

# International responses to the global financial crisis

by John Egan

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*One of the encouraging aspects of the sequel to the global financial crisis (GFC) is that, not only have international bodies formulated practical principles for the regulation and improvement of financial organisations but they, and individual government bodies, have continued to develop the principles and put together detailed arrangements for their implementation. This has been particularly so in regard to remuneration.*

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There may have been a decline of urgency when, in some countries, financial institutions survived in better condition than expected, albeit due largely to prompt government action. Luckily, this decline of urgency has not stifled the support for remuneration reform.

### **G20 Washington Action Plan**

The nations in the G20 group led the way with a statement covering the broad range of requirements. *"We commit to implementing policies consistent with the following common principles for reform."*

Go to:

[http://www.g20.org/Documents/g20\\_summit\\_declaration.pdf](http://www.g20.org/Documents/g20_summit_declaration.pdf).

The principles were grouped under the following headings:

*Strengthening Transparency and Accountability*

*Enhancing Sound Regulation*

*Promoting Integrity in Financial Markets*

*Reinforcing International Cooperation*

*Reforming International Financial Institutions.*

The Basel Committee on Banking Supervision is undertaking extensive work on risk management and related topics, but the main leadership on remuneration comes from the Financial Services Board.

### **FSF Principles for Sound Compensation Practices**

Another important stage in the international process was the release by the Financial Services Forum (FSF) in April 2009 of the FSF Principles for Sound Compensation Practices

[http://www.financialstabilityboard.org/publications/r\\_0904b.pdf](http://www.financialstabilityboard.org/publications/r_0904b.pdf)

These were endorsed by G20 and have been a good guide for individual governments since. They were followed in September 2009 by the Financial Services Board (FSB, the successor to the FSF) issuing the Implementation Standards for the Principles

The principles cover the following ground:

### **1. Effective governance of compensation**

1. The firm's board of directors must actively oversee the compensation system's design and operation.

2. The firm's board of directors must monitor and review the compensation system to ensure the system operates as intended.

3. Staff engaged in financial and risk control must be independent, have appropriate authority, and be compensated in a manner that is independent of the business areas they oversee and commensurate with their key role in the firm.

### **2. Effective alignment of compensation with prudent risk taking**

4. Compensation must be adjusted for all types of risk.

5. Compensation outcomes must be symmetric with risk outcomes.

6. Compensation payout schedules must be sensitive to the time horizon of risks.

7. The mix of cash, equity and other forms of compensation must be consistent with risk alignment.

### **3. Effective supervisory oversight and engagement by stakeholders**

8. Supervisory review of compensation practices must be rigorous and sustained, and deficiencies must be addressed promptly with supervisory action.

9. Firms must disclose clear, comprehensive and timely information about their compensation practices to facilitate constructive engagement by all stakeholders.

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## **UK – Financial Services Authority Remuneration Code**

Individual countries have developed the concepts listed above and adapted them to operations in their own legislative and financial regimes. In the UK, the Government has acknowledged the importance of the FSF Principles. The FSA Remuneration Code has recently been reviewed and extensive consultation has been undertaken in regard to the changes. The Code particularly emphasises the function of the board and the remuneration committee and the design of remuneration in dealing with risk.

## **US – Compensation reforms**

In the United States, a variety of initiatives are being developed. The Government has published a set of principles and corporate guidelines to enhance the management of remuneration as part of sound risk management. These include:

Compensation plans should properly measure and reward performance;

Compensation should be structured to account for the time horizon of risks;

Compensation practices should be aligned with sound risk management;

Companies should re-examine whether golden parachutes and supplemental retirement packages align the interests of executives and shareholders; and

Companies should promote transparency and accountability in the process of setting compensation.

In parallel, stringent remuneration regimes have been imposed on the organisations involved in the government-funded rescues following the GFC. These are managed by the Pay Czar, Kenneth Feinberg, whose decisions are not subject to appeal or objection.

While the new guidelines put new pressures on corporate boards, they have the potential to improve remuneration design and effectiveness.

## **Australia – APRA's Prudential Standards and the Productivity Commission's Report**

The Australian Government has also undertaken extensive review and action, not only in regard to remuneration in the financial services sector but in the wider market. See our summaries elsewhere in this newsletter.

## **Comment**

The outstanding benefit from the crisis has been the preparedness of major nations to co-operate in the better regulation and supervision of financial services providers and of the corporate governance area overall.

Most participating governments will have the task of co-ordinating regulation from several arms of government but this should contribute to a safer, fairer and, hopefully, more reliable world financial system.