February 1, 2010

Via Electronic Delivery

Secretariat to the Financial Stability Board
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

Re: FSB Thematic Peer Review on Compensation ("Peer Review")

Gentlemen and Ladies:

The Securities Industry and Financial Markets Association ("SIFMA")[1] is submitting this letter in conjunction with the members of the Remuneration Working Group of the Association for Financial Markets in Europe ("AFME")[2] in response to the request by the Financial Stability Board (the "FSB") for comments from financial institutions and other stakeholders regarding the FSB's Principles for Sound Compensation Practices, published in April 2009 (the "Principles") and the Principles' Implementation Standards, published in September 2009 (the "Standards"). We welcome the opportunity to share with you our feedback from financial institutions and other stakeholders on practical experiences in implementing the Principles and the Standards.

We feel that it is crucial that stakeholders have the opportunity to participate in the important process of identifying and implementing sound risk management practices both in and

---

[1] The Securities Industry and Financial Markets Association brings together the shared interests of more than 650 securities firms, banks and asset managers. SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members' interests locally and globally. It has offices in New York, Washington D.C., and London and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong.

[2] AFME was formed on November 1, 2009 following the merger of LIBA (the London Investment Banking Association) and the European operations of SIFMA. AFME represents a broad array of European and global participants in the wholesale financial markets, and its 197 members comprise all pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. AFME participates in a global alliance with SIFMA in the US, and the Asian Securities Industry and Financial Markets Association through the GFMA (Global Financial Markets Association), and provides members with an effective and influential voice through which to communicate the industry standpoint on issues affecting the international, European, and UK capital markets.

outside the context of compensation practices, and thus we are happy to respond to the FSB's request for feedback regarding the Peer Review and specifically stakeholders' experiences in implementing the Principles and Standards, as well as national rules established in conjunction with the Principles and Standards. As a threshold matter, we wish to highlight the immense amount of resources that member firms have diverted from other tasks in order to distil raw compensation-related data into information in the varying formats required by numerous regulators under very short deadlines. Members are making every effort to comply in good faith, but clear signals from regulators, clarification of ambiguity in requests, narrowing of scope of data requested to address specific requirements and clear timetables with adequate timing would greatly facilitate an orderly implementation of the Principles and Standards.

Interpreting the Standards

We understand that the Standards are illustrative of the methods by which the Principles may be achieved. In practice, however, application of the Standards in certain jurisdictions has operated to convert the Standards' guidance into rigid and prescriptive formulae. We are concerned that the Peer Review Template published in December 2009 reinforces, rather than remedies, the misconception that the Standards are mandatory rules, despite the clear fact that the Standards are phrased in a precatory manner. Specifically, the Standards use the word "should" rather than "must," indicating that the Standards are not intended to be compulsory. Additionally, the Standards were designed as an implementation method for the Principles, which specifically state that they are "*not* intended to prescribe particular designs or levels of individual compensation." (Emphasis in original).

The Standards should not be read to stand alone as a series of prescriptive rules; instead, they should be read in the context of the Principles. The Principles state that they are "intended to reduce incentives towards excessive risk taking that may arise from the structure of compensation schemes"; to the extent that a firm can demonstrate that it has implemented the Principles, neither the FSB nor member jurisdictions should be concerned with whether or not the firm has precisely followed the illustrative methods found in the Standards. However, Questions 6 through 8 in the Peer Review Template imply that the Standards are the exclusive means by which the Principles can be implemented. For example, the UK has promulgated prescriptive rules to define categories of employees and fix compensation ratios, stating that "employees with total expected compensation for 2009 which is greater than £500k and who have a bonus to salary ratio of 2:1 or greater should have a minimum level of deferment of 40%." Again, it is our understanding based on a reading of the plain language of the Principles and the Standards that mandatory, substantive rules such as those quoted above are not in accordance with either the Principles or the Standards.

The focus of the Standards as mandates rather than illustrations concentrates, rather than diversifies, risk to the financial system. Experience in the United States has shown that legislatively mandating forms of compensation frequently has unintended consequences that are possibly at odds with the intent of the mandate. Care needs to be taken before regulators decide to adopt simplistic and formulaic compensation rules on a global basis for the financial services industry.

Inconsistent Actions

One of the most challenging issues to arise from the implementation process of the Principles and Standards is the movement by many jurisdictions to take actions outside and otherwise inconsistent with the Principles and the Standards. The multitude of regulators attempting to address the same issues and add additional layers to the compensation regulations affecting financial institutions has led to a lack of uniformity in regulation.

A prime example of these extracurricular actions is the UK's much-publicized "bank payroll tax" ("BPT"), generally taxing banks at a 50% rate for any bonuses paid to certain employees to the extent they exceed £25,000. The BPT, while ostensibly in accordance with the general themes of the Principles and the Standards, is in fact largely inconsistent with those documents. While the Principles call for financial firms to link bonuses with firm performance, the concept of the BPT creates the opposite incentive by encouraging firms to pay a greater percentage of compensation as fixed salary. The BPT exempts from taxation pre-existing contractually guaranteed bonuses, a form of compensation disfavored by the Principles and the Standards. Furthermore, the BPT undermines the FSB's notion that compensation is ultimately a matter of corporate governance. Finally, the BPT has distorted economic incentives by artificially reducing the bonus paid to a UK employee for performance that is otherwise identical to that of an employee in another jurisdiction; even if the BPT is "socialized" across a global bonus pool to ensure equal compensation for equal performance, a bank is effectively forced to export UK taxation rules to other jurisdictions where such rules would otherwise not apply.

Similarly, in the United States, the Federal Reserve's regulatory proposal relating to sound incentive compensation policies has been followed by the Federal Deposit Insurance Corporation ("FDIC") publishing an advanced notice of proposed rulemaking that would also attempt to regulate executive compensation practices at financial institutions, as well as a number of legislative proposals purporting to address "overly risky" compensation practices at the same financial institutions. The FDIC stated that supervisory initiatives such as the FSB's "set a floor below which the [firm] cannot operate," whereas the FDIC intends to "provide incentives for institutions to adopt standards that exceed supervisory minimum standards." The potential for inconsistencies between these measures is great. It is effectively impossible for firms to abide by multiple regulatory schemes, each with an overlapping jurisdictional scope, also taking into account local tax and employment law, particularly if the schemes are based upon prescriptive, quantitative rules.

Home-Host Issues

We would request that the Peer Review and the related report to be released in March 2010 also confirm the principle that national authorities should give deference to a financial institution's home state jurisdiction in order to avoid inconsistent and/or contradictory regulatory efforts. We are encouraged by the Basel Committee on Banking Supervision's January 2010 "Compensation Principles and Standards Assessment Methodology," in which the Committee states that "the FSB Principles and Standards are to be applied by the banks at the group level," and that

> [A] bank's home country supervisor, as part of its overall risk assessment of a consolidated banking group, is responsible for evaluating the banking group's compensation policies. However, depending on the banking group's organisation and the importance of activities within the host country, host country supervisors may provide input into the home country assessment of compensation practices. Home country supervisors should therefore seek host country input, where appropriate.

If the Principles and the Standards are to be implemented effectively, it is absolutely essential that covered firms have a clear understanding of the regulatory scheme to which they are required to adhere. Allowing a bank's home country supervisor ultimate authority to evaluate the bank's compensation policies, while seeking input from host country supervisors where appropriate, would effectuate this goal. This principle has also been acknowledged by both the United States Federal Reserve[3] and the Hong Kong Monetary Authority.[4]

Resolving Material Ambiguities

As discussed above, we do not read the Standards as mandatory, though this reading seems to conflict with the Peer Review Template. Nevertheless, if the Peer Review Template is intended to endorse the regulatory trend of converting the Standards from illustrations into mandates, material ambiguities in the Standards must be resolved. While ambiguities are to be expected, material ambiguities in a compensation system so broad in its application and rushed in its implementation are not appropriate.

One example arises in Paragraph 8 of the Standards, which states, in part, "A substantial proportion, such as more than 50 percent, of *variable compensation* should be awarded in shares or share-linked instruments (or, where appropriate, other non-cash instruments), as long as these instruments create incentives aligned with long-term value creation and the time horizons of risk" (emphasis added). We believe that the word "deferred" was inadvertently omitted in Paragraph 8 when the Standards were published. This interpretation is based not only on the context of the paragraph within the Standards (most notably, the following paragraph – which begins, "The remaining portion of the deferred compensation…" – implies that the percentage discussed immediately above is also intended to refer to deferred compensation) but also on the fact that, if read literally, this requirement would dramatically accelerate the use of shares authorized under share programs of financial institutions and result in unanticipated dilution to shareholders. Alternatively, firms would need to use cash-settled, share-based instruments with potential adverse accounting consequences. While certain jurisdictions appear not to have appreciated the consequences of this significant ambiguity in their implementation of the

---

3 In its October 2009 Proposed Guidance on Sound Incentive Compensation Policies, the Federal Reserve made clear that, with respect to foreign banks operating in the U.S., "the organization's policies, including management, review, and approval requirements, should be coordinated with the foreign bank's group-wide policies developed in accordance with the rules of the foreign bank's home country supervisor and should be consistent with the foreign bank's overall corporate and management structure."

4 The Hong Kong Monetary Authority released a Guideline on a Sound Remuneration System in October 2009 that contained a special rule for institutions located in Hong Kong that were branches of overseas banks: "[T]he institution may adopt the remuneration policy formulated at the group level provided that it can demonstrate…that the relevant group remuneration policy is broadly consistent with this guideline."

Standards, others, particularly the German financial regulator BaFin, have interpreted the rule in a more logical fashion. In Section 4(e) of BaFin's December 21, 2009 release regarding the implementation of the Standards, which implements Paragraph 8 of the Standards, BaFin requires that at least 50% of *deferred* variable compensation depend on the "sustainable performance of the institution."

Paragraph 7 of the Standards contains an additional material ambiguity. It states, in part, "Compensation payable under deferral arrangements should generally vest no faster than on a pro rata basis." The use of the term "generally" is unclear. We would expect that the pro rata vesting concept refers to vesting in the ordinary course. We would hope that accelerated vesting in the event of termination of employment by reason of death, disability, change in control or retirement would be permitted. Moreover, the Standards seem to define the "vesting period" as the period to which the clawback applies, rather than a period during which a future service condition applies (and as a policy matter, it is clear that the FSB is focused on performance-based, rather than service-based, vesting requirements). Read in this light, firms would have broad flexibility in setting or waiving service-based vesting requirements, so long as the right to clawback only lapsed pro rata over the vesting period. However, it is simply not clear what the FSB's intent was in using the term "generally" in this context. Ambiguities such as those described should be resolved as quickly as possible.

We thank you for the opportunity to submit this comment letter. We would be happy to discuss with you any of the comments described above or any other matters you feel would be helpful in completing the Peer Review or completing future reports. Please do not hesitate to contact the undersigned at +1 202-962-7300 or +44 20 7743 9304 if you would like to discuss these matters further.

Sincerely,

Liz Varley

Elizabeth Varley
Managing Director
SIFMA

Lorraine Charlton

Lorraine Charlton
Managing Director and General Counsel
AFME