POSITION PAPER

ESBG Response to

CEBS consultation on its

Draft high-level principles of Remuneration Policies (CP23)

April 2009

ESBG

General comments

The European Savings Banks Group (ESBG) welcomes the opportunity to comment on the consultative document issued by the Committee of European Banking Supervisors (CEBS) entitled 'Draft high-level principles of Remuneration Policies'.

The ESBG agrees that it is particularly important that compensation incentives within an institution should be supporting long-term, firm-wide profitability. In the light of the current crisis, it appears that both, the level and the structure of remuneration may be factors that could encourage short-termism and induce high risk-taking to the disadvantage of a firm's long-term interests and of other stakeholders.

The ESBG fully supports the view that firms need to pay close attention to the alignment of compensation incentives with the long term interests of the whole firm. At the same time, the ESBG would like to underline that while inappropriate compensation policies have played a role during the current crisis, they were by far less relevant than other factors. Therefore the ESBG calls for the policy response to reflect this relative importance of reforming compensation policies in the light of the broader policy and regulatory review currently undertaken in response to the crisis. We consider that it is essential to be pragmatic and realistic about the impact of remuneration policies on improving risk assessment and behaviour.

The ESBG believes that an approach focusing on an overall reform of remuneration policy, as proposed by CEBS, risks diverting attention from the fact that only some parts of remuneration policy concerning specific categories of staff, specifically high bonuses paid to top executives and some traders, are at the core of concerns as regards inappropriate compensation incentives. Furthermore such a broad-brush approach would be unfair towards the largest part of the staff of financial institutions, who cannot be blamed altogether. Policy and regulatory reactions targeting remuneration issues should specifically focus on inappropriate compensation incentives.

We agree with CEBS that "the responsibility for the policy rests ultimately with the institutions themselves and, where applicable, the shareholders". Therefore, we consider that the principles of contractual freedom and of non-interference in the determination of the amount and structure of remuneration must be preserved. In our view, CEBS should also acknowledge the interference of the application of the proposed principles with national labour legislation and regulations. Furthermore, we would like to point to the fact that the EC Treaty does not establish Community competencies as regards the determination and level of remuneration (Article 137 EC Treaty).

Overall firm remuneration policies are very institution-specific and should constitute the remit of self-regulation by the industry. Therefore, the ESBG welcomes that CEBS opted for a high-level principles-based approach. Moreover, considering the number of non-EU firms operating in the internal market, it is crucial that such high-level principles are adopted on a global level.

Last, but not least, the ESBG believes that compliance with the principles on remuneration should be addressed by supervisors exclusively under Pillar 2, within the supervisory review and evaluation process. Thus, it would be welcomed if this were made more explicit when describing the scope of CEBS' high-level principles.

Comments to the proposed principles

i. The financial institution should adopt an overall remuneration policy that is in line with its business strategy and risk tolerance, objectives, values and long-term interests. It should not encourage excessive risk-taking. The remuneration policy should cover the institution as a whole and contain specific arrangements that take into account the respective roles of senior management, risk takers and control functions. Control functions should also be adequately rewarded to attract skilled individuals.

The framework for the remuneration strategy determined by each institution should allow a sufficient margin for accommodating variable components of remuneration as well as interdependencies between negative business-developments and individual remuneration. From this perspective we see that the objective of regulation is to identify a "range of good practices".

Although we subscribe fully to the long-term perspective that should be inherent to remuneration policies, this should not be interpreted as preventing altogether the possibility to make use of individual objectives and agreements, for instance for motivating staff members through variable remuneration structures towards targeted short-term objectives.

ii. The remuneration policy should be transparent internally and adequately disclosed externally.

Regarding the external disclosure of the remuneration policy, we consider that there should be a gradation of the details of public disclosure requirements in function of the addressee, which should allow for sufficient flexibility.

It is important that all staff members have access to the principles of the remuneration policy within the firm, whereas detailed disclosures are limited by the firm's trade secret, as well as confidentiality rights of staff members.

iii. The management body, in its supervisory function, should determine the remuneration of the management body, in its management function. In addition it should have oversight of the overall remuneration policy of the firm. The implementation of the remuneration policy should be subject to central and independent review.

We are of the view that the management body should be involved differently as regards remuneration principles, the concrete remuneration system and its practical implementation. It is important that political and strategical aspects are coordinated centrally, but the important role of more intermediate levels of management in setting the specific variable remuneration components (e.g. the concrete amount) for individual staff members should also be emphasised.

iv. Where the pay award is performance related, remuneration should be based on a combination of the individual performance's assessment, the performance of the business unit and the overall *results of the company or group. When defining the individual performance other factors apart from financial performance should be considered. The measurement of performance, as a basis for bonus awards, should include an adjustment for risks and cost of capital.*

The ESBG welcomes the requirement that any performance-related remuneration should rely on a combined assessment of individual performance and developments and results of the relevant unit, as well as of the whole company. We would like to point out however that the principle cannot be applied to all departments, respectively to all staff members of a firm. The ESBG would suggest making as regards variable remuneration a clearer differentiation between the staff members whose commitments to individual objectives are linked to considerable risks for the institution and those for whom this is not the case. We support the view that unconsidered focus on financial aspects could lead to unwanted behavior. At the same time, we don't consider that non-financial performance parameters such as additional qualifications should be specifically emphasized within the principles.

The ESBG is critical as regards the requirement to include in the measurement of performance the cost of capital, as this is hardly measurable, especially for capital market-oriented firms, and rather short term. Giving it too much weight would contradict the long-term perspective required in principle i.

v. There should be a proportionate ratio between base pay and bonus. Where a significant bonus is paid, the bonus should not be a pure upfront cash payment but contain a flexible, deferred component; it should consider the risk horizon of the underlying performance.

In our view, the choice of remuneration instruments should not focus exclusively on the absolute amount of the variable component of the remuneration (bonus) or on the ratio between base pay and bonus, but more on the risks that can be induced by bonuses due to individual staff members. Indeed, bonuses could be seen also as a risk management instrument – especially in view of personnel related costs or performance – if important parts of the variable remuneration are depending on the overall performance of the firm.

About ESBG (European Savings Banks Group)

ESBG (European Savings Banks Group) is an international banking association that represents one of the largest European retail banking networks, comprising about one third of the retail banking market in Europe, with total assets of € 5215 billion (1 January 2006). It represents the interest of its Members vis-à-vis the EU Institutions and generates, facilitates and manages high quality cross-border banking projects.

ESBG Members are typically savings and retail banks or associations thereof. They are often organized in decentralized networks and offer their services throughout their region. ESBG Member banks have reinvested responsibly in their region for many decades and are one distinct benchmark for corporate social responsibility activities throughout Europe and the world.

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