

## Update on ...

### Revision of FINMA Regulations Regarding Corporate Governance and Remuneration Schemes

#### Consequences for corporate governance and compensation practices in the financial services industry

December 2016

The Swiss Financial Market Supervisory Authority (FINMA) conducted a consultation from 1<sup>st</sup> March to 13<sup>th</sup> April 2016 to obtain input on proposed new requirements regarding corporate governance, compensation and risk management at financial services organizations. FINMA accepted a number of the recommendations from the consultation process.

The revision of the circulars was conducted on the basis of principle-based regulation, i.e. while the FINMA sets out the principle requirements, it is the responsibility of each institution to implement the requirements in such a way that they take into account their respective business model and risk profile. The following amendments have been made by FINMA:

#### **New circular 2017/1 (“Corporate governance – banks”/ “Corporate Governance – Banken”)**

FINMA has revised its corporate governance requirements for banks by consolidating the provisions of circular 2008/24 („Monitoring and internal control - banks“) and requirements defined in other circulars into a new circular 2017/1 („Corporate governance – banks“). The new circular will enter into force on 1<sup>st</sup> July 2017.

#### **Revised circular 2010/1 (“Remuneration schemes” / “Vergütungssysteme”)**

FINMA has also revised circular 2010/1 („Remuneration schemes“). The final circular will also enter into force on 1<sup>st</sup> July 2017.

#### **Circular 2017/1 (“Corporate governance – banks”)**

The new „Corporate governance – banks“ circular underlines the importance of modern corporate governance and appropriate and effective risk management. The most relevant requirements regarding corporate governance that are included in the new circular are as follows:

##### **Board of directors**

The duties and responsibilities of the board of directors include the appointment of the chief risk officer (CRO) and the head of internal audit (who can also be appointed by the audit committee). With regard to the composition of the board of directors, consultation participants agreed that the board of directors should be diversified in terms of expertise and specialist knowledge of key aspects of the business (including finance, accounting and risk management), but criticized the explicit requirements with regard to certain other competencies (in particular, IT). FINMA decided to keep the principle of the balanced composition of the whole

board while at the same time only mentioning those competencies, which are indispensable for any banking institution.

##### **Independence**

The circular introduces a requirement for at least one third of the board of directors to be independent. According to the consultation participants, this can cause difficulties for medium and small banks. The FINMA decided to retain this requirement, but introduced a possibility of granting exceptions in individual cases.

##### **Audit and risk committee and independence of committee members**

Consultation participants criticized the initial requirement for institutions to establish separate audit and risk committees, each with a majority of members that are independent. FINMA agreed that category 3 banks may, depending on the size and risk profile of the institute, establish a combined audit and risk committee and introduced a possibility of granting exceptions in individual cases with regard to the requirement for at least one half of the committee members to be independent.

##### **Chief Risk Officer (CRO) function**

Institutions in supervisory categories 1 to 3 are obliged to have an autonomous risk control and compliance function as independent control bodies. However, the CRO can, in addition to risk control, also be responsible for other independent control bodies (e.g. compliance). The new circular also prescribes that a CRO in systemically important institutions has to be a member of the executive board.

The circular provides for a transition period with regard to the last three requirements mentioned above. While the circular will come into effect on 1<sup>st</sup> July 2017 the above provisions must be implemented within one year after its entry into force, i.e. by 1<sup>st</sup> July 2018.

hkp/// group is a partner-led, international consulting firm headquartered in Switzerland, which specializes in performance management, talent management and compensation. We have extensive expertise in regulatory and corporate governance issues concerning the financial services industry. This update summarizes the recent revisions of FINMA circulars, which affect corporate governance and compensation practices.

## Circular 2010/1 (“Remuneration schemes”)

The following changes were made to FINMA circular “Remuneration schemes”:

### Scope of application

The implementation of the circular will be mandatory for all organizations, which are required to maintain equity capital of at least CHF 10 billion (previously CHF 2 billion). However, as was the case previously, all institutions (including those that are not required to comply with the circular) are recommended to take its principles into account.

### Clawback

A number of participants of the hearing expressed doubts about the legal enforceability of clawback clauses, which would require institutions to reclaim remuneration already paid. FINMA acknowledged these concerns and decided not to introduce a clawback requirement in the circular. However, in case of damage banks are required to review whether a clawback of compensation or legal action to obtain payment of damages is possible.

### Board approval of the remuneration of the heads of control functions

The revised circular now specifies that the remuneration of the heads of the control functions should now also be approved by the board of directors annually. During the consultation process it was discussed that board approval of the remuneration of the heads of the control functions should not be required. However, FINMA argued that in practice this requirement does not create additional requirements for those institutions that are required to implement the circular since they already have a compensation committee, which approves the remuneration of senior management, including the heads of the control functions.

### Hedging

The circular now explicitly prohibits transactions which run counter to the effectiveness of elements of the remuneration system, e.g. hedging transactions. During the consultation process it was argued that it is not possible for institutions to ensure compliance with this rule, e.g. where hedges are carried out by related parties. FINMA maintained that it expects institutions to enforce compliance.

## The hkp/// group perspective

The consolidation of the supervisory requirements relating to corporate governance, internal control systems and risk management into one circular creates clarity and transparency. While most of the requirements set out in the new circular 2017/1 (Corporate governance – banks) are already contained in relevant laws, financial services organizations are advised to review their current corporate governance practices to ensure compliance with the new circular.

The limitation of the scope of circular 2010/1 (Remuneration schemes) to organizations, which are required to maintain equity capital of at least CHF 10 billion, is welcome. The decision not to introduce a clawback requirement is appropriate as such provisions have been legally difficult to enforce. While monitoring the prohibition of hedging can create practical issues, the principle is in line with best practice in other jurisdictions and industries.

## Your contacts

If you have any questions regarding the content of this update or other regulatory matters affecting financial services, please contact:



Melanie Wagner  
Senior Manager  
+41 44 542 81 62  
melanie.wagner@hkp.com



Barbara Seta  
Senior Partner  
+41 44 542 81 67  
barbara.seta@hkp.com

### Amsterdam

Vondelstraat 89A  
1054 GM Amsterdam  
The Netherlands  
Phone +31 20 737 0687  
amsterdam@hkp.com

### Dordrecht

Singel 380  
3311 HM Dordrecht  
The Netherlands  
Phone +31 78 613 72 76  
dordrecht@hkp.com

### Frankfurt

Friedrich-Ebert-Anlage 35-37  
60327 Frankfurt am Main  
Germany  
Phone +49 69 175 363 30  
frankfurt@hkp.com

### Zurich

General-Guisan-Quai 36  
8002 Zurich  
Switzerland  
Phone +41 44 542 81 60  
zurich@hkp.com