

Press Release

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FINMA publishes Circular on remuneration schemes

The FINMA Circular on remuneration schemes is intended to have a lasting effect on remuneration practices in the financial sector. Remuneration schemes should not create incentives to take inappropriate risks and thereby potentially damage the stability of financial institutions. One of the focal points of the Circular is variable remuneration. In drawing up the Circular, FINMA has taken into account the results of the consultation process and international developments, in particular the latest standards issued by the Financial Stability Board. The Circular will take effect on 1 January 2010.

Experience in recent years has shown that remuneration schemes have considerable importance for risk management at financial institutions. Remuneration schemes can create false incentives which may lead to inappropriate risks being entered into, threatening the business and profitability of a financial institution and, at the end of the day, its stability.

FINMA is subjecting the remuneration policy of financial institutions to supervisory regulation based on the organisational provisions of financial market legislation. It is thereby meeting the requirements of the Financial Stability Board and of other international bodies. In addition, it is acting in accord with key supervisory authorities abroad.

Reaction to the consultation process

Despite many critical reactions, the Circular issued by FINMA remains essentially in line with the consultation draft. However, a few material changes have been made. The Circular will only be mandatory for the seven largest banks and five largest insurance providers. The linkage to economic profit has been replaced by economic performance; however, this must reflect the full cost of capital (including the cost of equity) and the risk profile of the institution. This adjustment allows institutions more flexibility but retains the nature of variable remuneration as a share in success. Clarification has also been given to the effect that while commission models, which are standard in the insurance industry for

example, are covered by the remuneration regulations, the intention is not that these should be rendered impractical. Other calls were not heeded by FINMA. It did not accede to the request that an absolute or relative cap be placed on salaries. FINMA also ruled out limiting the scope of application of the Circular to the two large banks.

Scope of the Circular

The Circular is intended for all banks, securities traders, insurance providers and persons and firms authorised under the Collective Investment Schemes Act. Implementation is mandatory for large banks and insurance providers. The scope of application is determined by threshold values based on equity capital requirements for banks and solvency margin requirements for insurance providers. Implementation is obligatory for firms required to have at least CHF 2 billion in equity capital or as solvency. By increasing the threshold values as against the consultation draft, FINMA wishes to prevent a disproportionate cost being imposed on small and medium-sized institutions. However, for these institutions the principles of the Circular represent guidelines to be used when determining their remuneration policy. FINMA will integrate the issue of remuneration more closely into its risk-based supervisory processes. It also retains the right to impose the terms of the Circular on individual institutions regardless of the threshold values. FINMA will make use of this power where this is felt to be appropriate in view of the risk profile or shortcomings and inappropriate remuneration practices.

Variable remuneration dependent on business performance and risk

The Circular pays particular attention to variable remuneration. FINMA wishes to treat variable remuneration as the employees' stake in the success of the company, by requiring that all variable remuneration paid out must actually have been earned by the company over the long term. Variable remuneration is therefore dependent on the business performance of the institution, taking account of the sustainability of this performance and the risks entered into. All the company's costs of capital are to be taken into consideration, including, the risk for providers of capital or shareholders. In addition, the effects of the remuneration policy on an institution's capital and liquidity situation are to be considered. The Circular does not limit the amount of variable remuneration. However, it aims to prevent high variable remuneration being granted merely as a result of entering into large risks and generating short-term, unsustainable earnings.

In addition, FINMA expects persons in the higher levels of the hierarchy in particular, who have significant responsibility for risk or high total remuneration, to receive a significant part of their variable remuneration with deferred effect and thus in a way which is linked to risk. Making the value of deferred remuneration such as blocked shares dependent on the future performance of the institution and its risks will strengthen risk awareness and the incentive for sustainable business. FINMA also welcomes "clawback" and "malus" arrangements. These have the advantage that compensation can be linked to specific risks within an employee's area of responsibility.

More stringent transparency requirements

FINMA wishes to ensure that market discipline is strengthened through transparency and reporting rules. It is placing a responsibility in this regard on boards of directors. The board will be required to

disclose the company's remuneration policy to the market and the company's owners in a remuneration report. FINMA is stipulating summary disclosure of the remuneration structure for all employees. However, it does not intend to insist that individuals' names be disclosed with the remuneration received.

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