RBI proposes tightening compensation norms for private, foreign banks

The proposed guidelines also said minimum 50 percent of variable pay is to be via non-cash component while mandating a compulsory deferral mechanism for variable pay, regardless of quantum of variable pay.

Seeking to curb excessive salary payout practices, the Reserve Bank has proposed strict compensation norms for senior officials of private as well as foreign banks, including minimum 50 percent variable component and money clawback provisions.

Floating a discussion paper, the central bank has also proposed that variable pay of CEO and whole-time directors, among other key personnel, should be "capped at 200 percent of fixed pay". Earlier variable pay was capped at 70 percent of fixed pay but did not include Employee Stock Option Plan (ESOP).

High pay packets and excessive risk-taking ways in the banking industry have been under the scanner ever since the global financial crisis of 2008. Employees were too often rewarded for increasing short-term profit without adequate recognition of the risks and long-term consequences for their organisations.

"These (2012) guidelines are being reviewed, with an objective to better align with FSB (Financial Stability Board) Principles and Implementation Standards, based on experience and evolving international best practices," the RBI said.

Apart from CEOs and whole-time directors, the proposed changes in compensation would be applicable for "material risk takers and control function staff".

It has also been suggested that ESOPs should be included as a component of variable pay.

The proposed guidelines also said minimum 50 percent of variable pay is to be via non-cash component while mandating a compulsory deferral mechanism for variable pay, regardless of quantum of variable pay.

"It should be ensured that there is a proper balance between fixed pay and variable pay. The total variable pay shall be limited to a maximum of 200 percent of the fixed pay (for the relative period).

"Within this ceiling, at higher levels of responsibility, the proportion of variable pay should be higher. The deterioration in the financial performance of the bank should generally lead to a contraction in the total amount of variable compensation paid," the discussion paper said.

Further, the paper said banks are required to put in place appropriate modalities to incorporate "malus/ clawback mechanism" in respect of variable pay, taking into account relevant statutory and regulatory stipulations as applicable.

"Wherever the assessed divergence in bank's asset classification or provisioning from the RBI norms exceeds the prescribed threshold for public disclosure, the bank shall not pay the unvested portion of the variable compensation for the assessment year under 'malus' clause," it added.

A malus arrangement permits a bank to prevent vesting of all or part of the amount of a deferred remuneration. A clawback, on the other hand, is a contractual agreement between the employee and the bank in which the employee agrees to return previously paid or vested remuneration to the bank under certain circumstances.

In case of divergence (difference between bad assets declared by bank and assessed by RBI), no proposal for increase in variable pay (for the assessment year) should be entertained, it added.

Comments have been sought on the discussion paper till March 31.

In the discussion paper, the RBI said compensation practices, especially of large financial institutions, were one of the important factors which contributed to the global financial crisis in 2008.

"These perverse incentives amplified the excessive risk taking that severely threatened the global financial system. The compensation issue has, therefore, been at the centre stage of the regulatory reforms," it said.

The Financial Stability Forum (later the Financial Stability Board) in 2009 brought out a set of Principles and Implementation Standards on sound compensation practices.

The guidelines have been proposed for private sector banks, including Local Area Banks, Small Finance Banks and Payments Banks. For the foreign banks operating in India by way of Wholly Owned Subsidiary structure, the guidelines would be same as that for private sector banks in the country.

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