PROSKAUER ROSE LLP

International HR Best Practices

Tip of the Month

MONTH 10

A monthly "best practices" alert for multinationals confronting the challenges of the global workplace

This Month's Challenge

The global financial crisis has spawned a global search for new ways to structure and control bonus compensation for bank executives.

Best Practice Tip of the Month

Recommendations and regulations vary from country to country, but a consensus appears to be growing for extended deferral periods, payment in stock or similar instruments, and clawbacks if performance is not sustained.

Law & The Workplace

Limiting Bankers' Compensation and Bonuses: The Emerging Global Consensus

It is widely accepted that the enormous bonuses paid by banks to traders and executives played some role in the worldwide financial crisis, and that changes in the way bankers are paid must be made. With the economic downturn, financial organizations and regulators have been giving consideration to the need to promote responsible remuneration practices.

Although the concern may be global, the solutions proposed so far have varied from country to country. As could be expected, different countries, with different historical, cultural, political and business contexts, have approached this problem in different ways. Variations reflect different approaches to mandatory regulations versus voluntary recommendations, and detailed proscriptions versus generalized guidance.

Financial Stability Board (G20)

In connection with last month's summit meeting of the G20 countries in Pittsburgh, the Financial Stability Board (which consists of representatives from the G20 countries, plus Spain and the European Commission), issued what it labeled "Implementation Standards" for its "Principles for Sound Compensation Practices." Along with proposals dealing with corporate governance and transparency, the FSB made specific recommendations regarding variable compensation for senior executives at major financial institutions, including the following:

- 40 – 60 percent of the variable compensation of senior executives (and even more for the most senior management) should be deferred over a period of three years or more.
- "Subdued or negative financial performance" should result in less variable compensation, including clawbacks of amounts previously awarded.
- More than half of the variable compensation should be awarded in shares or similar instruments.

- Guaranteed bonuses (after the first year of employment) should not be provided.
- Termination payments should be related to compensation for “performance achieved over time” and should not “reward failure.”

United Kingdom

In the UK, the Financial Services Authority released in August an amendment to its code of conduct containing eight “remuneration principles” to regulate the payment of bonuses. The Code will be applicable to 26 UK banks as of January 1, 2010. Those companies will have to release their remuneration schemes to the FSA before October.

The key problem with existing remuneration arrangements, according to the FSA, was that “shareholders have allowed management to introduce compensation policies that in effect subordinate the interests of shareholders to those of employees, particularly senior employees engaged in trading businesses.” In particular, existing bonus practices, by paying cash bonuses based on current year revenues rather than risk-adjusted profit, provided “strong incentives for managers to shy away from conservative valuation policies, strong incentives to ignore concentration risks, strong incentives to rig the internal transfer pricing system in their favour and strong incentives to ignore risk factors . . . that could place the institution under stress at some point in the future.”

The key substantive elements of these guidelines call on the banks to:

- Measure performance on the basis of profits rather than revenue, and provide appropriate adjustments for current and future risk and other relevant long-term factors.
- Ban the practice of paying “guaranteed minimum bonuses” over a period of several years and similar incentive arrangements not tied to the employee’s performance during the relevant performance period.
- Defer a substantial portion of a bonus for a period of time, with a minimum vesting period. The guidelines recommend deferring two-thirds of a bonus for at least three years.
- Use multiple performance criteria to determine bonuses, including individual performance, performance of the business unit and the firm, and nonfinancial factors, including adherence to sound risk management practices and regulatory compliance.

Germany

In Germany, the Federal Financial Supervisory Authority (“BaFin”) has given the banks until December 31, 2009 to implement measures designed to:

- Prohibit the use of short-term profits in determining variable compensation.

- Tie variable compensation to profitability of both the organizational unit and the overall profitability of the institution.
- Provide for repayment by the trader of all or part of his bonus if the risks that he took on certain investments have generated losses.

Netherlands

In the Netherlands, the Netherlands Bankers' Association ("NVB") established an Advisory Committee on the Future of Banks in the Netherlands, which issued a broad-ranging report on numerous aspects of bank management and regulation, including compensation arrangements. In the Advisory Committee's view, banks in recent years had paid too much attention to the interests of their shareholders, and not enough to the interests of the other major stakeholders – clients, employees and society as a whole. As a result, too much of the bankers' compensation was tied to high, short-term profits, which rewarded excessive risk.

To counter this "'incentive to behave badly,'" the Advisory Committee recommended that:

- The income of bank executives should be "slightly below" the median of comparable positions within and outside the financial sector.
- Bank executives' bonuses should be based, in substantial part, on achievement of non-financial targets relating to client satisfaction, risk management, investor relations, operating targets, human resources, integrity, compliance, sustainability and similar intangible goals.
- Only one-third of any cash bonus should be paid immediately; the remaining two-thirds should be deferred for three or four years.
- Non-cash incentive compensation, which could include stock awards but not stock options, should likewise be deferred for three or four years.
- Bonus compensation should range from 0% of fixed compensation (when no profits were generated), to no more than 100% of fixed compensation, and the 100% of yearly salary level should generally be confined to the largest banks with extensive international operations or small banks with low fixed compensation levels.

The NVB has indicated that these changes should be adopted as of January 1, 2010. This recommendations are applicable to the 90 Dutch or foreign banks located in the Netherlands, as well as to the subsidiaries of the Dutch banks located abroad. In addition, each bank is invited to set out caps regarding the remuneration of its employees.

France

In France, in February, the French Banking Federation ("FBF"), which represents all the French banks, issued a code of conduct which prohibits banks from providing a guaranteed bonus over a period of more than one year. In addition, bonus payments earned in one year should be paid out over several years.

In August, the FBF added some additional requirements:

- Bonuses should be paid out over several years (generally, three years) and only if the activity or the institution is profitable. For the highest bonuses, only one-third of the bonus should be paid at the end of the year, the remaining two-thirds should be deferred, and withheld if the operation on which the trader worked turns out not to be profitable.
- One-third of the deferred bonus should not be paid in cash but in stock, which should be kept at least two years.
- The transparency in disclosing to the bank's shareholders the methods of calculation of the bonuses and the proportion of the bonuses paid compared to the earnings of the bank should be improved.

European Union

On September 17, 2009, the 27 EU members reached a consensus on bank executive and trader compensation. Their agreement included these key points:

- The need to avoid guaranteed bonuses;
- The need to ensure appropriate board oversight of the compensation and risk;
- The need to strengthen transparency and disclosure requirements;
- A "clawback" system whereby bonuses of the traders could be cancelled where the bank's earnings deteriorated after the original performance period;
- A "bonus/penalty" system: payment of the major part of a bonus would be deferred for an appropriate period of time in order to ensure that the investment or operation on which the remuneration is based has been profitable;
- The calculation of bonuses should take into account the performance of the bank, the business unit and the individual;
- Variable remuneration should be set at an appropriate level in relation to fixed remuneration;
- Bankers should be prevented from exercising stock options and from selling such stocks for an appropriate period of time; and
- Supervisory boards must have the means to reduce compensation if the bank's performance deteriorates.

So far, no consensus has been reached in the EU regarding the possibility of capping bankers' remuneration. The Members States have indicated only that they will explore ways to limit total variable remuneration in a bank to a certain proportion either of total compensation or of the bank's revenues and/or profits.

International Labor and Employment Law Practice Group

Proskauer Rose LLP's International Labor and Employment Law Practice Group counsels companies doing business globally in connection with the employment issues they face in their workplaces around the world.

For more information about this practice, click here or contact:

Bettina B. Plevan
212.969.3065 – bplevan@proskauer.com

Aaron J. Schindel
212.969.3090 – aschindel@proskauer.com

Howard Z. Robbins
212.969.3912 – hrobbins@proskauer.com

Yasmine Tarasewicz
33.1.53.05.60.18 – ytarasewicz@proskauer.com

Anthony J. Oncidi
310.284.5690 – aoncidi@proskauer.com

Jeremy M. Mittman
310.284.5634 – jmittman@proskauer.com

Allan H. Weitzman
561.995.4760 – aweitzman@proskauer.com