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Contribution to the Consultation on the CEBS' "High-level Principles of Remuneration Policies"

The current crisis in financial markets has brought about a great awareness on the role of remuneration and incentive structures in risk management for traders and executives in the finance sector. UNI Europa Finance welcomes the initiative from the European Commission to develop recommendations on remuneration in the financial services sector.

However, the focus on remuneration structures and risk management should not only stay with the remuneration of top executives and traders. Remuneration structures and incentive systems for employees at lower levels play a major systemic role in risk management and are a potentially destabilising factor in financial markets.

The use of sales targets and remuneration structures exclusively rewarding sales of products increase the risk of products being sold to customers which they do not need or want or even cannot afford. The 2007 sub-prime crisis on the US housing market is clear evidence of the systemic impact of inappropriate incentive structures. Incentive structures must encourage prudent advice and good customer service – as an aim in itself, but also to mitigate the risk of the recurrence of a similarly devastating crisis.

Appropriate remuneration systems are key to ensure the development of a new long-term oriented, risk-conscious business model. Therefore:

1. Recommendations on remuneration in the financial services sector should explicitly cover employees in sales and advice functions in financial institutions at all levels.
2. Incentive structures for employees in sales and advice functions should encourage good customer services and qualified advice and not only sale of products. Remuneration structures should not be linked to individual sales targets.
3. Prudent supervision should oversee that remuneration structures at all levels – including sales and advice functions – are appropriate and risk conscious. Authorities should be able to penalise inappropriate practice.
4. There should be structured dialogue between unions in the finance sector and supervision authorities at all levels to address these matters and other internal practices affecting companies' risk management and the stability of the financial system.
5. Charters on responsible sale of financial products should be developed by each financial institution and to be agreed between management, unions and other stakeholders

UNI Europa Finance is the European-level trade union body for the finance sector. It represents 100 unions with 1.5 million workers in the banking and insurance industries. It is part of UNI Global Un ion and recognised by the European Union as a social partner.

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A. Principles on remuneration

Incentive structures, sales targets and performance related pay

1) Remuneration and incentive systems for employees at all levels should be realistic and fair. They should be based on long-term and sustainable business goals. They should be risk conscious and should not be based foremost on increasing short-term revenues. They should always be accountable and disclosed for independent assessment.

2) The fixed part of the salary should be high enough to make a decent living. Bonuses should be used to reward good performance and not be an implicit part of the salary.

3) Incentive structures for employees in sales and advice functions must reward good customer services and qualified advice – not only sale of products. Incentive systems should encourage coherence between the products sold by the financial institution and the risk profile of the individual customer.

4) Conflicts of interests, roles and responsibilities of employees must always be clear in a sales situation. Consumers should be informed of any commission, bonus, incentive or remuneration implications that the employee might receive as a result of selling a financial product.

5) Sales targets must be reasonable and achievable not to put finance employees in a dilemma between selling products and giving good advice. They should not be linked to remuneration structures, nor to individual performance of the employees.

6) Excessive sales targets cause high levels of stress on employees and must be avoided. Employees should not be disciplined, lose their job or not receive a salary increase solely because they have not met their sales targets. Sales targets should be determined by management through consultation with employees and union representatives.

7) Variable pay and bonus systems should always be built on transparent rules and objective criteria. Bonus and performance related pay systems should include quality targets in addition to quantity targets. Qualitative measures such as cooperation, compliance with procedures and training of others should also be rewarded.

Negotiating criteria for pay policies

8) Criteria for all kinds of performance related pay should be negotiated in collective agreements between management and union representatives in the company. Trade unions should have the right to monitor the implementation of the remuneration policies.

9) Remuneration policies must always respect the autonomy of the social partners and the primacy of collective agreements.

Training and financial education

10) Measures should be taken to ensure sufficient and continuous training of employees to keep up with the increasing complexity of the financial products they sell. Employees must have a full understanding of the products they sell in particular in terms of the implications for customers. Standardised global principles on the competences required to sell financial products work should be developed.

11) Employees in the finance sector play a decisive role in financial education of consumers. A *code of conduct on financial education* should be developed to guarantee prudent circumstances allowing advising and education of costumers. This could be in cooperation with the OECD and ILO.

Directors' pay

12) Variable pay schemes for executives should be kept at reasonable levels. The portion of variable pay should in no case be more than the fixed component. Prudent and risk-conscious behaviour should be encouraged, rather than short-term revenue generation and excessive risk-taking.

13) Bonus payouts should be a mixture of shares and cash and staggered over several years to link bonuses to long-term success. The vesting periods of share-based compensation should furthermore be extended and bonus claw back provisions should be established

14) There should be more independent and knowledgeable people on the board’s remuneration committee of a financial institution, including employee representatives to ensure all stakeholder interests are addressed. Criteria for executives pay models should be the result of a negotiation between representatives of shareholders and unions or a sectoral agreement.

B. Remuneration structures, supervision and risk management

15) The prevalent perspective on supervision only works from the top-down. It should be complemented by a bottom-up approach that puts the factor “employees” into the equation of financial regulation, supervision and risk management. To assess a company’s business model effectively, it is essential to take account of internal operating procedures and actual practice with the resulting motivations and constraints for employees. Financial supervisors and companies must ensure that these factors promote rather than hinder regulatory objectives and excellent customer service.

16) Such a mechanism would provide an inside view of what is happening supplementary to that provided by senior management and auditors. It would be an additional element for enhancing checks and balances as well as early warning systems at all levels. Emerging problems could thus be known earlier and dealt with more effectively. Employees are in the best position to provide information about finance companies day-to-day practices.

17) UNI Europa Finance supports the recommendation by the High Level Expert Group presided by J. de Larosière that “supervisors should oversee the suitability of financial institutions' compensation policies, require changes where compensation policies encourage excessive risk-taking and, where necessary, impose additional capital requirements under pillar 2 of Basel 2 in case no adequate remedial action is being taken”.

18) The information provided to the supervisory bodies at all levels, and used as a base of its risk assessments, should systematically include experiences and information on the negative and positive impact of internal operating procedures and actual practices as assessed by finance employees. These elements must be included in risk assessment to ensure an effective risk warning taking all factors into account.

19) Internal operating procedures and practices to take into account are:

- regulation and practice on remuneration and incentive systems as well as working conditions, including workload;
- regulation and practice on the marketing of financial products, including sales targets and sales practices (e.g. on credits);
- training of staff in regulatory compliance and understanding financial products
- regulations avoidance through product and practice innovation;
- identification of new risks and trends;
- breaches of compliance.

20) As a general principle, stakeholders, including trade unions from the finance sector and consumer associations, should be involved in financial oversight mechanisms at national, regional and international level to allow regular exchanges on these topics. A structured dialogue must be in place to ensure systematic gathering of information from all relevant parties.

21) Supervisors and regulators should set out guidelines and regulation on the above-stated issues (para. 19) to minimise risks deriving from inappropriate procedures and practices in companies. They should give regular reports on implementation and compliance by financial institutions. If compliance is insufficient, sanctions should be imposed in line with the measures suggested by the de Larosière Group (para. 17).

22) Procedures should be established to identify and fight against breaches of regulatory standards, regulations avoidance, undue risk taking and unsustainable business practices. This should include:

- developing a legislative framework to protect “whistle blowers” for reporting breaches to regulators and supervisors;
- creation of an ombudsman at company level or across the industry to whom staff can report breaches and who will follow-up on them (ombudsmen for corruption might be a model).

C. A charter on responsible sale of financial products

23) To minimise risks deriving from inappropriate business practices, each bank and insurance company should have a charter on responsible sale of financial products. The charter should make the company’s principles on selling its products and services as well as relevant work practices explicit, public and verifiable. A key objective is to stop predatory sales practices and excessive risk taking. At the centre of the financial business should be excellent customer service.

24) Principles to be addressed by the charter include:

- practices on the marketing of financial products, including sales targets, conflicts of interest, roles and responsibilities of staff in a sales situation;
- remuneration and incentive systems as well as working conditions (including workload);
- training of staff;
- financial education.

25) Such a charter should be a commitment by the company as a whole – management and individual employees. A member of the top board of directors should be in charge of its implementation. The charter should be formulated and agreed between top management, trade unions and workers’ representatives. It may also involve other stakeholders such as consumer associations.

26) The implementation of the charter should be monitored by a department at the group-level or a company ombudsman. It should be supervised by a committee bringing together key stakeholders, including management, shareholders, consumer associations, unions and workers’ representatives as well as public institutions.

27) Regular reports should be published on the charter’s implementation. They should also include a description of actual sales practices, including relevant elements of individual remuneration and incentive systems as well as sales targets.

28) UNI Europa Finance will invite consumer associations, financial institutions, governments and other stakeholders to develop a model charter on responsible business practice.

D. Risk management and regulatory measures

29) Standards for financial supervision and regulation as well as risk assessment procedures within companies should be updated constantly to keep up with new requirements and the innovativeness of the industry.

30) Responsibility for regulatory compliance and risk management at company level should be vested in a member of a company’s top management.

31) A high-level of consumer protection at national and international level should be ensured by law, guaranteeing that financial institutions provide any customer with qualified and proper advice based on her or his interests.

32) Regulation should specify for top-level decision-makers in financial institutions, including pension funds, that fiduciary duties entail pursuing a long-term and sustainable business strategy and avoiding undue risk-taking and a focus on short-term profits.