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From: Prof. Alexander Kostyuk, Executive Director,
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Date: 15 December, 2010

To: Secretariat of the Basel Committee on Banking Supervision,
Bank for International Settlements, CH-4002 Basel, Switzerland

Subject: Comments to the Consultative Document
Range of Methodologies for Risk and Performance Alignment of Remuneration

Dear Sir/Madam.

I enclose our comments to your Consultative Document "Range of Methodologies for Risk and Performance Alignment of Remuneration". These comments have been prepared by the team of researchers at the International Research Center of Banking & Corporate Governance at Ukrainian Academy of Banking of the National Bank of Ukraine (Ukraine) consisting of Prof. Alexander Kostyuk, Mr. Dmitry Govorun and Mr. Yuri Galich. We hope that the comments would be taken into consideration when approving the final Paper. Your feedback would be appreciated by us.

With the best regards,
Prof. Alexander Kostyuk

RANGE OF METHODOLOGIES FOR RISK AND PERFORMANCE ALIGNMENT OF REMUNERATION - CONSULTATIVE PAPER: COMMENTS

Well, in general the Range of Methodologies for Risk and Performance Alignment of Remuneration issued by Basel Committee on Banking Supervision is well structured and covers all the main points, which should under consideration while discussing remuneration.

There are some things which are **not considered in the document and problem should be raised**. They are as follows:

- 1.** From my point of view the first incomplete work becomes evident in the **issue 1.5.2**, which is named “Proportionality between institutions”. The trough of the meter is that **the list of the factors** which should be taken into account when considering proportionality **is not complete** enough.

Recommendations:

Actually, we found it imperative to work out the list of the factors more carefully and include into list such factors as **Background of the institution; Reputation of the institution** and **Specialization of the bank** (in terms of business sphere it operates and clients it services).

All these factors and three factors which are considered in the document (size and complexity of the institution, business models, and risk tolerance) will help to create clearer vision on proportionality between institutions. It'll help to make a complex analysis as well.

- 2.** The next drawback is in the **issue 2.1.1 (points 92-93)**. Text of these two points is not argumentative. It lacks of figures. In fact absolute performance measures and relative performance measures are considered. There is no evidence to right about measures without exact figures of benchmarks.

Recommendations:

No need to expend the text in the point or somehow specify. Almost everything is clear. The only thing to do is **to add the list of benchmarks**, which institutions

should use for comparing its own relative performance measures. In case such list is created there is a necessity to append it to the issue. In case there is no list of benchmarks it should be worked out ASAP and appended. Such improve will make using the document easier and more effective.

3. Next drawback is in the **issue 2.3.3** which is about Allocation (it means the mechanism used for distributing a bonus pool to employees). The main point of the problem is in **absence of criteria** which **will bind employers** to use one or another scheme of allocation. It means that at this stage they can choose scheme of distributing at discretion. In capitalistic society it is unacceptably. In other words employer always chooses such allocation in which employees are out of the mechanism of distributing. Or their role is minimizing. It'll certainly break the balance in distributing a bonus pool.

4. From our point of view document has a problem in **issue 2.3.1 (points 118-119)**. There are two approaches to the award process in banks which are considered in the document. Each of the approach could be used separately or in complex. We think there is **no necessity to include Bottom-up approach, as a separate one** and describe the mechanism of its implementing. Top-down approach is much effective because of its considering firm's overall performance. Bottom-up approach doesn't consider it but only single employee level. It is impossible in the organization – not to consider firm's overall performance.

Recommendations:

It is imperative just to improve Top-down approach by including some elements from another approach, but the basis of the award process should remain firm's overall performance. It is not done to implement approach which takes into account only single employee level. Such approach doesn't make employees interested in company's successful and effective performance. People simply loose one of the most important motives for developing the company.