Governance
for Owners

Swiss Financial Market Supervisory Authority FINMA
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By email: oliver.wuensch@finma.ch

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Dear Madam/Sir

Thank you for the opportunity to submit comments in relation to the latest review of the Circular on remuneration systems. By way of background, and to put our comments in context, Governance for Owners (GO) is an independent partnership dedicated to adding long-term value to clients' equity holdings through relational investing and active share ownership.

We are aware that high level politicians have asked the forthcoming G20 September 2009 summit to put the remuneration of employees in the financial sector on the top of its agenda as concerns over the fact that some actors in the sector (both in the US and Europe) are reverting poor past practices.

We have some suggestions for enhancing the circular on remuneration systems of financial institutions.

Principle 1: The Board of Directors is responsible for the design and implementation of the financial institution's remuneration policy and issues remuneration regulations.

We agree with this recommendation. Boards of directors are responsible for the design and implementation of the remuneration policy. In doing so boards and remuneration committees in particular should take into account various principles such as benchmarks, balance, consistency and transparency. It is important that the board of directors sets up a remuneration committee composed solely by independent directors to take the lead on the design and implementation of the policy.

Equally, when setting up committees, boards should, inasmuch as possible, separate the committees so that remuneration committees are distinct from the nominations and audit committees.

Principle 2: The remuneration system is simple, transparent, and enforceable as well as oriented towards the long term.

We agree with this recommendation. Given the increasing scrutiny of remuneration from all parties (governments, employees, customers, shareholders, regulators) it is important that the public can see that all the remuneration components are simple and transparent. Clarity of the rules must be the overarching principle in determining remuneration policy. It must also be understandable so that anyone analysing it can link all its components (fixed components, variable components, performance shares, stock options, pension terms and other benefits, directors' fees) to the motivation and reward of employees and the long-term performance of the company.

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Equally, in some markets retesting of targets is allowed for incentive schemes and we believe that this practice should be highly discouraged as it allows for changes in the remuneration system according to the financial institution's performance which does not necessarily benefit the general interest of the company but rather one or more individuals.
We do agree with the recommendation that overlapping or constantly changing remuneration systems for individual groups of employees should be avoided.

Principle 3: In designing and applying the remuneration system human resources and control functions are involved

We agree with this recommendation and in our opinion the involvement of human resources, risk control and compliance in the design and application of the remuneration system can only be a positive element, notwithstanding that the ultimate responsibility for it rests with the board of directors.

Principle 4: The structure and level of total remuneration are aligned with the financial in-situation's risk policy and enhance risk awareness

We agree with the five recommendations. It is now widely acknowledged that boards of directors and managements of financial institutions did not always understand the characteristics of the complex financial products they were dealing with and/or or the exposure of their institutions.

We are particularly concerned that companies should organise themselves so that remuneration incentives are not too much tilted towards risk taking. Therefore we welcome the fact that remuneration will take into account the risks that an employee bears in accordance to her/his strategic or operational responsibilities.

We also do believe that the remuneration of those employees who are supposed to control risk should be revisited so that there is minimal imbalance between those who take the risks and those who control the risks. This has in the past been an issue.

Principles 5, 6 and 7: Variable remuneration depends on the long-term economic success of the financial institution. Variable remuneration is granted according to sustainable criteria. Deferred remuneration gives the employees a symmetric participation in the financial institution's future development and its risks.

We agree with these recommendations. Variable remuneration should reflect actual performance and long term economic success.
The award of stock options and performance shares should be defined to pre-determined stringent performance criteria.

Therefore we advocate abolishing "guaranteed bonuses" as they do not take into consideration reward and long-term performance or even risk taking. Bonuses should not be guaranteed in advance but rather determined solely on actual performance and set in a longer period framework – say 3 to 5 to years – so that it can take into account potential losses incurred during a certain period of time.
Deferred remuneration allows for the alignment of the employees' remuneration and their participation in the institutions' development and the related risks.

In order to avoid any misunderstanding boards of directors should define in advance what exceptional circumstances can potentially justify for the award of special payments or the adjustment of any performance criteria applied to the vesting of long-term incentives.

Principle 8: The remuneration of the control functions does not give rise to conflicts of interest.

We agree with this remuneration, in particular with the fact that the total remuneration of the control functions must be adequate to attract qualified, high calibre and experienced staff.

Principle 9: The Board of Directors reports annually on the implementation of the remuneration policy.

We believe it would be helpful if companies provided tables for the disclosure of the compensation of employees. These tables should not replace but rather enhance the information already provided by companies. This would enable shareholders to have a full understanding of the remuneration policy. As a precedent, the French AFEP/MEDEF recommendations on the compensation of executive directors[1] dated October 2008 ask companies to provide such tables.

Principle 10: Deviations from these principles are possible only in well-founded exceptional circumstances and must be disclosed.

We agree with these recommendations and suggest that a report on the development in the monitoring of these recommendations to be made public each year.

Golden parachutes: the recommendations should include rules regarding termination payments. Whenever applicable and justified, those payments should not exceed two years of an employee's total remuneration. Employees who leave an institution should not receive a severance payment if their contract termination resulted from poor performance.
However termination payments should not be granted if an employee decides to leave the institution, change their position or are entitled to exercise their rights to pension in a near future.

Additional pension rights: It would be useful if institutions provided more detailed information on pension rights and potential additional pension rights as well as the cost to the company of providing such pension benefits. When in place, additional defined benefit pensions' value should be taken into account when boards of directors determine the overall level of an employee's compensation. Institutions should refrain from allowing any pension schemes that give employees a right to an excessive level of the total remuneration on retirement.

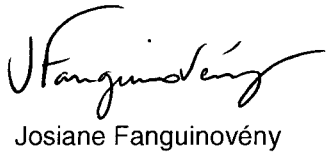
Hedging: neither institutions nor participants (directors or management) should hedge exposure to equities-based incentives.

Remuneration committees: remuneration committees could usefully provide more detailed explanation of their activities over the year.

Remuneration of non-executive directors: As part of the consultation, we suggest it might be valuable to investigate mechanisms by which non-executive directors could best be rewarded, taking into account their responsibilities and specific situations.

We hope you find these comments helpful.

Yours sincerely



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[1] http://www.medef.fr/medias/files/132856_FICHIER_0.pdf