29 August 2017

Financial Stability Board
Centralbahnplatz 2
CH-4002 Basel
Switzerland

Via email: fsb@fsb.org

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

Dear Sir or Madam

Please find below the Global Financial Markets Association's (GFMA's) response to the FSB consultation on Supplementary Guidance to the FSB Principles and Standards on Sound Compensation Practices. If you require any further information, please do not hesitate to contact us.

Sincerely,

Allison Parent
Executive Director
GFMA

Consultation response

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

29 August 2017

The Global Financial Markets Association[1] welcomes the opportunity to comment on the **Supplementary Guidance to the FSB Principles and Standards on Sound Compensation Practices** ("the Guidance").

We summarise below our high-level response to the consultation, which is followed by answers to the individual questions raised.

Executive Summary

- We fully support measures to improve compensation practices and align them with risk management and misconduct policies.
- The use of high-level principles in the Guidance is appropriate, allowing them to be used by a broad spectrum of market participants.
- Firms should have the flexibility to use a range of tools to adjust compensation to address misconduct risk.

Questions

Question 1: Should the Guidance be more specific with regard to the respective roles of the board or that of senior managers with regard to compensation and misconduct?

GFMA supports the use of high-level principles in this Guidance, rather than specific provisions on the role of the board and senior management. Corporate structures across FSB member jurisdictions can vary widely, and use of principles avoids a "one-size-fits-all" approach, permitting diversity of incentive compensation practices among financial institutions. The principles-based approach is also necessary to ensure that boards are not overloaded with excessively granular requirements that detract from other important responsibilities (including corporate strategy, economic risk management and talent development) or that blur the line between supervisory and management activities.

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[1] The Global Financial Markets Association (GFMA) brings together three of the world's leading financial trade associations to address the increasingly important global regulatory agenda and to promote coordinated advocacy efforts. The Association for Financial Markets in Europe (AFME) in London and Brussels, the Asia Securities Industry & Financial Markets Association (ASIFMA) in Hong Kong and the Securities Industry and Financial Markets Association (SIFMA) in New York and Washington are, respectively, the European, Asian and North American members of GFMA. For more information, visit http://www.gfma.org.

As such, we suggest inclusion of language that clarifies that, in a group (e.g. parent/subsidiary entities) structure, it is appropriate for the board or senior management of a subsidiary entity to be responsible for compensation decisions and oversight related to that subsidiary, and that those determinations are not necessarily for the parent-level board or senior management. This is particularly key for larger and/or multinational firms, where the implementation of the Guidance needs to be reflective of diverse corporate structures and proportionate, allowing the flexibility to address items of regional or local-entity level significance at a regional level

We have some additional technical points that we wish to raise:

As noted in the introduction to the 2009 Principles[2], compensation "must work in concert with other management tools in pursuit of prudent risk taking". We suggest that this could be expanded upon in the Guidance to recognise that compensation adjustments on their own may not always be the most effective and/or appropriate actions to address misconduct.

Point 2 of the Guidance (page 6) suggests "adequate involvement by control functions in compensation design and decision-making". While we recognise the value in having control functions involved in compensation design and decision-making, we believe that management should bear ultimate accountability for ensuring that the risk-balancing features of compensation programs are appropriately utilised to negatively impact the compensation of employees in instances of misconduct.

The Guidance states in Point 3 (page 6) that boards should hold senior management accountable for implementing "a compensation system that effectively identifies, prevents and remediates any unacceptable behaviour through the use of compensation tools and other mechanisms." However, we do not believe that compensation systems or arrangements can be used effectively to *identify* misconduct risk *a priori*. Rather, compensation systems and arrangements can be designed to mitigate misconduct risk and to deter misconduct through negative adjustments to compensation. We suggest that the wording is amended accordingly.

<u>Question 2: The Guidance suggests that qualitative, non-financial assessments should have a direct impact on compensation and that they are important in determining how to align compensation with risk. Would additional guidance be helpful? Please provide data if your firm uses such provisions including the types of metrics used, and a discussion of any challenges you face in their use.</u>

While we believe that Guidance provided on qualitative, non-financial assessments is generally sufficient and does not require further granularity, we believe the Guidance should clarify that formulaic weighting of qualitative, non-financial metrics is not required.

The Guidance also states that "[t]o be effective, compensation adjustments for misconduct should be considered within the context of performance management systems that take into account the full range of financial and non-financial incentives over the life cycle of employment (e.g. as part of hiring, performance review, promotion, succession planning and talent development strategies)." We seek clarification on how this would be implemented. For example, compensation adjustments are not relevant to hiring.

As associations, we are unable to provide data on use of such provisions within individual firms.

<u>Question 3: The Guidance identifies three tools most commonly used to address misconduct: in-year adjustment (adjustment to the current year's variable compensation before it is awarded); malus (reduction of deferred compensation before it has vested or fully transferred); and clawback, which</u>

[2] http://www.fsb.org/wp-content/uploads/r_0904b.pdf

permits recovery of variable compensation that has already been paid and vested. Given the particular characteristics of misconduct risk, do you believe that all three tools need to be available to a firm to establish appropriate incentives to deter misconduct?

GFMA believes that it is beneficial for firms to have at their disposal a range of compensation tools to address misconduct. This allows firms to adjust compensation both before and after it has been awarded, and extends the opportunity until well after the individual in question has left the firm. However, *requiring* the use of any one of the three common tools is not appropriate and firms should have maximum flexibility in this regard.

Question 4: The Guidance suggests minimum scenarios where adjustment of compensation should occur. Are there additional circumstances in which adjustments to compensation should be expected? What are the advantages and disadvantages of suggesting such minimum conditions? In particular, is there evidence from past use of such tools that might be instructive in how to formulate such scenarios?

We do not have any additions to the minimum scenarios noted in the Guidance. But, as noted earlier, we support principles-based guidance, rather than specific provisions indicating when compensation reviews should occur, to give firms flexibility to design and enforce risk-balanced compensation arrangements.

Question 5: How much variable compensation should be placed at risk of adjustment in order to effectively impact incentives for excessive risk-taking or other inappropriate conduct?

We note that this question only refers to variable compensation, whereas the Guidance considers compensation more broadly.

GFMA believes that it should be up to each individual firm to determine what proportion of variable compensation should be placed at risk. Any examples of circumstances where an individual's variable compensation may be adjusted down to zero should therefore not be prescriptive. This is in line with the statement in the Guidance that use of compensation tools should "take into account all relevant indicators of the severity of impact".

Question 6: Does the Guidance adequately cover compensation incentives that may be relevant to addressing misconduct risk in all sectors of the financial industry? Are there additional specific provisions that should be considered to better address misconduct risks in particular financial sectors? Are there specific provisions in the guidance that may not be relevant to a particular financial sector?

GFMA supports the use of high-level principles in this Guidance and, as such, we suggest that the final Guidance clarify that the list of specific criteria to be considered when determining accountability (section 2.2.2 of the Consultation) is non-exhaustive.

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