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Bank for International Settlements  
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Subject: Eumedion's response to the consultative document on Supplementary Guidance to the FSB Principles and Standards on Sound Compensation Practices

The Hague, 31 August 2017

Dear members of the FSB,

Eumedion welcomes the opportunity to comment on the draft Supplementary Guidance to the FSB Principles and Standards on Sound Compensation Practices (hereafter: Guidance). By way of background, Eumedion is the Dutch based corporate governance and sustainability forum for institutional investors. Our 65 Dutch and non-Dutch participants represent more than € 5 trillion assets under management. Participants include a wide range of institutional investors; pension funds, mutual funds, asset managers and insurance companies. It is the objective of Eumedion to maintain and further develop good corporate governance and sustainability performance of Dutch listed companies.

Eumedion generally supports and appreciates the proposals as set out in the draft document. We agree with the remark on p. 4 that compensation tools can play an important role in addressing misconduct risk by providing both ex ante incentives for good conduct and ex post adjustments mechanisms that ensure appropriate accountability. The Guidance will hopefully contribute to addressing misconduct risk in future. Below you will find our answers to the specific questions raised. Given the scope of Eumedion our answers are confined to the role of boards.

**Q 1. Should the Guidance be more specific with regard to the respective roles of the board or that of senior managers with regard to compensation and misconduct?**

First we would like to make a more general remark. The consultation document (p. 6) states that each jurisdiction should apply the provisions in a manner consistent with local frameworks and that the Guidance is intended to cover both the supervisory function and the management function, as appropriate (p. 6). We support this approach. In our view it is the board of directors that directly or indirectly determines the compensation of all the other employees of significant financial institutions. We agree that the board should define misconduct risk based on the firm's characteristics and business, that the effective management of misconduct should fall within the responsibilities of boards and that the responsibility for ensuring accountability should lie primarily with the board of directors (p. 8). We are of the opinion that the role of the board is sufficiently clear.

**Q 2. The Guidance suggests that qualitative, non-financial assessments should have a direct impact on compensation and that they are important in determining how to align compensation with risk. Would additional guidance be helpful? Please provide data if your firm uses such provisions including the types of metrics used, and a discussion of any challenges you face in their use.**

Compensation should in our view not contribute to inappropriate risk-taking and should contribute to long-term value creation by significant financial institutions. A situation should be prevented in which compensation encourages boards to focus too much on the short term, thus losing sight of long-term value creation. We believe that variable compensation should be subject to financial and non-financial performance criteria that are specified in advance and can be measured. We generally agree with recommendation 5 according to which compensation should be adjusted for all types of risk, both financial and non-financial, including misconduct or behaviour that can result in harm to both firms and their customers. In that case the compensation should be adjusted downwards. Such compensation adjustments should also be triggered in case of fraud, gross negligence or material failure of risk management controls, including a serious breach of internal rules or regulations and when a person failed to meet appropriate standards of fitness and propriety (we also refer to our answer to Q 3). As correctly mentioned in the consultation document (p. 10) performance assessments should consider the full spectrum of risks. With respect to the wording of recommendation 5 we would like to make a somewhat more technical remark. Besides the firm and customers also other stakeholders might be harmed by misconduct. We advise to reflect this in recommendation 5.

**Q 3. The Guidance identifies three tools most commonly used to address misconduct: in-year adjustment (adjustment to the current year's variable compensation before it is awarded); malus (reduction of deferred compensation before it has vested or fully transferred); and clawback, which permits recovery of variable compensation that has already been paid and vested. Given the particular characteristics of misconduct risk, do you believe that all three tools need to be available to a firm to establish appropriate incentives to deter misconduct?**

It is important to ensure that significant financial institutions have an adequate toolkit at their disposal in case misconduct occurs. Against this background we are of the opinion that all three tools need to

be available to a firm. In addition to this, it is important that compensation payout schedules are sensitive to the time horizon of risks and that variable compensation payments are deferred accordingly (this is already incorporated in the existing Principle 6 of the FSB Principles on Sound Compensation Practices).

***Q 4. The Guidance suggests minimum scenarios where adjustment of compensation should occur. Are there additional circumstances in which adjustments to compensation should be expected? What are the advantages and disadvantages of suggesting such minimum conditions? In particular, is there evidence from past use of such tools that might be instructive in how to formulate such scenarios?***

Eumedion agrees that the compensation policy should specify the parameters on the basis of which a significant financial institution may, under pre-determined circumstances, reclaim the variable compensation granted or adjust such compensation downwards. This may provide more clarity about the situations in which those powers can be used. We support the suggested minimum scenarios where adjustments of compensation should occur (p. 11) and we advise to clarify that the compensation should also be adjusted in case a person failed to meet appropriate standards of fitness and propriety. This is also in line with article 94 (1) (n) of the Capital Requirements Directive. However, we would like to note that it is impossible to describe all the situations that might occur beforehand in the compensation policy. Eumedion believes that boards should – including in a situation which is not mentioned beforehand in the compensation policy - be able to adjust bonuses on the basis of the concrete facts and circumstances of the individual case. This principle should in our view be reflected in the Guidance.

***Q 5. How much variable compensation should be placed at risk of adjustment in order to effectively impact incentives for excessive risk-taking or other inappropriate conduct?***

As correctly stated in the consultation document (p. 5 ) risk management failures and misconduct can often take years to come to light. According to the Guidance (p. 10) adequate amounts of compensation should be placed at risk of reduction. We agree with the FSB that the duration of the look-back period during which events may be identified should be determined in national laws and regulations and compensation policies (p. 11/12). The FSB should not be too prescriptive in this respect.

***Q 6. Does the Guidance adequately cover compensation incentives that may be relevant to addressing misconduct risk in all sectors of the financial industry? Are there additional specific provisions that should be considered to better address misconduct risks in particular financial sectors? Are there specific provisions in the guidance that may not be relevant to a particular financial sector?***

We are of the opinion that the Guidance adequately covers compensation incentives that may be relevant to addressing misconduct risk in all sectors of the financial industry.

If you would like to discuss our views in further detail, please do not hesitate to contact us. Our contact person is Diana van Kleef ([diana.vankleef@eumedion.nl](mailto:diana.vankleef@eumedion.nl), tel. 070 2040 302).

Yours sincerely,

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