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TRADE UNION SUBMISSION
TO THE BASEL COMMITTEE ON BANKING SUPERVISION

CONSULTATIVE DOCUMENT ON PILLAR 3 DISCLOSURE REQUIREMENTS FOR REMUNERATION

25 FEBRUARY 2011

General comments

1 We welcome the opportunity to submit written comments on the consultative document by the Basel Committee on Banking Supervision on a proposal of disclosure requirements for remuneration under Pillar 3 of the Basel prudential framework[1]. For trade unions, binding regulatory reforms are the principal response to the irresponsible growth in bankers' and traders' pay in the past decade. At the same time we recognise the important complementary role that market discipline and long term responsible shareholders can play. Transparency is needed and the Consultative document is a step in the right direction. We believe however that the disclosure requirements could be enhanced and improved in a number of areas so as to empower the banks' key stakeholders, including shareholders and workers, and help them to make informed choices with respect to the company in which they invest. More specifically, our comments and proposals of amendment are driven by the following concerns.

Alignment with relevant standards and principles

2 The consultative document draws extensively, and for a cause, on the Financial Stability Board Principles for Sound Compensa-

1 http://www.bis.org/publ/bcbs191.htm

About ITUC, TUAC & UNI

The International Trade Union Confederation (ITUC, www.ituc-csi.org) is the main international trade union organisation, representing the interests of working people worldwide. It has 301 affiliated member organisations in 151 countries and territories, with a total membership of 177 million workers.

UNI Global Union (www.uniglobalunion.org) provides a voice and a platform for workers at the international level in the service sector. With 20 million workers in 900 unions worldwide UNI fosters international solidarity and provides a voice at the international level for all its members.

The Trade Union Advisory Committee (TUAC, www.tuac.org) to the OECD is an interface for trade unions with the OECD. TUAC's affiliates consist of over 58 national trade union centres in the 34 OECD industrialised countries which together represent some 66 million workers.

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tion Practices issued in April 2009[2] (hereafter the FSB Principles), their Implementation Standards of September 2009[3] (hereafter the FSB Implementation Standards) as well as on a recent paper by the BIS: "Range of Methodologies for Risk and Performance Alignment of Remuneration, October 2010[4] (hereafter the BIS Issues Paper). It is also in line with the Committee of European Banking Supervisors' Specific and General Requirements on Disclosure issued in December 2010[5] (hereafter the CEBS Requirements). There are key features of the above guidance documents that are not dealt with in the current consultative paper however and that accordingly should be introduced in the text.

3 Similarly, the text could usefully be amended to take account of recent OECD guidance on corporate governance, such as the Conclusions and emerging good practices to enhance implementation of the OECD Principles of Corporate Governance issued in February 2010[6] (hereafter the "OECD Principles").

Coverage of pension schemes and company-wide remuneration policy

4 Neither the FSB Principles and Implementation Standards nor the current consultative document make explicit reference to the pension retirement schemes that benefit executive officers and other key risk takers of banks. This is regretful because pension packages represent an important element in the total remuneration of corporate executives. When badly designed they pose the same problem of asymmetric alignment between risk and performance than other sources of compensation and hence would also be of value for the banks' shareholders and workers. According to the AFL-CIO, pension packages represent a growing part of the total remuneration of the CEOs of the S&P 500[7]. Retirement schemes are acknowledged in the CEBS Requirements, but they are not in the BIS proposal.

5 The consultative document and the related FSB instruments are focused on top management, other 'risk takers' (such as traders) and on control officers. Other category of the workforce however

2 http://www.financialstabilityboard.org/publications/r_0904b.pdf

3 http://www.financialstabilityboard.org/publications/r_090925c.pdf

4 http://www.bis.org/publ/bcbs178.pdf

5 http://www.eba.europa.eu/cebs/media/Publications/Standards%20and%20Guidelines/2010/Remuneration/Guidelines.pdf

6 http://www.oecd.org/dataoecd/53/62/44679170.pdf

7 Although average total compensation for these CEOs (USD9.247m) "declined" 9 percent from the previous year, executive retirement benefits increased 23 percent http://www.aflcio.org/corporatewatch/paywatch/pay/index.cfm

should be included. Incentive plans benefiting lower-paid category of workers may have marginal impact on the company-wide risk profile on an individual basis but not collectively. Badly designed incentives targeted at sales staff of retail credit products for example can create company- if not systemic-wide risks, as acknowledged by the OECD Good Practices on Financial Education and Awareness Relating to Credit of May 2009[8].

Expanding quantitative disclosure to measure concentration

6 The current proposal on quantitative disclosures does not sufficiently inform on the level of concentration of remuneration within the banks' top management and risk takers. This is crucial information for shareholders and for workers in evaluating, among others, reputation risks arising from excessive concentration as well as the distribution of risks and rewards within the company.

Proposals of amendments

7 Based on the above remarks, the following outlines our proposals of amendment to specific parts of the consultative document (inbox text). These are followed by brief explanations.

Section (a)

Marked-up proposal

"(a) Information relating to the bodies that oversee remuneration. Disclosures should include:

- Name, composition and mandate of the main body overseeing remuneration.
- <u>Proportion of members that are considered as independent and criteria for defining independence.</u>
- External consultants whose advice has been sought, the body by which they were commissioned, and in what areas.
- <u>Provision of other services delivered to the benefit of the bank by members of the bodies overseeing remuneration and by external consultants.</u>
- Scope of the bank's remuneration policy (eg by regions, business lines, entities).
- Applicability of the bank's remuneration policy to foreign subsidiaries and branches.

8 http://www.oecd.org/dataoecd/52/3/46193051.pdf

- Types of employees considered as material risk takers.
- Whether a remuneration report is disclosed to shareholders and whether procedures are in place to enable shareholders to express their opinions on the report"

8 Disclosure should include reference to the independence of members of the remuneration committee (and other bodies overseeing remuneration) in line with FSB Principle 1[9], FSB Implementation Standard 1[10] and the OECD Conclusions[11].

9 It should further include disclosure of any situation of conflict of interest that may threaten the independence of external consultants and whether a remuneration report is disclosed to shareholders in line with OECD Conclusions[12].

Section (b)

Marked-up proposal

"(b) Information relating to the design and structure of remuneration processes.

Disclosures should include:

- Key features and objectives of remuneration policy.
- 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.
- Frequency of review, date of last review, significant changes made at last review.
- Any exceptional intervention by supervisory authorities with regard to the remuneration system and policy of the bank.
- How the bank ensures that risk and compliance employees are remunerated independently of the businesses they oversee and are based principally on the achievement of the objectives of their functions.

9 "relevant board members and employees [involved in the compensation system] must have independence and expertise in risk management and compensation"

10 "The remuneration committee should be constituted in a way that enables it to exercise competent and independent judgment".

11 "it is considered good practice to give a significant role to non-executive independent board members in the [remuneration] process".

12 The role of remuneration consultants, "including other work for the company, should be disclosed in a remuneration report. Boards need to ensure their continued independence by prohibiting or limiting the contemporaneous provision of other remuneration services and by requiring them to adhere to a code of conduct" & "Their remuneration should be decided through a transparent and robust process that is disclosed in the remuneration report to shareholders" & "it can be considered good practice that remuneration policies and implementation measures are submitted to the annual meeting and that there are procedures that enable shareholders to express their opinions".

- Whether risk and compliance employees are able to report directly to the highest governing body, its audit committee or equivalent "

10 Disclosure of the remuneration of the risk and compliance officers should include reference to performance measures in line with the FSB Implementation Standard 2[13]. Their access to the board – and in particular whether they have the right to report directly to the board – should be disclosed in line with the OECD Conclusions[14].

11 It should also include reporting on compliance with key standards as called for in the FSB Implementation Standard 1[15] as well as on any exceptional supervisory intervention in the bank to restructure compensation and/or to impose higher capital charges in line with FSB Implementation Standards 10[16] and 18[17].

Section (c)

Marked-up proposal

"(c) Description of the measures used to take account of current and future risks in their remuneration processes, and how these measures complement or are linked to the bank's overall risk management framework. Disclosures should include:

- Key risks that the bank takes into account when implementing remuneration measures for senior management, other material risk takers, and other workforce which incentives programmes are individually insignificant but which, taken together, can create company-wide risks.
- Measures used to take account of these risks, including difficult to-measure risks such as liquidity risk, reputation risk and cost of capital.

13 "For employees in the risk and compliance function [...] performance measures should be based principally on the achievement of the objectives of their functions."

14 "It is considered good practice that risk-management and control functions are independent of profit centres and the "chief risk officer" or equivalent should be able to report directly to the Board along the lines already advocated in the OECD Principles for internal control functions reporting to the audit committee or equivalent"

15 "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"

16 "In the event of exceptional government intervention to stabilise or rescue the firm: supervisors should have the ability to restructure compensation in a manner aligned with sound risk management and long-term growth; and compensation structures of the most highly compensated employees should be subject to independent review and approval."

17 "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."

- Ways in which these measures affect remuneration.
- How these measures have changed over the past three years, and reason(s) for change, as well as the impact of changes on remuneration.
- A discussion of how these measures complement or are linked to the bank's overall risk management framework."

12 The text should refer explicitly to the main sources risk as noted by FSB Principle 4[18] and FSB Implementation Standard 4[19], and to the impact on the banks' capital base in accordance with FSB Implementation Standard 3[20].

13 The discussion on risk-adjusted remuneration policies should be expanded beyond the realm of senior management, traders and risk control officers to include other parts of the workforce, which incentive plans may have marginal impact individually, but not collectively. As noted in the FSB Principles "Large numbers of lower-level employees with inappropriate incentives can take actions that are individually insignificant but that, taken together, can harm the firm". This view is further supported by the BIS Issues paper[21] as well as by the above-mentioned OECD Good Practices with regard to the sales staff of credit-related products[22].

18 "Risk adjustments should account for all types of risk, including difficult to-measure risks such as liquidity risk, reputation risk and cost of capital"

19 "For significant financial institutions, the size of the variable compensation pool and its allocation within the firm should take into account the full range of current and potential risks, and in particular: the cost and quantity of capital required to support the risks taken; the cost and quantity of the liquidity risk assumed in the conduct of business; and consistency with the timing and likelihood of potential future revenues incorporated into current earnings"

20 "Significant financial institutions should ensure that total variable compensation does not limit their ability to strengthen their capital base"

21 Para 68 "Even though these persons may not pose a risk to the financial soundness of an institution on an individual basis, they can present a material risk on a collective basis. Indeed, relatively low paid staff may pose just as great a threat to prudent risk management, for example where the business line is organised on a commission basis or where profit generation is the key performance metric, without any offsetting risk mitigation requirements. Financial institutions need to have in place policies and procedures to identify such arrangements, as well as control procedures to reduce and mitigate the risks arising from them."

22 para 27 "Sales staff or agents should be adequately qualified and trained in this respect, and their remuneration and incentive structure should be designed accordingly. This should particularly apply to complex credit products, products that carry higher inherent risks for consumers (such as variable interest rates, foreign currency loans, etc), products involving long-term commitments, or commitments which represent a substantial proportion of current and future income or which feature important penalty clauses in case of payment default or contract termination by the consumer."

Section (d)

Marked-up proposal

"(d) Description of the ways in which the bank seeks to link performance during a performance measurement period with levels of remuneration. Disclosures should include:

- Main performance metrics for bank and top-level business lines, in particular the profit or income components used in making decisions on variable remuneration.
- Main performance metrics for individuals (scorecard/ other).
- A discussion of how individual remuneration has been tied to bank-wide and individual performance.
- What measures the bank will implement to adjust remuneration in the event that performance metrics are weak.
- <u>Whether employees are allowed to use personal hedging strategies or compensation- and liability-related insurance scheme to offset the downside risks."</u>

14 In line with FSB implementation standard 14[23] disclosure should inform on whether employees are allowed to hedge the downside risks associated with their incentive remuneration schemes and hence create asymmetric alignment between risk and performance.

Section (e)

Marked-up proposal

"(e) Description of the ways in which the bank seek to adjust remuneration to take account of longer-term performance. Disclosures should include:

- Bank's policy on deferral and vesting of variable remuneration, <u>including with respect to the FSB 40% minimum ratio of deferred payments in total compensation (60% for senior management) and to the FSB minimum 3-three year deferral period.</u>
- Bank's policy and criteria for adjusting deferred remuneration before vesting and (if permitted by national law) after vesting through clawback arrangements."

23 "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."

15 Disclosure should be broadened to include reference to the 40% and 60% thresholds in considering the desirable proportion of deferred payments in the total variable compensation as advocated by the FSB Implementation Standard 6[24] and to the minimum deferral period of three years in line with FSB Implementation Standard 7[25].

Section (f)

Marked-up proposal

"(f) Description of the different forms of variable remuneration that the bank utilises and the rationale for using these different forms. Disclosures should include:

- Forms of variable remuneration offered (eg cash, equity, options, long-term incentive plans)
- <u>Forms of retirement schemes offered and differences in design with other retirement schemes covering the bank's workforce</u>.
- Discussion of the parameters used to allocate cash vs equity (or equity-type) remuneration for different staff categories.
- Discussion of the parameters used to allocate fixed/ variable remuneration for different staff categories.
- Discussion of the parameters used to allocate deferred/non-deferred remuneration for different staff categories."

16 As noted in our general comments, retirement schemes constitute an important component of the total remuneration of senior management and other top executive officers, and should be referenced explicitly in the disclosure requirements.

Footnote 3

Marked-up proposal

- "3 Quantitative disclosures should be broken down between (a) senior management, (b) other material risk takers, and (c) financial and risk control staff. The definitions should be disclosed. <u>The perimeter should include employees as well other persons carrying out these activities on behalf of the company."</u>

24 "a substantial portion of variable compensation, such as 40 to 60 percent, should be payable under deferral arrangements over a period of years; and these proportions should increase significantly along with the level of seniority and/or responsibility. For the most senior management and the most highly paid employees, the percentage of variable compensation that is deferred should be substantially higher, for instance above 60 percent."

25 "The deferral period described above should not be less than three years"

[17] The term "employee" – which is used throughout the quantitative disclosure sections – refers to a contractual relationship between a worker and an employer that is regulated by labour law. This may be not be the only form of relationship in the banking sector. Hence we suggest broadening the disclosure requirement so as to ensure that the perimeter is not unduly restricted by any legal implications the term "employee" may have in different jurisdictions.

Section (i)

Marked-up proposal

(i)

- Total bankwide remuneration for the financial year, broken down into fixed and variable components (including cash, equity, options, long-term incentive plans) and retirement schemes.
- Total number of employees receiving a variable remuneration covered by the risk adjustment process.
- Share of the 10% highest paid employees in the total bank-wide remuneration.
- Number, median, share of top 10% and total amount of guaranteed bonuses paid during the financial year broken down into one-year and multi-year guaranteed bonuses.
- Number, median, share of top 10% and total amount of sign-on awards paid during the financial year.
- Number, median, share of top 10% and total amount of severance payments made during the financial year.
- Number, median, share of top 10% and total amount of remuneration's adjustments performed during the financial year to reflect weak performance metrics (ie corresponding to the measures referred to in item (d) above)."

Section (k)

Marked-up proposal

"(k) Breakdown of total value, median and share of top 10% of remuneration awards for the financial year to show:

- fixed and variable.
- deferred (broken down into deferral periods below and above 3 years) and non-deferred.
- different forms used (cash, equity, other , including retirement schemes).

Example for reporting in Table A (Annex).

Breakdown of total value, median and share of top 10% remuneration expenses for the financial year to show:

- awards relating to current year.
- awards relating to prior years.

Example for reporting in Table B (Annex)."

18 As noted above disclosures should include retirement schemes, deferral periods below 3 years and should provide with a measurement of the level of concentration of remuneration within the bank – in our amendments we suggest disclosure the top 10%. Disclosure should also distinguish between one-year and multi-year guaranteed bonuses in line with FSB Implementation standard 11[26].

26 "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."

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