BANCO DE PORTUGAL
EUROSYSTEM

BANKERS' PAY, INCENTIVES AND REGULATION CONFERENCE
Lisbon, 29 -30 September 2017

Opening Remarks by Governor Carlos da Silva Costa[1]

Let me start by welcoming you all to Lisbon and to Banco de Portugal to discuss bankers' pay, incentives and regulation.

Since the 2008 financial crisis, these topics have received much attention and have been frequently debated by academics, policy-makers, supervisors, regulators and market analysts.

The specific goal of this Conference is to bring together researchers working on these areas – both at the theoretical and empirical level – so as to provide better foundations for solid policy-making. I am sure that tomorrow, at the end of the Conference, we will be able to say that this objective has been accomplished.

Inadequate corporate governance models can lead to distorted policies, wrong incentives, short-termist behaviour, accounting manipulation and even fraud. In particular, poorly designed remuneration policies and incentives can potentially have detrimental effects on the sound management and control of risks and favour excessive risk-taking.

[1] As prepared for delivery.

The fact that bankers' pay and incentives have been blamed, at least in part, for the global financial crisis, has led regulators all around the world to respond and to move towards new standards and new rules in this area. Indeed, there have been widespread concerns and evidence that the prevailing compensation structures of financial firms created the conditions for excessive and imprudent risk-taking with the highly damaging consequences that we all have witnessed.

Consequently, improving banks' governance models and compensation practices came to the forefront of regulatory reform efforts, in an attempt to align incentives and to ensure long-term sustainability of financial institutions.

The regulatory framework reflects society's preferences in terms of risk protection. These preferences evolve over time and so does regulation. In the aftermath of the crisis, the general public as well as political leaders and decision-makers asked for stricter financial regulation and supervision, leading to unprecedented changes on the financial front, which included compensation policies. This should be taken into account when society changes its preferences over risk protection.

This challenge has also been addressed by EU regulators, namely through the CRDIV/CRR provisions and EBA and ESMA guidelines on sound remuneration policies. The remuneration requirements aim to ensure that remuneration policies are consistent with and promote sound and effective risk management, do not provide incentives for excessive risk-taking and are aligned with the long-term interests of the institutions across the EU.

I am sure that the discussion at this conference will shed more light on compensation design and practice in the banking sector and on the role of compensation schemes on bank risk-taking and misconduct. Additionally, it is important to go beyond the identification of the problems and of their potential consequences on the financial system. It is also necessary to look at the effectiveness and the consequences (intended and unintended) of the regulatory remedies.

The role of financial regulators is, first and foremost, to ensure the stability of the financial system. To fully accomplish their mission, it is essential that they continue exploring the ultimate causes of financial crises, with valuable input from researchers. It is also crucial that they monitor and treat those causes – relying on current or new policies – while paying due attention to potential unintended consequences, namely those stemming from a changing environment.

Regulation plays a key role in reducing vulnerability and sources of risk and in containing the costs of financial instability when it arises. It should seek to make the financial system safer, but flexible enough to play its role as a driver of economic development and to respond to new paradigms.

Thank you.