30 August 2017

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

General Comments

GFIA appreciates the opportunity to submit these comments to the FSB.

Overall, the supplementary guidance is well structured, but despite not setting new Principles and Standards, it seems to link existing and well established supervisory principles on compensation with market conduct (in Section 3). Market conduct is defined and GFIA would suggest it simply means member compliance with applicable jurisdictional standards. Companies, of course, may wish to achieve higher standards and gear their compensation practices accordingly.

This supplementary guidance, in its prescriptiveness and design (spanning two areas of regulation), runs the risk of introducing new requirements for supervisors and/or supervised entities. Whatever the value of this voluntary guidance to companies, it should not be made mandatory as it is too prescriptive. In any event, GFIA is not of the view that most supervisors have sufficient knowledge, experience, or resources to apply these guidelines as mandates. Therefore, although GFIA agrees with the statement immediately after the box with 8. on page 12 that: "Supervisors should, with due regard to supervisory authority, proportionality, and risk-based analysis", overall, GFIA is of the view that Section 3 should be deleted.

Questions from the paper

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?

The existing language is sufficient and GFIA sees no need for additional guidance.

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.

The existing language is sufficient and GFIA sees no need for additional guidance.

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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 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?

Firms should be able to be flexible in choosing governance tools that address the firm's individual misconduct risk appropriately. The question is not entirely clear, as the reference to "the particular characteristics of misconduct risk" seems to contradict the supplementary guidance itself, which states that "misconduct risk should be defined by the board and senior management based on the firm's characteristics and business…" (page 8, first bullet point) – i.e. that there are no "particular characteristics" to be associated with conduct risk in general. The law should certainly not forbid the use of any of the listed tools and as such, all three should be available to firms. Furthermore, it should be left to the firm and its individual assessment of its misconduct risk as to what tools should be used, when, and to what extent.

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?

No to all 3 questions. There are no additional circumstances in which adjustments to compensation should be expected, and GFIA does not consider there is evidence from past use of tools that might be instructive. Any examples would likely vary significantly by sector and business model (banking vs insurance, commercial vs consumer). As the FSB guidance is cross-sectoral, GFIA would suggest that examples and minimum scenarios are too prescriptive and will likely not be applicable to all sectors.

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?

There is no one-size-fits-all solution on how much variable compensation should be placed at risk of adjustment in order to properly manage misconduct risk. Variable compensation may be dependent on a number of factors by design, and a general ratio of how much would need to be at risk of adjustment to avoid misconduct is therefore unlikely to be appropriate for all variable compensation. The FSB should refrain from making any attempt of quantifying an amount in that regard.

It should further be clarified that the full amount of all variable compensation does not need to be covered by one or more of the three tools listed in the supplementary guidance. This is confirmed from the background section of the consultation document, where on page 4 and 5 it says that "…these tools *should* include in-year adjustment and malus or clawback for all variable compensation."

GFIA would suggest that it would be sufficient to say that the payment of *a substantial portion of the variable remuneration component*, shall contain a flexible (e.g. deferred) component that takes account of the nature and time horizon of the firm's business.

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?

GFIA is of the view that additional guidance for the insurance sector is not warranted, considering the good practices of insurers, existing guidelines and jurisdictional standards, regulation and supervision. Beyond general principles in guidelines, companies should set their own compensation practices reflecting their goals, business model and need to protect their own reputation.

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