aligned with sound risk management and long-term growth; and</li> </ul>

	<ul style="list-style-type: none"> <li>▪ compensation structures of the most highly compensated employees should be subject to independent review and approval.</li> </ul>
<b>Standard 13.</b>	Significant financial institutions should take the steps necessary to ensure immediate, prospective compliance with the FSB Standards and relevant supervisory measures.
<b>Standard 16.</b>	Supervisors should ensure the effective implementation of the FSB Principles and Standards in their respective jurisdiction.
<b>Standard 17.</b>	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.
<b>Standard 18.</b>	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.
<b>Standard 19.</b>	Supervisors need to coordinate internationally to ensure that these standards are implemented consistently across jurisdictions.
<b>Principle 9.</b>	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.
<b>Standard 15.</b>	<p>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:</p> <ul style="list-style-type: none"> <li>▪ the decision-making process used to determine the firm-wide compensation policy, including the composition and the mandate of the remuneration committee;</li> <li>▪ 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;</li> <li>▪ 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: <ul style="list-style-type: none"> <li>– amounts of remuneration for the financial year, split into fixed and variable compensation, and number of beneficiaries;</li> <li>– amounts and form of variable compensation, split into cash, shares and share-linked instruments and other;</li> <li>– amounts of outstanding deferred compensation, split into vested and unvested;</li> <li>– the amounts of deferred compensation awarded during the financial year, paid out and reduced through performance adjustments;</li> <li>– new sign-on and severance payments made during the financial year, and number of beneficiaries of such payments; and</li> <li>– the amounts of severance payments awarded during the financial year, number of beneficiaries, and highest such award to a single person.</li> </ul> </li> </ul>

## **Annex E: Questionnaire for FSB survey on implementation of the Principles and Standards**

This questionnaire is designed to collect information on actions and new initiatives by FSB member jurisdictions to fully implement the [FSB Principles for Sound Compensation Practices](#) and their [Implementation Standards](#) (see Annex D for a summary of the P&S). The information should primarily reflect developments since the [2011 thematic peer review](#) on this topic. CMCG members should not repeat the responses provided by their national authorities in last year's peer review, unless pertinent in providing context for any additional or updated information.

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

### **1. National framework for remuneration policies**

- 1.1 Since the completion of the 2011 peer review, has your jurisdiction's regulatory and supervisory priorities in implementing the P&S (e.g. in terms of specific objectives that are given higher priority) materially changed? If so, please describe the main changes.
- 1.2 Since the completion of the 2011 peer review, what new legislation or regulatory or supervisory guidance has been issued to implement the P&S? Please include (if available in English) a weblink or attach a copy of the relevant legislation, regulatory rule, or supervisory guidance.
- 1.3 What are your plans for taking forward the implementation of the P&S, e.g. in terms of additional legislation, regulatory or supervisory guidance in 2012 or beyond? Please elaborate.
- 1.4 Please revise Annex B of the questionnaire, which shows the status of national implementation of the P&S as at the time of the October 2011 peer review, so as to reflect any subsequent changes to national regulatory and supervisory frameworks. For those P&S that were designated as "initiatives under preparation (IP)" or "initiatives under consideration (UC)" in Annex B, please indicate the steps taken or planned to implement them since the October 2011 peer review.
- 1.5 Please revise Annex C of the questionnaire, which shows the remaining gaps in national implementation at the time of the October 2011 peer review, so as to reflect any subsequent actions taken to address these gaps and other relevant developments.
- 1.6 Please indicate the scope of application of the FSB P&S in your jurisdiction. Do the P&S apply only to significant financial institutions? How do you define significant financial institutions and do these also include non-bank financial institutions (e.g. insurers)?

1.7 If applicable, please indicate the specific criteria in national regulation or supervisory guidance that support the application of the principle of proportionality.

1.7.1 *If the institutions are classified into different categories for the purposes of applying the P&S, please indicate the buckets, the criteria to allocate the institutions to those buckets, and how the P&S apply to the institutions in the different buckets.*

1.7.2 *If the principle of proportionality also applies to employees within the firm (e.g. if the P&S are applied differently to different categories of employees, e.g. to material risk takers), please describe the specific criteria in regulation and supervisory guidance supporting the principle.*

## **2. Supervisory monitoring of implementation / enforcement**

2.1 Have any material supervisory actions taken place since the 2011 peer review to monitor implementation of the regulatory or supervisory guidance on the P&S? What new material information (e.g. via supervisory reviews) has been collected on firms' remuneration policies and practices? Have supervisors taken any enforcement action against firms for not implementing the P&S? If so, please briefly describe the nature of findings and supervisory actions taken.

2.2 As indicated in Recommendations 5 and 6 of the October 2011 peer review report, what steps have been taken in your jurisdiction to ensure that all financial institutions deemed significant for the purposes of the P&S:

- Align their practices with the key requirements in the area of effective governance of compensation (particularly the independence and expertise of the institution's remuneration committee, the independence of risk and compliance functions in the compensation process etc.); and
- Comply with the Basel Committee's Pillar 3 disclosure requirements for remuneration from 1st January 2012?

2.3 Please describe any further supervisory actions planned for 2012 or beyond.

## **3. Overall assessment of the level of implementation by firms**

3.1 Please indicate, in a prioritized way, major gaps or areas of difficulty in implementing the FSB P&S for significant financial institutions in your jurisdiction in each of the following areas: a) effective governance of compensation, b) ex ante risk adjustment; c) alignment of compensation with performance; d) compensation structures and ex post performance adjustment; e) disclosure; and f) other features of compensation systems. Where applicable, please describe actions taken or planned to address the gaps or areas of difficulty, either by national authorities or third parties (e.g. industry groups).

- 3.2 Please describe the approaches taken by firms to the definition of material risk takers (MRTs). If the definition of MRTs is given in national regulation or supervisory guidance, please indicate that definition.
- 3.3 Please describe unintended consequences (if any) from the implementation of the P&S in your jurisdiction, i.e. shifts in firms' behaviour and practices that could run against the objective of providing prudent risk taking incentives.

#### **4. Supervisory cooperation**

- 4.1 The October 2011 peer review report noted that supervisory cooperation - via supervisory colleges or other networks - in the area of compensation practices should be stepped up (see Recommendation 4). Please provide an update on progress in this area, as it relates to any bilateral or multilateral supervisory networks that you participate.

#### **5. Preparations for the bilateral complaint handling process**

- 5.1 What steps have you taken and/or intend to take in order to prepare for the bilateral complaint handling process? In particular, which modalities for communication to the relevant firms and industry groups operating in your jurisdiction do you intend to adopt?
- 5.2 What are your expectations regarding the number and nature of complaints that may be received from firms in your jurisdiction?