



Why HRD and Reward teams must work together to respond to the FSA's new focus on bonus plans

Summary

- o The changes to financial sector reward systems likely to result from the global financial crisis are not just an issue for reward specialists. HRD and reward teams will need to work together to ensure a fit between new reward structures and the approach to performance and talent management.

Context

- o City bonus structures are seen as partly to blame for the current financial crisis.
- o The Financial Services Authority (FSA) has engaged in debate with major banks about how bonus structures should be changed in future. This includes some high-level examples of what the FSA sees as good and bad practice in this area.
- o The implication is that businesses that don't satisfy the FSA that their reward arrangements follow good practice will be hit financially through higher regulatory fees and/or the requirement to maintain a higher level of capitalisation - so there's a real imperative to act.

How bonus structures are likely to change

- o Achievement of financial targets - probably profit - will remain key, but on a risk-adjusted basis. The riskier the underlying transactions, the smaller the resulting bonus for a given level of profit.
- o The impact of behaviours on clients and colleagues is likely to play a bigger part in determining bonus levels.
- o Performance over a number of years will be a factor in bonus payments.
- o Bonus deferral will become standard practice, and deferral may be for longer than the typical current practice of three to four years.
- o Bonus claw-back arrangements will be put in place so that bonus awarded for transactions that look good at the time but which go wrong in subsequent years can be scaled down through the non-payment of the deferred portion of the award.

The implications for HR professionals

- HR will need to understand how business risk is measured and monitored, and what constitutes an acceptable level of risk. This is especially true for reward professionals, but also for HR teams tasked with developing robust performance management systems, and for anyone engaged in identifying and coaching high fliers.
- Businesses still need to take risks to survive and prosper. Successful businesses will be those that manage these risks most effectively. Executive coaching and talent management systems must give the appropriate weight to risk-taking and risk management skills.
- Do existing performance review systems provide the right information for bonus decision-makers? They should cover the way in which results are delivered (behaviours/working methods) as well as what is achieved in terms of financial targets.
- Individual performance will need to be tracked across a number of years. This is needed for decisions on payment of deferred bonuses. The FSA have suggested averaging results over a seven-year period for determining what portion of a deferred award should be paid out. This needs some thought about how meaningful performance information (mainly financial) can be maintained over this kind of time-frame, and how to take account of information on other factors (business re-organisation, market shifts, decisions taken by other people) that may effect how transactions undertaken this year are viewed in the future.

Practical steps that HR teams can take now

- Don't leave it to the reward professionals to develop a response, get HRD and reward teams working together from the outset.
- Build your understanding of financial management information - how risk is measured in different parts of the business, how individual or team financial performance is tracked.
- Review existing bonus structures, performance and talent management systems and identify what action needs to be taken.
- Monitor the evolving market practice closely. Your competitors will be tackling exactly the same issues, there may be lessons to be learned from their approach and in any event it will be important to maintain a competitive position for your reward structures.
- Involve key business stakeholders, e.g. sales leaders and risk managers, and get their input and buy-in to the changes you plan to make.
- Don't leave successful implementation to chance - put a robust project management framework in place.