



**UNIVERSITY OF GOTHENBURG**  
**SCHOOL OF BUSINESS, ECONOMICS AND LAW**

Master Degree Project in Accounting

# **Remuneration Policies for Banks without Variable Remunerations**

Interpretation of regulations in savings banks

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Master Degree Project No. 2014:25  
Graduate School

## Acknowledgements

We would like to express our gratitude to the people who made this thesis possible. Firstly, we would like to thank our supervisors Mikael Cäker and Viktor Elliot for their commitment and support. We have especially appreciated their quick responses and valuable feedback during our thesis process. Secondly, we would like to thank our four respondents from Sparbanken Alingsås AB, Tjörns Sparbank, Orusts Sparbank and Sparbanken Lidköping AB for taking their time to participate in this study and for sharing their thoughts on the subject. Finally, we would like to thank the students in our seminar group for giving us feedback throughout this process.

Gothenburg, 26<sup>th</sup> of May 2014

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## Abstract

**Master thesis in Accounting, University of Gothenburg - School of Business, Economics and Law.**

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**Title:** Remuneration policies for banks without variable remunerations - Interpretation of regulations in savings banks.

**Background:** After the latest financial crisis, a debate regarding risk management and remunerations within the financial sector has arisen. New regulations concerning remuneration have been launched in order to reduce short-term thinking and excessive risk-taking in the sector. Savings banks have historically had low credit losses and are considered to be risk averse; despite this the savings banks must comply with the regulations that generally are perceived to be aimed at the larger banks.

**Purpose:** The purpose of this thesis is to understand how savings banks have interpreted regulations concerning remuneration.

**Method:** In order to fulfill the purpose of this thesis, four minor case studies have been conducted. These minor case studies are primarily based on interviews with four savings banks, and complemented with the savings banks' remuneration documents. In addition, we have reviewed the relevant regulations concerning remunerations. By using these three sources of material we are able to understand how savings banks have interpreted regulations concerning remuneration.

**Conclusion:** Our conclusion is that the savings banks emphasize the importance of complying with regulations in order to gain legitimacy, but at the same time the regulations concerning remuneration policies have not resulted in any significant changes in the savings banks' operations or remuneration system. Thus, two parallel phenomena regarding how savings banks interpret regulations concerning remuneration exist.

**Suggestions for further research:** We suggest two areas of interest for further research. Firstly, it would be interesting to gain a deeper understanding of how FFFS 2014:1 influence savings banks' operations. Secondly, a case study could be conducted to understand savings banks' risk management deeper and how employees at different positions perceive and work with risk.

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## Chapter One: Introduction

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*In this first chapter, a background and problem discussion is presented, which ends with our research question. Further, the purpose of this thesis is stated and finally the disposition of the following chapters is provided.*

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### 1.1 Background and problem discussion

In the aftermath of the latest financial crisis, a discussion regarding remunerations in the financial sector has arisen. Part of the debate focuses on risk management by stakeholders such as politicians and regulators. Risk management is particularly important within the financial sector since it creates trust and stability (The Swedish Financial Supervisory Authority, 2013). In 2008, the European Commission appointed a group to write a report regarding the European financial regulations. This work resulted in The Larosière report, which discusses reasons for the financial crisis and several of these reasons are connected to the subject of risk management. The report states that within the financial sector, the remuneration structure has led to risk-taking and short-term focus. Furthermore, the authors claim that remunerations have been excessive (Larosière, Balcerowicz, Issing, Masera, Mc Carthy, Nyberg, Pérez & Ruding, 2009). This view is also presented by Shlomo, Eggert & Nguyen (2013) who emphasize that bonuses within the financial sector were not risk-adjusted prior to the latest financial crisis. The authors conclude that there has not been sufficient risk management in order to prevent excessive incentives (Shlomo, et. al, 2013). Another study concerning British banks finds that business failure might be partly explained by insufficient remuneration policies (Chen, Zhang, Xiao & Li, 2011). Recently, remuneration reforms have been implemented in Europe to reduce short-term focus (Shlomo, et. al, 2013). This is for instance visible in Sweden, where the first regulation concerning remuneration policies *FFFS 2009:6 Regulations and general guidelines governing remuneration policies in credit institutions, investment firms and fund management companies* was launched in 2009 in order to decrease short-term focus and risk-taking within the banking sector (The Swedish Financial Supervisory Authority, w.y. a).

In 2011, *FFFS 2009:6* was replaced by *FFFS 2011:1 Finansinspektionen's regulations regarding remuneration structures in credit institutions, investment firms and fund management companies licensed to conduct discretionary portfolio management*, which aims to improve the risk management concerning remuneration policies within companies in the financial sector (The Swedish Financial Supervisory Authority, w.y. b). This regulation concerns both larger banks and savings banks in Sweden (*FFFS 2011:1*). Savings banks have a history of being risk averse (Bergendahl & Lindblom, 2008; Gardener, Molyneux, Williams & Carbo 1997) and having low credit losses (The Swedish Savings Banks Association, 2014). According to Silver (2007, 2011), new regulations are forced upon savings banks despite the fact that the regulations are generally perceived to be aimed at the larger banks. It can also be seen that it is more difficult and more expensive to operate a savings bank today (Silver,

2011). Further, it has been found that many regulations have a more negative impact on smaller organizations than on larger ones (Chilton & Weidenbaum, 1982). In addition, Lundberg (2013) came to the conclusion that Swedish savings banks might need a regulatory framework separated from the one for larger banks.

The savings banks are considered important to maintain competition within the financial sector (Ayadi, Schmidt, Valverde, Arbak, & Fernandez, 2009). Another advantage with different forms of financial institutions is that savings banks and larger banks tend to have different portfolio structures and different attitudes towards risk, which reduces systemic risk (Ayadi et al., 2009). Goodhart & Wagner (2012) state that financial regulators increase systemic risk by imposing regulations, which force the financial institutions to become too similar. The authors claim that it is important to have diversity among the actors in the financial sector. The reasoning by Ayadi et al. (2009) and Goodhart & Wagner (2012) highlight the importance of understanding how savings banks manage external pressure, in form of new regulations, that require the savings banks to change and formalize their existing risk management processes.

In order to gain a deeper understanding of how the savings banks interpret regulations and handle risk management, we draw upon the notions of Power (2009) and Mikes (2011). Power (2009) discusses different ways of handling risk management, and highlights two main approaches, namely rule-based compliance and critical imagination of alternative futures. Mikes (2011) develops Power's ideas and applies his notions on the banking sector. Mikes (2011) finds that banks handle risk management in two ways. The first group has a quantitative enthusiasm, where risk measurement is fundamental. The second group has a quantitative skepticism, and adopts an approach that is more influenced by judgment. These theoretical notions will be used in our analysis, and our study aims to contribute with new insights and understanding regarding how savings banks handle risk management and interpret new regulations. The regulation concerning remuneration policies is not aimed at an issue that specifically is associated with savings banks. Despite this, the savings banks must comply with the regulation, which could indicate a mismatch between the regulation and savings banks' operations. Thus, it is highly interesting and relevant to try to better understand how savings banks interpret and manage regulations that are not specifically made for their operations.

## 1.2 Research question

- How have savings banks interpreted regulations concerning remuneration policies?

## 1.3 Purpose

The purpose of our thesis is to understand how savings banks have interpreted regulations concerning remuneration. We aim to fulfill this purpose by conducting four minor case studies, based on interviews, remuneration documents published by the banks, and relevant regulations.

## 1.4 Disposition

### Introduction

In the first chapter, a background and problem discussion is presented, followed by the research question and the purpose of the study.

### Method

In the second chapter, the research approach and design is presented, followed by the chosen method. Throughout the chapter, we discuss measures to increase the quality of the study.

### Frame of reference

In the third chapter, the relevant theoretical framework is presented, including risk management and judgment, the 4I framework and incentive systems.

### Empirical material

In the fourth chapter, we present the relevant regulations, followed by a presentation of Swedish savings banks. Further, the four savings banks are presented, including their remuneration documents and material from the conducted interviews.

### Analysis

In the fifth chapter, we analyze our empirical material by using our frame of reference. The emphasis is on how the savings banks have interpreted the regulations concerning remuneration policies.

### Final discussion

In the sixth chapter, we draw conclusions based on our analysis. Finally, we provide two suggestions for further research.



## Chapter Two: Method

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*In this chapter we present our research approach and design. We then present and discuss our chosen method. Throughout the chapter, we discuss measures to increase the quality of the study.*

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### 2.1 Research approach

Our research question belongs to the interpretivism paradigm, which considers the reality to be subjective and that people have their own view of reality. Further, interpretivism is often connected with qualitative methods (Collis & Hussey, 2009). A qualitative study is to prefer when the researcher aims to understand the respondent's reasoning concerning a specific phenomenon (Trost, 2005) and to reach an understanding of the respondent's experiences (Kvale, 1996). Since FFFS 2011:1 can be considered to be foremost aimed at larger banks, and our area of interest is savings banks, it is interesting to understand how an increased launch of regulations influence savings banks. In order to get an understanding of underlying reasons for different interpretations and to understand how the respondents' experiences influence this interpretation we use a qualitative method to answer our research question. During our research process, we conducted interviews and analyzed four Swedish savings banks' remuneration documents. In addition, our empirical material includes information regarding the relevant regulations from The Swedish Financial Supervisory Authority.

### 2.2 Research design

In order to fulfill our purpose, namely to understand how savings banks have interpreted regulations concerning remuneration, we have conducted four minor case studies. These minor case studies are primarily based on interviews, and complemented with remuneration documents that are published by the savings banks on their websites. Further, the empirical material contains a presentation of the relevant regulations concerning remuneration. These three sources of material enable us to understand how savings banks have interpreted regulations concerning remuneration. Since the control function at each savings bank consists of one employee we were able to gain the needed information by conducting only one interview at each bank. Hence, we got the possibility to interview several savings banks, which enabled us to see how four different savings banks have interpreted and handled the regulations.

### 2.3 Interviews

In this section, we describe how the interviews were prepared and conducted. Furthermore, the limitations of the method are discussed and the actions taken in order to secure the quality of the study are presented. Interviews is a qualitative method that was suitable for this study since it allows the researcher to investigate what people think or feel about a certain phenomenon (Collis & Hussey, 2009). Silverman (2011) states that an interview is useful since the method contributes to an understanding and knowledge about the studied

phenomenon. The method allows the researcher to obtain the respondent's point of view and experiences (Silverman, 2011). Further, Trost (2005) states that qualitative interviews contribute with extensive answers. There are different types of interviews, namely unstructured, semi-structured and structured. We perceived that the semi-structured interview was the most suitable method for this study since it provides some structure, but at the same time allows for probes and an opportunity for the interviewee to elaborate on interesting aspects. The semi-structured interview increases the possibility of capturing important insights (Collis & Hussey, 2009).

Some critique towards interviews as a method has been raised. One risk is that the respondents do not fully understand the questions asked during the interview (Silverman, 2011). In an attempt to avoid this, we stated the questions as clear and precise as possible. Another risk when conducting interviews is that the interviewer does not have sufficient knowledge to ask the relevant questions (Silverman, 2011). In order to minimize this risk, we read and thoroughly prepared for each interview.

It is important to be well prepared for the interview to capture as much information as possible. For instance, the aim of the research should be determined to construct suitable questions. When approaching the potential respondents we described the purpose of our study to make sure that they knew what was expected from both parties (Patel & Davidson, 2003). We also sent the interview guide in advance so that the respondents could prepare themselves. We were aware of the fact that sending the questions in advance might result in less spontaneous answers during the interview. However, we valued the possibility of receiving extensive and elaborate answers. Further, one of us was responsible for posing the questions, while the other one took notes (Collis & Hussey, 2009). Trost (2005) claims that it could be a potential advantage to be two interviewers present since the chance of capturing the correct content increases. However, there is a risk that the respondent might feel outnumbered and intimidated by two interviewers (Trost, 2005). Therefore, we began the interviews with a general question regarding the respondent's work experience in order to make the respondent comfortable (Collis & Hussey, 2009).

Further, we asked the respondent in the beginning of each interview for permission to record it. One of the respondents did not give his permission to record the interview, and therefore notes were taken extra carefully during this interview. The rest of the interviews were recorded. After each interview, we discussed our perceptions of the interview and transcribed it to secure that the information was correctly interpreted (Kvale, 1996). Another advantage with recording the interviews is the possibility to both analyze the respondents' tone as well as to analyze our own performance. In this way, we learned and improved our interviewing techniques for the next interview (Trost, 2005). Kvale (1996) states that interviewing can be seen as a craft and therefore it was important that we practiced our interviewing skills. Finally, we sent a summary of the interview to the respondents in order to receive feedback and to assure that we had interpreted the respondent's answers correctly, and hence increased the validity of the study (Collis & Hussey, 2009). One of the respondents asked for a clarification, which we took into consideration and it resulted in a small adjustment.

## 2.4 Selection

In order to answer our research question *How have savings banks interpreted regulations concerning remuneration policies?* we conducted interviews. The purpose of our study is to understand how savings banks have interpreted regulations concerning remuneration. Therefore, we selected a sample that was based on our research question.

### 2.4.1 Selection criteria

To select a sample we started by going through all websites of the savings banks located in the west region of Sweden focusing on their remuneration documents. The reason for limiting the sample to Swedish savings banks located in the west region was the possibility to get in touch and visit the branches. When we went through the websites of the savings banks, we encountered different ways of publishing their remuneration documents, which indicated different interpretations and implementations of FFFS 2011:1 and FFFS 2011:3. *FFFS 2011:3 Regulations amending Finansinspektionen's regulations and general guidelines (FFFS 2007:5) regarding disclosure of information concerning capital adequacy and risk management* includes regulations concerning disclosure of information regarding remuneration systems (FFFS 2011:3). For instance, FFFS 2011:3 states that “*a firm shall disclose the following information about its remuneration policy and the application of this policy in an appropriate manner given the firm's size and the nature, scope and complexity of its activities*” (FFFS 2011:3, p. 2). Further, FFFS 2011:3 includes a general guideline stating that information regarding remuneration systems “*should be available on the firm's website even if it is provided in the annual report, the consolidated accounts or the interim reports*” (FFFS 2011:3, p. 2). FFFS 2011:1 states that the so-called specially regulated staff shall be identified by the firm (FFFS 2011:1). As can be noticed, the abovementioned formulations open up for different interpretations.

We classified the banks depending on which remuneration documents that were published on their websites and we identified four main ways of publishing this information, which we have divided into four groups. First, some banks published a remuneration policy. Second, others published an information document concerning remuneration. Third, some banks published two documents, namely both their remuneration policy and an information document regarding remuneration. Finally, the remaining banks published the same documents as group three, but with the addition that they specifically named the specially regulated staff. These four different ways of publishing the information might be an indicator that the Swedish savings banks have interpreted and implemented the regulation differently.

Based on the aforementioned groups, Sparbanken Alingsås AB was chosen as a respondent in the first group, namely a bank that publishes a remuneration policy. In the second group, Tjörns Sparbank was chosen as a respondent among the banks that publishes an information document concerning remuneration. Orusts Sparbank was selected for group three, namely the banks that publish two documents: both their remuneration policy and an information document regarding remuneration. Finally, Sparbanken Lidköping AB was chosen as respondent in the fourth group, namely the banks that publish the same documents as group three, but with the addition that they specifically name the so-called specially regulated staff.

Thus, these four savings banks were our sample, and it is presented in the following table (table 1).

Group	1	2	3	4
Bank	Sparbanken Alingsås AB	Tjörns Sparbank	Orusts Sparbank	Sparbanken Lidköping AB
Remuneration policy	X		X	X
Information document		X	X	X
Names specially regulated staff				X

*Table 1. Overview of the selected savings banks' documents regarding remuneration.*

### 2.4.2 Selection of respondents

It is important that the respondents have the relevant experience and knowledge about the savings bank's remuneration system and remuneration documents. Since the savings banks are relatively small we approached the CEO of each savings bank. The CEO then guided us to the right employee who could answer our questions regarding the interpretation of FFFS 2011:1. The respondent from Sparbanken Alingsås AB was the risk control manager. Regarding Tjörns Sparbank, the respondent was the compliance officer. The respondent from Orusts Sparbank was the deputy CEO and credit officer. Finally, the CEO represented Sparbanken Lidköping AB.

### 2.5 Interview guide

Several aspects were considered when we constructed the questions for the interview guide. In general, we carefully considered and discussed the formulation of the questions. Trost (2005) emphasizes the importance of asking direct and clear questions, which we had in mind when constructing the interview guide. Further, we avoided using negations, provocative or hypothetical questions, which is in line with the ideas of Trost (2005). We started the interviews by asking the respondents to briefly describe his or her professional background and then we introduced the main topic. According to Kvale (1996) and Trost (2005) it is suitable to start the interview with such introducing questions. Closed questions were avoided to a large extent in order to gain broad information (Collis & Hussey, 2009). However, some closed questions were deliberately used in order to obtain concrete information. In order to not miss out on broader information we asked probing questions, which enabled the respondent to elaborate on the issue (Kvale, 1996). The interview guide is attached in Appendix 1.

### 2.6 Analysis of regulations concerning remuneration and of remuneration documents

Two of The Swedish Financial Supervisory Authority's regulations, namely FFFS 2011:1 and FFFS 2011:3 were the starting point of this thesis. These regulations were retrieved and analyzed to gain an understanding of the content. In order to broaden and deepen our empirical material, we retrieved the chosen savings banks' remuneration documents. As aforementioned, the savings banks did not publish the same documents, but we collected the available ones from their websites. The collected documents were carefully read and used throughout the process to gain an understanding of how the savings banks have interpreted the

regulation. The interview material was complemented with information found in the collected documents. In addition, an internal document has been used in the empirical section, but only a short paragraph was based on this document. The reason for using this document was that the information could not be found elsewhere and that we consider the document to be credible.

## **2.7 Construction of frame of reference**

In order to gather information regarding our topic, we used several sources. Firstly, we started by reading previous master theses and licentiate theses. Secondly, we read academic articles and books in order to deepen our knowledge. By doing this, we found information related both to banks, remuneration policies and risk management, as well as input to construct our theoretical framework. When we read the material, we followed up on relevant sources found in the articles and books. Thirdly, different websites were used, for instance The Swedish Savings Banks Association, The Swedish Financial Supervisory Authority and the savings banks' own websites. Finally, in order to find appropriate articles and books we used the databases provided by the Gothenburg university library.

Key words that we used were for instance remuneration, banks, financial institutions, savings banks and risk management. In addition, we used synonyms and alternative combinations of the wordings in order to increase the possibility of finding appropriate material. Further, we carefully collected and saved all used resources throughout our process. Moreover, during our research process we constantly discussed and critically evaluated our material.

## **2.8 Method for analysis**

The analysis of the collected empirical material was conducted in several steps. Firstly, we started by going through the transcribed material, and if needed listened to the recorded material in order to obtain the respondent's voice and tone (Troost, 2005). Secondly, we used our theoretical framework when developing suitable themes in the empirical material in order to structure the material (Kvale, 1996). Thirdly, we conducted data reduction to systematically choose what information to use in the analysis (Lantz, 2007). Fourthly, we interpreted the collected material using our frame of reference, and theoretical concepts were used in the analysis even though the respondents had not explicitly used these concepts (Lantz, 2007). In addition, during the entire process of writing this master thesis, we continuously reflected and took notes regarding possible ideas for the analysis (Troost, 2005). However, we put the empirical material away for a few days to get some distance before starting the full analysis of the material, which is in line with Troost's (2005) recommendations.

## **2.9 Ethical issues**

Kvale & Brinkmann (2009) present four ethical guidelines that should be considered when conducting interviews, namely informed consent, confidentiality, consequences and the role of the researcher. Firstly, it was important to explain the purpose of our study to the respondents and make sure that they understood that their participation was voluntary. Secondly, none of the respondents requested to be treated with confidentiality. Thirdly, it was important for us as researchers to critically reflect upon what the consequences of our study

were for the involved parties. Finally, it is important to consider the role of the researcher and his or her integrity (Kvale & Brinkmann, 2009).

### **2.10 Credibility**

It is important for researchers to assure that his or her work is credible (Trost, 2005). In order to secure that our master thesis has high credibility, we took certain measures throughout the process. Firstly, we reflected and discussed potential ethical issues, which we also included in this method chapter. Secondly, we attached the interview guide used during our interviews in order to be open with the questions used (Trost, 2005). Worth noticing, however, is that the interviews were conducted in Swedish and that the original interview guide was in Swedish as well. We are aware of the fact that the translation of the interviews from Swedish to English could result in subtle nuance differences. In order to neutralize these differences we thoroughly considered wording and language when we translated the interview material. In addition, we attended language tutoring provided by the University of Gothenburg in order to improve our English skills.

Thirdly, we aimed to be as neutral as possible during the interviews in order to not affect the interviewees' responses (Trost, 2005). Finally, factors such as stress and the interviewees' mood might have influenced the interviewees' answers. In order to avoid a stressful situation, we had in advance dedicated one to one and a half hours for each interview, and we stayed within this time frame. According to our perception, all of the interviewees were relaxed and did not stress through the interview.

### **2.11 Criticism of the sources**

Generally, when using different sources, it is important to critically reflect upon the origin of the sources. There is a risk that the sources are biased and incomplete (Lundahl & Skärvad, 1999). Therefore, one purpose of criticism of sources is to assess the credibility of the sources (Thurén, 2005). Further, we aimed to use material that was published relatively recent, which according to Thurén (2005) increases the credibility of the source. In our master thesis, some older sources have been used; these have been frequently cited and considered to be still valid. The academic articles used were found in the database provided by Gothenburg university library and published in different scientific journals.

## Chapter Three: Frame of reference

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*In this third chapter, we present relevant theoretical frameworks for this thesis. Firstly, we describe the subject of risk management and judgment, followed by a presentation of the 4I framework. Finally, incentive systems and its risks are presented.*

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### 3.1 Risk management and judgment

In this section we present Power's notions of risk management and Mikes' extension of Power's ideas. Mikes applies Power's notions on financial institutions to find out how they handle risk management. We find Mikes' ideas interesting since they are focused on banks, which is relevant for our study. Power's framework outlines two different approaches to risk management; one focusing on risk measurement and one focusing on judgment. In order to answer our research question, it is useful to consider these different risk management approaches to better understand how savings banks have interpreted and implemented regulations concerning remuneration.

Power (2009) presents two approaches of risk management, namely rule-based compliance and critical imagination of alternative futures. Rule-based compliance sets out the required regulations to comply with and involves box ticking. This approach is time consuming, costly and there is a risk of standardization of the risk management. Critical imagination of alternative futures is another approach that stresses the importance of imagining different future scenarios and the inherent risks. Actors within organizations can perceive the rule-based approach as more concrete, while the other approach can cause uncertainty within the organization. However, since the latest financial crisis it has been argued that the critical imagination of alternative futures should be used instead of the rule-based approach.

Further, Power (2004a) states that people in favor of measurement argue that it contributes to increased transparency, while opponents of measurement argue that the role of human judgment will decrease if the focus on measurement becomes too strong. Power (2004b) also discusses the rise of risk management and the strive to manage everything. Wahlström (2013) claims that the strive to manage everything might result in a decreased use of judgment of experts. Moreover, concerning accounting standards, there are two main forms, namely principle-based and rule-based. The first one usually demands for a higher degree of judgment; however, both forms need judgment to some extent (Stuebs & Thomas, 2009). Therefore, judgment and experience is needed in order to complement the formal rules (Schiller, 2013).

Mikes (2011) builds on Power's ideas and investigates risk management within the banking sector and finds that there are two main ways of dealing with risk management. The first group of banks perceives measurement models as robust and concrete, and that risk measurement is central within the risk function. The author means that this group has a

quantitative enthusiasm. The second group on the other hand adopts an approach where judgment is more central, which the author refers to as quantitative skepticism. This group combines initial risk measurements with intuition and experiences. Further, the quantitative skeptics discuss possible future scenarios and provide the top management with this information. These future scenarios are based on prior experience and judgment.

In recent years, it has been an on-going discussion regarding the usefulness of risk measurement and regulation of banks (Mikes, 2011). However, to be able to manage risk, it must be identifiable. Based on the experiences from the latest financial crisis, it seems difficult to predict and identify potential risks (Wahlström, 2013). Further, Wahlström (2013) states that it can be risky to rely on the regulation of risks, since it may provide a false sense of safety. Moreover, Kaplan and Mikes (2012) state that there is a great difference between managing risk and strategy. While strategy focuses on future performance and opportunities, risk management focuses more on threats. It can be seen that many leaders tend to focus on strategy rather than risk, and therefore it is argued that a separate function handling risk is needed in most companies today. However, the authors emphasize the importance of a close relationship between the risk function and top management in order to have a well-functioning risk management (Kaplan & Mikes, 2012).

Chu (1996) discusses the importance of banking regulations since they contribute to maintain stability in the monetary system and to protect the smaller depositors. It can be seen that regulatory bodies continuously launch new regulations upon banks concerning risk measurement (Wahlström, 2013). Moreover, Silver (2007, 2011) states that new regulations are forced upon savings banks despite the fact that the regulations generally are perceived to be aimed at the larger banks. As a result, it is considered to be more expensive to operate a savings bank today, and the competence requirements have increased (Silver, 2011). In addition, Chilton & Weidenbum (1982) have found that many regulations have a more negative impact on smaller organizations than on larger ones.

Finally, we perceive that the regulation provided by The Swedish Financial Supervisory Authority is a formal rule, but despite this rule, judgment and interpretations must be used when implementing a new regulation. The background and experience that the person implementing the new regulation possesses could also influence the way the regulation is interpreted and implemented. In order to communicate and preserve the interpretation of the new regulation, the following section presents an organizational learning framework.

### **3.2 4I framework**

When the new regulation FFFS 2011:1 was introduced, the savings banks had to interpret and adopt this regulation. The process of implementing a new regulation can be regarded as a form of organizational learning, starting at the individual level and ending at the organizational level. Therefore, the 4I framework is used in order to analyze how the Swedish savings banks have interpreted and implemented regulations concerning remuneration.



Based on the organizational learning literature, Crossan, Lane and White (1999) develop a framework called the 4I framework. The 4I framework builds on four assumptions. Firstly, there is a tension between existing learning (exploitation) and new learning (exploration). Secondly, the organizational learning occurs at three levels, namely on individual, group and organizational level. Thirdly, these levels are connected by the four processes of intuiting, interpreting, integrating and institutionalizing (4I's). Fourthly, actions are affected by cognition, but at the same time actions affect cognition. The 4I's are overlapping, but generally intuiting and interpreting occur at the individual level. At the group level interpreting and integrating appear. Finally, at the organizational level integrating and institutionalizing occur.

Intuition is something that only occurs at the individual level since it involves recognizing patterns and possibilities. Intuition can be difficult to convey to others and therefore metaphors can be used in order to communicate the intuition to others. The second process, interpreting, involves explaining one's intuition to other people, and in this process language is important to convey the intuition. The third process, integrating, comprises to find a mutual understanding of the concepts. Since people in an organization can interpret the same information differently, it is important to resolve this by discussing the interpretations in groups in order to find this mutual understanding. When a shared understanding is present the next process is to find coherence between the group's actions. This can be achieved by dialogue where the language is developed further and the shared understandings can be deepened. The last process, institutionalizing, concerns capturing the individual's learning into routinized practices and structures. Thus, one main challenge for the organization is to balance between exploitation and exploration (Crossan, et. al., 1999).

### 3.3 Incentive systems

In this section we shortly present an overview of incentive systems, followed by a discussion of potential risks with incentive systems. As described below, there is a debate regarding the problems and risks with incentives, which indicate that there is a need for regulations in the area. Knowledge about incentives is needed to understand how incentive systems work, as well as to analyze how the interviewed savings banks handle risks with remunerations.

Bonuses, salary increases and provisions for pensions are examples of monetary incentives that are commonly used within organizations (Cäker, 2013). These rewards can be either short-or long term based (Merchant & Van der Stede, 2012), and there can be advantages with postponing the payment of the reward in order to decrease the risk of short-term behavior (Cäker, 2013). Rewards can also be group-based, which is suitable when the organization values teamwork (Cäker, 2013). This form of reward is especially useful when collaboration is more valued than competition among the employees (Ellingsen & Johannesson, 2007). There are also some problems connected to the use of incentive systems, for instance that employees are motivated by different things (Cäker, 2013). Further, since incentive systems permeate the entire organization, it is important to construct a fair system. In addition, it can be difficult to assess the employees' performance, which could complicate the construction of a well-functioning incentive system.

### 3.3.1 Risks with incentive systems

Kohn (1993, 1998, 2009) questions the use of incentive systems and claims that rewards can result in temporary compliance, but that in the long run they fail to create desired behaviors. Research has shown, in contrast to the general belief, that people do not work better if being rewarded (Kohn, 1993, 1998). Furthermore, Kohn (2009) states that people tend to lose interest in their work when they are rewarded and Ellingsen & Johannesson (2007) state that monetary rewards may have a negative effect on the performance. In the long run, using rewards tend to decrease the quality of the work within an organization (Kohn, 1998). Rather than just changing the employees' behavior, Kohn (2009) advocates the need to find what really motivates employees to get the best results. If rewards are being used within an organization, Kohn (1998) argues that it gives better results to set up an incentive system that potentially can reward all employees, rather than excluding some of the staff. Moreover, studies have shown that other factors than money, such as good co-workers, are important for the employees in order to perform well (Kohn, 1998). However, many managers believe that rewards lead to better performance (Kohn, 1993).

According to Bannier, Feess & Packham (2013), the recent financial crisis was partly caused by the banking sector's remuneration systems, and especially bonuses. This view is shared with Bebchuk & Spamann (2010), who claim that compensation packages may have spurred excessive risk-taking. Bhagat & Bolton (2014) advocate that compensation packages should be restricted, i.e. the recipient of the compensation should not be allowed to withdraw it under a certain period of time. Shlomo et. al. (2013) also emphasize that remuneration packages, such as shares, should not be possible to sell instantly after receiving them. In addition, Shlomo et. al. (2013) stress that the packages have to be more transparent.

Before the crisis, there was a significant increase of payments within the banking sector (Bannier et. al., 2013) and Chen et. al. (2011) discuss the issue that British banks' performance was not in line with the high remuneration packages. In their study, Bannier et. al. (2013) concludes that social welfare as well as the bank's profits decrease as a result of excessive risk-taking. Therefore, the authors argue that regulations restricting compensation are needed in order to avoid these negative effects, and Bhagat & Bolton (2014) claim that new regulations have taken excessive risk-taking into consideration. Moreover, Shlomo et. al (2013) conclude that many of the new regulations regarding remuneration are primarily principle based which allows for interpretations.

Another issue with remuneration systems is that there is often a mismatch between the executives' short-term thinking and investors' long-term focus (Chen et. al., 2011). Further, Sykes (2002) emphasizes that remuneration systems also create undesirable short-term behavior. Bebchuk & Spamann (2010) state that it is generally known that compensation packages to a large extent are focused on short-term outcomes and Shlomo et. al (2013) claim that these packages can lead to opportunistic behavior. Therefore, Shlomo et. al. (2013) claim that regulations concerning remuneration policies must assure that remuneration are in line with a well-functioning risk management. However, according to Cash Acrey, McCumber & Nguyen (2011) there is no empirical fact that compensations to CEOs necessarily drive risk in

banks. In their study the authors conclude that CEO compensation packages did not seem to drive risk. Further, a study by Gregg, Jewell & Tonks (2012) concludes that incentives cannot explain executives' short-term thinking.

### **3.4 Summary**

Power (2009) presents two approaches of risk management, called rule-based compliance and critical imagination of alternative futures. Mikes (2011) elaborates Power's ideas, and finds that there are two main ways of dealing with risk management in the banking sector, namely either by quantitative enthusiasm or quantitative skepticism. The 4I framework describes four processes of organizational learning, and the implementation of a new regulation can be seen as a form of organizational learning. Finally, there are risks with incentive systems such as excessive risk-taking and short-term thinking

## Chapter Four: Empirical material

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*In this fourth chapter, we start by presenting the relevant regulations, followed by a presentation of Swedish savings banks. Further, each interviewed savings bank and its remuneration documents are presented, while the remaining information is based on the conducted interviews.*

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### 4.1 FFFS 2011:1

FFFS 2011:1 is a regulation that was implemented first of March 2011 and concerns financial institutions in Sweden, and therefore covering Swedish savings banks. The purpose of the regulation is to improve financial institutions' risk management of their remuneration systems (The Swedish Financial Supervisory Authority, w.y. b). FFFS 2011:1 replaced FFFS 2009:6 (The Swedish Financial Supervisory Authority, w.y. b), which was the first regulation concerning remuneration policies within the financial sector in Sweden (The Swedish Financial Supervisory Authority, 2009). When comparing FFFS 2009:6 and FFFS 2011:1 it can be seen that there are no longer any general guidelines in the new regulation.

Another change in FFFS 2011:1 is that financial institutions have to categorize the employees who are considered to be specially regulated staff, which includes for instance the management and employees responsible for control functions. Further, FFFS 2011:1 has a more long-term focus. For instance, if a specially regulated staff receives a variable remuneration over SEK 100 000 within one year, at least 40 % of that amount should be deferred three to five years until the employee can access the remuneration.

According to FFFS 2011:1 companies should have a documented remuneration policy, which encourages a healthy and effective risk management and counteracts excessive risk-taking. The remuneration policy should cover all employees and be continuously updated. Further, the remuneration policy should be designed in a suitable way with regard to the company's size and internal organization, as well as the company's nature, scope and complexity. In addition, the company should analyze the risks associated with the company's remuneration policy and system.

### 4.2 FFFS 2007:5 and FFFS 2011:3

FFFS 2007:5 is a regulation that was implemented first of February 2007 and concerns public disclosure of information regarding risk management and capital adequacy (The Swedish Financial Supervisory Authority, w.y. c). In 2011, FFFS 2011:3 was launched as an amendment to FFFS 2007:5. FFFS 2011:3 includes regulations concerning disclosure of information regarding remuneration systems (FFFS 2011:3).

Information that shall be made available for the public according to FFFS 2011:3 shall be published at least once a year. The information can be disclosed either in the annual report, the consolidated financial statement, the interim statement or on the company's website.

According to a general guideline in FFFS 2011:3, the information should be published on the company's website even though it is disclosed in one of the other mentioned reports. Further, the company should consider the company's size, nature, scope and complexity when deciding which information to publish regarding their remuneration policy. In addition, the information shall be published in a way that does not risk revealing specific persons' economic or other conditions.

### 4.3 Swedish savings banks

The first savings bank in Sweden started its operations in 1820 in Gothenburg, and the original idea of the savings banks was to enable bank savings opportunities not only for the wealthy people (Körberg, 2010). The concept grew rapidly with support from for example merchants and the positive attitude towards enabling savings for everyone (The Swedish Savings Banks Association, 2013a). The 1892 Savings Banks Act resulted in a clearer separation between savings banks and larger banks. The savings banks' role was to handle people's savings, while the larger banks were to handle the contact with the business world. In the 1950s, the larger banks directed their focus on people's savings as well, since the welfare had increased among the population in Sweden. Hence, the savings banks now faced an increased competition, and in order to compete in this new environment several mergers between the savings banks emerged (Körberg, 2010). In 1985, The Swedish Savings Banks Association was founded to represent the interest of its members (The Swedish Savings Banks Association, 2013b) and today, The Swedish Savings Banks Association have 61 savings banks members (The Swedish Savings Banks Association, 2013c). Körberg (2003) states that the Swedish savings banks have a long experience of collaboration between each other and this collaboration is enabled by for instance The Swedish Savings Banks Association (Eriksson, 2005). In 1991, some Swedish savings banks changed their association form from savings bank to a limited company. One reason for this change was due to the inability to generate external capital (Körberg, 2007).

In 1992, Sparbanken Sverige AB was formed through a merger between the majority of the largest savings banks as well as some of the smaller ones. However, 90 savings banks did not join Sparbanken Sverige AB, and therefore maintained their independence (Olsson, 2009). In 1997, Sparbanken Sverige AB merged with Föreningsbanken into FöreningsSparbanken (The Swedish Savings Banks Association, 2013a). Föreningsbanken was originally formed for agricultures and farmers. In 2006, FöreningsSparbanken changed its name to Swedbank AB (Körberg, 2007). Today, the savings banks own approximately 8,5 % of the shares in Swedbank (The Swedish Savings Banks Association, 2013d). However, the savings banks do not only own shares in Swedbank, but they are also customers and suppliers (Olsson, 2009).

According to The Swedish Savings Banks Association, one of the main differences between a larger bank and a savings bank is that the savings bank has a focus on the local society (The Swedish Savings Banks Association, 2013e). Further, the Swedish savings banks are regarded to emphasize the relationship between the bank and its customers (Silver, 2011). Savings banks do not have shareholders, but instead either a foundation or locally chosen principals

who make the decisions at the annual general meeting (The Swedish Savings Banks Association, 2013e).

In savings banks with locally chosen principals, half of the principals should according to the Savings Bank Acts (SFS 1987:619) be chosen by the municipality, while the other half is chosen among the savings bank's depositors by the existing principals. The principals' function corresponds to the owners in other companies, by for instance electing the savings bank's board and supervise the operations by electing an auditor (Olsson, 2009). It is important to emphasize that the savings banks are local banks where the decisions are made at local level (The Swedish Savings Banks Association, 2013e). It has been argued that savings banks are less focused on profit than larger banks and that one central stakeholder is the customers (Bergendahl & Lindblom, 2008). Further, historically savings banks have been regarded as risk avert (Gardener et. al., 1997; Bergendahl & Lindblom, 2008). However, Olsson (2009) states that savings banks have adapted to strategies similar to larger banks and thus have a focus on profit as well.

Concerning remuneration, many of the Swedish savings banks use the foundation Guldeken, which is a profit sharing system and administers the banks' variable remunerations (internal document). The purpose of Guldeken is to motivate employees within the Swedish savings banks. Swedbank Robur administers Guldeken and the foundation had 1 257 MSEK in total assets in 2012. In the end of 2012 the foundation had 7 698 shareholders, and the general principle is that the capital must be funded in Guldeken for five years before it can be withdrawn.

#### **4.4 Sparbanken Alingsås AB**

Sparbanken Alingsås AB was established in 1833, and in 2012 the number of employees was 95. The turnover in 2012 was 317 MSEK and the total assets were 9 147 MSEK, while the business volume was 28 266 MSEK. The business volume is the customers' deposits and loans in the bank, as well as products mediated to Swedbank AB, for instance mortgages (Sparbanken Alingsås AB, w.y.a). In 2012, the bank had five branches and the headquarters is located in Alingsås. Sparbanken Alingsås AB is a limited company fully owned by Sparbanksstiftelsen Alingsås (Sparbanken Alingsås AB, w.y.a). The respondent from Sparbanken Alingsås AB is the risk control manager, who has worked within the bank for 25 years. He has a business degree and has worked with bookkeeping and auditing before he started working at the bank. The respondent has had different positions within the bank, for instance credit manager, and he has had the current position as risk control manager for seven years.

##### **4.4.1 Remuneration documents**

Sparbanken Alingsås AB publishes a two-page remuneration policy at their website (Sparbanken Alingsås AB, w.y.b). The remuneration policy refers to FFFS 2011:1 and is based on a risk analysis. Except for the profit sharing system, Guldeken, no other variable remuneration exists within the bank. The maximum amount that can be deposited in Guldeken is 1,5 price base amount per employee and year. In 2014 the price base amount was 44 400 SEK (Statistics Sweden, 2013). The remuneration that is deposited in Guldeken may be

withdrawn after five years. In the remuneration policy, Sparbanken Alingsås AB specify their specially regulated staff to be the management and employees responsible for the risk control functions. All employees are entitled to the profit sharing system and the amount of money deposited in Guldeken is based on the fulfillment of certain goals.

#### **4.4.2 Risk management and remuneration system**

At Sparbanken Alingsås AB the risk control function is handled in-house, while the compliance function is outsourced to another savings bank. The respondent emphasizes that risk is present in all of the bank's operations, and he believes that it is important to communicate this to all employees. Therefore, he gives lectures concerning risks, morals and ethics twice a year in order to inform the employees. Further, the respondent emphasizes the importance of setting a good example from the management. The bank uses different risk measures, but the respondent stresses that past experience guides what to focus on and he uses the concept of materiality.

In 2013, the maximum amount that could be deposited into Guldeken was 40 000 SEK. Of these 40 000 SEK, 36 000 SEK is based on the bank's result, while the remaining 4 000 SEK is based on other goals. The respondent explains that there has been a discussion whether to exclude the management and the control function from the remuneration system. The result from this discussion was that the management and control function should be included, but that the management maximum can receive 36 000 SEK. The reason to exclude the remaining 4 000 SEK was that it could be a matter of judgment. There was also a discussion if the control function should have a separate goal, but the bank could not find a suitable goal.

#### **4.4.3 Reaction and consequences of regulations concerning remuneration policies**

The respondent's reaction to the new regulation was that it was not aimed at savings banks; rather he believes that the regulation was a reaction to the remunerations used in the larger banks. According to the respondent, the bank has not had any problems with short-term thinking or excessive risk-taking, and therefore he does not consider that the regulation has made the bank's operations more secure. A consequence of both FFFS 2009:6 and FFFS 2011:1 is that the bank no longer uses any other variable remuneration except for Guldeken. Previously, smaller variable remunerations such as sales competitions occurred. Moreover, since the bank's variable remuneration can be maximum 40 000 SEK, and thus is below 100 000 SEK, deferral will never be applied.

#### **4.4.4 Interpretation of regulations concerning remuneration policies**

The respondent was responsible for the interpretation and implementation of the regulation. Generally, when a new regulation is launched, the respondent carefully reads through it and makes his own interpretations. The respondent explains that he uses own experiences and judgment when interpreting regulations.

*“I try to work much with common sense as well as some intuition.”*

Then he often discusses his interpretation and potential questions with other savings banks and his compliance network. In some cases the respondent receives guidance from The

Swedish Savings Banks Association. However, he does not remember that he was given any guidance from The Swedish Savings Banks Association when interpreting FFFS 2011:1. Moreover, the respondent has a good relation with the internal auditors and they are used as a sounding board in some questions. Finally, the respondent presents his ideas to the CEO who makes the final decisions.

Furthermore, the respondent remembers that the bank had to interpret what the breaking point of 100 000 SEK implied. Since the bank's variable remuneration system is less than 100 000 SEK the bank reflected if the regulation was applicable to Sparbanken Alingsås AB at all. However, they soon came to the conclusion that the bank had to comply with the entire regulation since the breaking point of 100 000 SEK only concerns deferral. The respondent did not perceive that there were any major difficulties with the categorization of specially regulated staff. Instead, it was natural to include the management and the control function within this category. In their remuneration policy, Sparbanken Alingsås AB specify their specially regulated staff by position. However, the bank does not specify the names of the persons holding these positions. According to the respondent, the bank has decided to specify positions instead of names in all of their documents. In the past, the bank used to name persons in their documents, but after a sudden loss of an employee the bank decided to just write positions in their documents.

Based on the respondent's interpretation of the new regulation as well as discussions with external parties, Sparbanken Alingsås AB came to the conclusion that they only have to publish one document regarding remunerations, namely their remuneration policy. The respondent explains that the bank has to comply with all regulations, but does not publish anything extra than what is perceived to be required by law. However, the respondent discusses that the bank should consider what information its stakeholders request, and in the future publish information in line with this request.

Moreover, the respondent argues that since Sparbanken Alingsås AB chooses to be in the financial sector they have to comply with all the relevant regulations. He believes that it is important to apply the same set of regulations and demands on all financial institutions regardless of size. Hence, the respondent does not believe that savings banks should have a separate regulatory framework, but he states that it has become more complex and resource intense to operate a bank due to an increasing number of regulations. Further, the respondent discusses the development of society and the need for regulations in order to avoid opportunistic behavior.

*“The society has developed quickly towards a more egoistic society, which results in a need for regulations.”*

#### **4.5 Tjörns Sparbank**

Tjörns Sparbank was established in 1906 (Tjörns Sparbank w.y.a), and in 2012 the number of employees was 31. The turnover in 2012 was 73 MSEK and the total assets were 2 483 MSEK, while the business volume was 7 153 MSEK. In 2012, the bank had three branches



and the headquarters is located in Skärhamn. The bank does not have any owners, but instead locally chosen principals (Tjörns Sparbank w.y.b). The respondent from Tjörns Sparbank is the compliance officer and has worked within the bank for 14 years after finishing her business studies. The respondent started to work as a corporate advisor, and in 2009 she became compliance officer and risk control manager.

#### **4.5.1 Remuneration documents**

Tjörns Sparbank publishes a two-page information document concerning their remuneration system at their website (Tjörns Sparbank, w.y.c). The information document refers to FFFS 2007:5 and includes a risk analysis of one third of a page. The variable remuneration within the bank is deposited to the profit sharing trust Guldeken. The remuneration that is deposited in Guldeken may be withdrawn after five years. The information document states that there is a maximum amount that could be deposited in Guldeken, and that it is the same for all employees. The amount of money deposited in Guldeken is based on the fulfillment of two goals. Firstly, two thirds of the maximum amount is decided as a percentage of the bank's result after credit losses. Secondly, the remaining third is decided based on the fulfillment of four activity goals, namely one common goal and one goal for each operational area (private, corporate and administration). Employees working with control functions receive variable remuneration based only on the bank's result. Finally, the document presents a table that shows the bank's total remunerations, both fixed and variable. In this table, the employees are divided into two categories. Category one includes the management and other employees that could affect the bank's risk level and category two includes the remaining employees.

#### **4.5.2 Risk management and remuneration system**

At Tjörns Sparbank the compliance function is handled in-house, while the risk control function is outsourced to another savings bank. Within the bank, the compliance function works with several policy areas, covering for instance credits and employees. The respondent continuously goes through instructions and policies, as well as monitors if the operations correspond to the policies. In general, the respondent perceives that Tjörns Sparbank manages the bank's risks in a good way since the management knows the employees as well as their customers. However, a drawback with such a close relationship might be that the bank does not dare to ask the customers the most difficult questions. According to the respondent, risk is discussed within the entire organization at all levels in order to make all employees aware of the bank's risks. Moreover, Tjörns Sparbank uses different quantitative measures to control risks, such as how much credit losses that are accepted or how much of the total lending that can be assigned to a specific industry. These measures are based on past experience. Finally, the bank discusses its risk appetite in order to find a suitable level of risk.

Regarding the remuneration system, the respondent emphasizes that all employees are rewarded with the same amount if the bank's established goals are met in order to encourage collaboration among the employees. When FFFS 2011:1 was launched, Tjörns Sparbank discussed if the management and the control functions should be excluded, but decided that the maximum amount is too low to drive risk and that it is more important to promote collaboration within the bank.

#### 4.5.3 Reaction and consequences of regulations concerning remuneration policies

The respondent remembers that the first reaction to the new regulation was that it was aimed at larger banks rather than at savings banks. Despite this, the regulation was directed to all financial institutions, and therefore Tjörns Sparbank had to interpret and implement FFFS 2011:1. Further, the respondent emphasizes that the bank had not had any problems with their remuneration system and therefore did not perceive the regulation to be relevant to their context. In addition, the respondent does not perceive that the regulation has made Tjörns Sparbank more secure since the bank previously has not suffered from excessive risk-taking or short-term thinking. A consequence of the new regulation was that the bank had to write down procedures concerning their remuneration. For instance, the bank had to consider and write down which of the employees belonged to the category of specially regulated staff. However, the respondent did not perceive that there were any difficulties with this categorization of employees. In addition, the respondent believes that it was meaningful to go through and reflect on their remuneration system.

The respondent says that the balance between fixed and variable remuneration has not changed due to FFFS 2011:1. Since the bank's variable remuneration can be maximum 30 000 SEK, and thus is below 100 000 SEK, deferral will never be applied. Finally, the respondent states that it requires much resources to interpret and implement new regulations, and that since the latest financial crisis several new extensive regulations have been launched, which have made it more difficult to operate a smaller bank.

#### 4.5.4 Interpretation of regulations concerning remuneration policies

Regarding the implementation of FFFS 2011:1, the respondent together with the CEO discussed how to interpret and phrase the new document. The CEO was responsible for the implementation, but the respondent interpreted and wrote the required documents. The respondent explains that they interpreted the regulation according to their operations and remuneration system. The respondent remembers that one difficulty was to interpret and establish suitable goals for the control function.

*“A suitable goal has to be measurable and possible to follow up.”*

One possibility was to evaluate the control function's ability to report in time to the board of directors. However, the bank did not perceive that this goal was suitable, and instead the control function receives variable remuneration if the bank's result meets the pre-set goal. This issue was discussed with other savings banks as well as with The Swedish Savings Banks Association, but in the end the respondent claims that each bank must make their own judgments and interpretations of the regulation.

Tjörns Sparbank does not publish its remuneration policy externally; it is an internal document. The respondent says that the bank has not interpreted that the remuneration policy must be published externally, but it is available if for instance the Swedish Financial Supervisory Authority requests it. Furthermore, the bank does not consider that for instance customers or other external parties need to access this information. The same reasoning is

behind the choice of not publishing information regarding the specially regulated staff and naming them. However, the respondent emphasizes that Tjörns Sparbank publishes the required information in their information document, and that information regarding remunerations is to be found in the annual report. This information is based on their internal remuneration policy. Further, the respondent discusses the possibility of having a separate regulatory framework for smaller financial institutions, but concludes that rather than having a separate regulatory framework the principle of proportionality could be used more frequently.

#### **4.6 Orusts Sparbank**

Orusts Sparbank was established in 1887, and in 2012 the number of employees was 48. The turnover in 2012 was 195 MSEK and the total assets were 6 260 MSEK, while the business volume was 15 919 MSEK. In 2012, the bank had four branches and the headquarters is located in Henån. The bank does not have any owners, but instead locally chosen principals (Orusts Sparbank w.y.a). The respondent from Orusts Sparbank has worked within the bank for 25 years. He started his career in customer service and then took some time off to study business at the University. After his graduation he returned to the bank and started to work with family law and later continued with tasks related to regulations and compliance. The respondent later became compliance officer, and today he is deputy CEO and credit officer.

##### **4.6.1 Remuneration documents**

Orusts Sparbank publishes two documents, namely both their remuneration policy and an information document regarding remuneration. The information document is two pages and states that the bank has a remuneration policy (Orusts Sparbank, w.y.b). Except for the profit sharing system, Guldeken, no other variable remuneration exists within the bank and all employees are entitled to the profit sharing system. All employees receive the same amount, except for employees working less than full-time who receive a remuneration corresponding to their employment. The amount of money deposited in Guldeken is based on the fulfillment of three criteria. Firstly, the return on risk-weighted assets should exceed a pre-set level. Secondly, the bank's cost to income ratio before and after credit losses must not exceed a pre-set level. Thirdly, sales targets regarding products and services must be achieved, while employees working with control functions must report in time. In the document specially regulated staff is specified, which includes the management, employees in risk control functions, the compliance function, private market manager, corporate manager and permanent members of the credit delegation. Finally, the document presents a table that shows the bank's total remunerations, both fixed and variable. In this table the employees are divided into three categories; (i) the management, (ii) the remaining specially regulated staff, and (iii) the remaining employees.

The second document, the remuneration policy, is nine pages and states that the CEO is responsible for its implementation (Orusts Sparbank, w.y.c). The document provides definitions of the concepts used in the policy and states that the remuneration policy is based on a two-page risk analysis of variable remuneration, which is included in the document. The document categorizes the specially regulated staff into five categories. The first category includes the management, which consists of the CEO and deputy CEO. Secondly, employees

in senior strategic position namely the private market manager and the corporate market manager. Thirdly, employees responsible for control functions, which are the compliance officer and the risk control manager. Fourthly, employees that are risk takers, which includes the management, employees in senior strategic positions, employees responsible for control functions, employees whose remuneration is or exceeds the total remuneration assigned to the management and finally permanent members in the credit delegation. Fifthly, employees whose remuneration is or exceeds the total remuneration assigned to the management, but currently the bank does not have any employees belonging to this category.

The variable remuneration can be maximum two fifths of the employee's fixed remuneration. Variable remuneration to specially regulated staff should be based on additional three criteria, namely the employee's result, the concerned profit center's result and the bank's total result. Moreover, variable remuneration to employees working with control functions is based on goals related to the control functions, which are independent of the result in the business areas they control. Finally, the policy should be continuously updated, at least yearly.

#### **4.6.2 Risk management and remuneration system**

At Orusts Sparbank the compliance function is handled in-house, while the risk control function is outsourced to another savings bank. Even though a certain employee is responsible for the compliance function, several other employees are involved in the risk management work. Furthermore, the bank uses certain quantitative measures, and the respondent considers that quantitative measures and judgment are closely interlinked.

*“We use much experience and judgment, and based on these we establish quantitative measures.”*

The respondent gives the example that the bank takes into consideration for instance past experiences concerning losses, and as a result the quantitative measures are based upon previous experiences. Further, the respondent experiences that there has been a shift from more quantitative regulations, for instance that specific measures must reach a specific level, towards own assessment and evaluation of risks. He discusses that some people in the industry perceived it to be easier to comply with more quantitative regulations, while the respondent means that every bank is unique and that the same level of risk measures is not suitable for all banks. This in turn can cause a false sense of security. The respondent perceives that this shift indicates that the bank must go through its operations thoroughly in order to assess and evaluate potential risks.

The remuneration that is deposited in Guldeken may be withdrawn after five years. The bank has discussed whether to exclude the management from the variable remuneration or not, but decided that the amount of remuneration is too low to drive risk and therefore the management is included in the remuneration system. Moreover, the employees are being evaluated on a group level, since the bank's management believes that this encourages the employees to strive in the same direction.

#### 4.6.3 Reaction and consequences of regulations concerning remuneration policies

The respondent remembers that the bank reflected on that the updated version FFFS 2011:1 was launched shortly after FFFS 2009:6. The bank had already in 2009 established that it had a variable remuneration system, so the main difference in FFFS 2011:1 was that the bank had to decide which documents to publish and how to categorize the employees. According to the respondent, the new regulation required much effort and resources. However, he still thinks that the regulation is relevant to Orusts Sparbank since the bank, by complying with the regulation, achieves a certain degree of quality. Another consequence of FFFS 2011:1 is that it became clear that the bank must analyze certain parameters that can drive risk. Previously, Orusts Sparbank had not made any deeper assessments or analyzes of such parameters. Furthermore, the bank does not perceive that it has had any problems with short-term thinking. According to the respondent, this can be explained by two reasons. Firstly, the majority of the employees work within the bank for many years. Secondly, the amount of remuneration is considered too low to drive short-term thinking.

The respondent says that the balance between fixed and variable remuneration has not changed due to FFFS 2011:1. He discusses that other banks that had very high variable remunerations may have had to reconsider this balance, but this has never been applicable to Orusts Sparbank due to the bank's low variable remuneration. Moreover, the respondent says that according to the bank's criteria for variable remuneration, the variable remuneration cannot exceed 100 000 SEK, and thus deferral will never be applied.

#### 4.6.4 Interpretation of regulations concerning remuneration policies

The respondent together with the management was responsible for the implementation and interpretation of FFFS 2011:1. When interpreting the regulation, Orusts Sparbank discussed the regulation with external parties. Firstly, The Swedish Savings Banks Association has provided the bank with some general guidelines regarding the interpretation. Secondly, Orusts Sparbank has benchmarked its remuneration policy against other savings banks' policies. Thirdly, the bank's management has discussed the issue with other savings banks located nearby, which are similar in size and volume.

According to the respondent, the categorization of specially regulated staff was one of the most difficult parts to interpret within the new regulation, for instance to decide which positions that should be included. The respondent describes that Orusts Sparbank used own judgment when making this categorization. Moreover, it was a challenge to decide what information to publish and where to publish it. The respondent perceives that more judgment than before is needed when interpreting new regulations today. Former regulations had more concrete measures to comply with, which did not require the same amount of judgment. The respondent considers that it was easier to interpret the old regulations with specific quantitative measures that should be reached. However, he argues that these quantitative measures did not necessarily manage the bank's risks in the best way.

Orusts Sparbank specifies in their remuneration policy the specially regulated staff by position. However, the bank does not specify the names of the persons holding these

positions. The respondent interprets that according to FFFS 2011:1 this is the required information. Further, he argues that since the banking sector has a tradition of secrecy he does not consider it to be natural to name each person in the remuneration policy. Regarding the publication of both a remuneration policy and a separate information document, the respondent perceives that according to the regulations the bank must publish these two documents. He discusses that the bank aims to publish sufficient information, i.e. to publish neither more nor less information than needed. The respondent continues by arguing that too little information may indicate that the bank has something to hide, while publishing more information than needed is time consuming and requires a lot of effort from the bank. Orusts Sparbank has chosen to publish the two documents on their website to assure that the information is easily accessible.

The respondent discusses the possibility of having a separate regulatory framework for smaller financial institutions but concludes that it is important to have the same regulation concerning risk management for all financial institutions. By having one regulation for all actors, a certain level of quality can be achieved within the sector. As an example, the respondent says that if savings banks had lower legal requirements on them, it could be turned against them and one could argue that the savings banks would be less secure than other banks. Furthermore, the respondent means that it requires much time to interpret new regulations and that the banks must consider how to allocate resources.

*“It is important to constantly consider the allocation of resources on either interpreting regulations or operating the bank per se.”*

## **4.7 Sparbanken Lidköping AB**

Sparbanken Lidköping AB was established in 1834, and in 2012 the number of employees was 59. The turnover in 2012 was 185 MSEK and the total assets were 5 684 MSEK, while the business volume was 14 836 MSEK. In 2012, the bank had one office, which is located in Lidköping. Sparbanken Lidköping AB is a limited company fully owned by Sparbanksstiftelsen Lidköping (Sparbanken Lidköping AB, w.y.a). The respondent from Sparbanken Lidköping AB is the CEO who has had this position since 2002. He has worked within different banks at different positions during his career and has a business degree.

### **4.7.1 Remuneration documents**

The bank publishes two documents, namely both their remuneration policy and an information document regarding remuneration. The information document is two pages and refers to FFFS 2007:5 (Sparbanken Lidköping AB, w.y.b). The document states that Sparbanken Lidköping AB publishes a remuneration policy based on a risk analysis. In 2012, no other variable remuneration except for the profit sharing system, Guldeken, was applied. The maximum amount that can be deposited in Guldeken is 40 000 SEK per employee and year, and the remuneration that is deposited in Guldeken may be withdrawn after five years. All of the employees are entitled to the profit sharing system. The amount deposited in Guldeken is based on pre-set criteria and measurable goals that correspond to the bank's overall plans. If the bank's operating result is below 70 % of the previous year's operating result no variable remuneration is deposited. In 2012, 14 000 SEK per full-time employee was

deposited in Guldeken. Finally, the document presents a table that shows the bank's total remunerations, both fixed and variable. In the table, the employees are divided into three categories. The first category consists of the management, namely the CEO and the deputy CEO. Secondly, the employees who can influence the bank's risk level, namely the members of the bank's management and credit committee as well as the risk controller. The third category consists of the remaining employees.

The second document, the remuneration policy, is nine pages (Sparbanken Lidköping AB, w.y.c). The document provides definitions of concepts used in the policy and states that the remuneration is based on a one-page risk analysis of variable remuneration, which is included in the document. The document categorizes the specially regulated staff into five categories. The first category includes the management, which consists of the CEO and deputy CEO. Secondly, employees in senior strategic positions, namely employees in the management group. Thirdly, employees responsible for control functions, which is the compliance officer. Fourthly, employees that are risk takers, which includes the management, employees in senior strategic positions, employees responsible for control functions, employees whose remuneration is or exceeds the total remuneration assigned to the management and finally members in the credit delegation. Fifthly, employees whose remuneration is or exceed the total remuneration assigned to the management, but currently the bank does not have any employees belonging to this category.

According to the remuneration policy, the variable remuneration is based on pre-set and measureable goals. Further, if the bank's operating result is below 70 % of the previous year's operating result no variable remuneration is deposited. The maximum amount that could be deposited in Guldeken is 40 000 SEK per year and full-time employee. The remuneration that is deposited in Guldeken may be withdrawn after five years. Furthermore, the policy should be continuously updated, at least yearly. Five criteria determine the amount that is deposited in Guldeken. Firstly,  $\frac{\text{operating result}}{\text{business volume}}$  should be top seven of the 20 largest savings banks in The Swedish Savings Banks Association. Secondly,  $\frac{\text{costs}}{\text{business volume}}$  excluding credit losses should be top seven of the 20 largest savings banks in The Swedish Savings Banks Association. Thirdly, the bank's total deposits should strive to exceed the bank's lending. Fourthly,  $\frac{\text{costs}}{\text{revenues}}$  before credit losses should be top ten of the 20 largest savings banks. Fifthly, Knyck Sparavolym including for instance deposits should be 50 MSEK. In the risk analysis these five criteria are analyzed. Moreover, employees responsible for control functions receive variable remuneration if the board of directors considers that the control function has carried out the work in a satisfactory manner. Finally, the specially regulated staff is presented in a table describing their title, name and type of specially regulated staff.

#### 4.7.2 Risk management and remuneration system

At Sparbanken Lidköping AB the risk control function is handled in-house, while the compliance function is outsourced to another savings bank. The employee responsible for risk control at Sparbanken Lidköping AB has a very extensive experience of banking operations. According to the respondent, issues related to risk management has increased during the past

five years, which have resulted in an increasing number of regulations focusing on risk. Furthermore, the respondent says that the entire organization is aware of the bank's risks and that the bank historically has had low credit losses. According to the respondent, it is important that the management sets the tone at the top and emphasizes the importance of complying with regulations. Each quarter, a risk council, consisting of the compliance officer, risk control manager, credit manager, safety manager and the CEO, meets to discuss risks. Moreover, Sparbanken Lidköping AB uses different measures to assess risk, and the respondent emphasizes the importance of having a high debt to equity ratio since it increases the chances of surviving an unforeseen crisis. In addition, the bank has established their risk appetite. However, the respondent emphasizes the importance of making own judgments.

According to the respondent the maximum amount that could be deposited in Guldeken is 40 000 SEK per employee and year, which is below 100 000 SEK and therefore deferral is not applied. The board of directors emphasize the importance of having a common goal for the entire organization, and therefore the remuneration system covers all employees. However, the risk control function is evaluated separately. Finally, the variable remuneration is considered to be too low to drive risk.

#### **4.7.3 Reaction and consequences of regulations concerning remuneration policies**

According to the respondent, the immediate reaction was that the regulation was aimed at larger banks and their bonuses. Further, as aforementioned the bank has had low credit losses and few problems overall. However, the respondent states that Sparbanken Lidköping AB has to comply with the regulation as well. He also discusses the principle of proportionality and means that the Swedish Financial Supervisory Authority has taken this into account to a certain extent. However, the respondent perceives that this principle could have been more central when designing the new regulation. Moreover, the respondent did not perceive the regulation to be complicated or difficult to interpret, but it was extensive. Therefore, it took time and effort to write the required documents, which demanded much resources.

#### **4.7.4 Interpretation of regulations concerning remuneration policies**

The CEO was responsible for the implementation of FFFS 2011:1, but the risk controller wrote the required documents. Further, the respondent did not perceive any particular difficulties with interpreting the new regulation. As mentioned before, the regulation seemed to be aimed at larger financial institutions and therefore the regulation was perceived to be more of a formality, something that the bank had to deal with. Many of the employees within the bank have extensive experience and when new regulations are launched they use their previous experiences and judgment to interpret the new regulations. Moreover, the respondent explains that experienced staff knows the bank's risk and what to focus on. Further, the respondent says that Sparbanken Lidköping AB has a close relationship with the savings banks located nearby, as well as a well-functioning collaboration with The Swedish Savings Banks Association.

One thing that the CEO together with the management had to discuss deeper, was the categorization of specially regulated staff. The respondent emphasizes the importance of interpreting the regulation in the same way in order to find consensus within the bank.



Sparbanken Lidköping AB names the specially regulated staff in their remuneration policy. The respondent claims that the bank does not see any reason not to name the specially regulated staff in their policy; instead the bank prefers to be over explicit. The bank has interpreted that according to the regulations the bank is required to publish two documents, namely a remuneration policy and an information document regarding remuneration. The respondent emphasizes the importance of being transparent with the bank's operations and claims that Sparbanken Lidköping AB publishes as much information as possible.

#### **4.8 Summary of the four savings banks**

The review of the savings banks' remuneration documents shows that there are differences between the banks. These differences are visible in the choice of documents to publish, its content and extent. The interviews show that all savings banks perceive that there has been an increase launch of regulations concerning risk management, which is resource intense. When working with risk management, all savings banks use a combination of quantitative measures and judgment. Further, three of the savings banks emphasize that FFFS 2011:1 is aimed at larger banks, but all savings banks must comply with it. When interpreting new regulations, all savings banks use judgment and past experience, and one bank uses intuition as well. In addition, all savings banks discussed the regulation with external parties, such as other savings banks and The Swedish Savings Banks Association. Different difficulties were perceived by the savings banks when interpreting the regulation, for instance one bank found it difficult to set a suitable goal for the control function, and another bank found it difficult to categorize the specially regulated staff. Overall, none of the savings banks have experienced any problems with short-term thinking or excessive risk-taking, and two of the banks emphasize that the regulation has not made their operations more secure.

## Chapter Five: Analysis

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*In this chapter we analyze our empirical material by using our frame of reference. Firstly, a shorter analysis of the relevant regulations is presented, followed by the savings banks' risk management and remuneration system. Then, we analyze the reaction and consequences of regulations concerning remuneration policies. Finally, the savings banks' interpretation of the regulations is analyzed.*

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### 5.1 FFFS 2011:1 and FFFS 2011:3

As stated in the empirical section, FFFS 2011:1 no longer contains any general guidelines. Instead, the regulation consists of formal rules and is now more extensive than before. This could imply less judgment and more rule following when implementing new regulations, which would suggest that the savings banks' remuneration documents should be similar. However, certain paragraphs in the regulation open up for interpretation and judgment, which causes uncertainty. For instance, the categorization of specially regulated staff seems to require a certain use of judgment. The respondent from Orusts Sparbank emphasizes the difficulty to interpret and decide which employees that should be classified as specially regulated staff. Another paragraph in FFFS 2011:1 that seems to cause uncertainty states that a company should have a documented remuneration policy. According to our findings, the savings banks have interpreted this differently. Three of the savings banks have interpreted that they should publish a remuneration policy externally; while the fourth bank has interpreted that the remuneration policy is an internal document.

Moreover, a company's remuneration policy should be designed in a suitable way, for instance with regard to the bank's size and internal organization. This phrasing can be seen as a form of the principle of proportionality, which opens up for a potential uncertainty regarding how to design the remuneration policy. The principle of proportionality is also visible in FFFS 2011:3, regarding which information regarding remuneration that should be published. The respondent from Orusts Sparbank says that the bank had to reflect upon which information regarding remunerations that should be published and where to publish it. This causes an uncertainty, which is evident when comparing the four banks' remuneration documents. To sum up, the regulations have room for interpretations and judgment, which causes uncertainty.

### 5.2 Risk management and remuneration system

All of the savings banks have a separate function for risk management, which is in line with the ideas of Kaplan & Mikes (2012) who state that a separate function for risk management is needed in most companies today. Today, the savings banks have one employee in-house responsible for the control function who have a close relationship and collaboration with the bank's CEO. Such a close relationship is emphasized by Kaplan & Mikes (2012) in order to have a well-functioning risk management. The relationship between the control function and

the CEO varied between the savings banks when they interpreted and implemented FFFS 2011:1. The control function at Tjörns Sparbank and at Orusts Sparbank had a continuous dialogue with their CEOs and management regarding how to interpret and implement FFFS 2011:1. The control function at Sparbanken Alingsås AB and at Sparbanken Lidköping AB interpreted the regulation themselves and then presented their interpretation and draft to the CEO.

All of the interviewed savings banks use variable remunerations, which are deposited in Guldeken for five years before it can be withdrawn. This is an example of postponing the payment of the remuneration, which according to Cäker (2013) can decrease the risk of short-term behavior. Further, all banks' remuneration system covers all employees. All the respondents emphasize the importance of having goals for the entire organization in order to foster collaboration, which is in line with Cäker (2013) and Ellingsen & Johannesson (2007). Moreover, Gregg et. al. (2012) state that the level of executive remuneration is influenced by the company's size. All savings banks consider their variable remuneration to be too low to cause risky behavior and therefore all employees, including the management, are entitled to the remuneration. None of the savings banks have experienced any problems with neither short-term thinking, nor excessive risk-taking, which could be explained by their history of being risk averse (Gardener et. al., 1997; Bergendahl & Lindblom, 2008).

The savings banks have different views on whether the new regulation was relevant to their context or not. Sparbanken Alingsås AB perceives that the society is more egoistic today and that regulations are needed in order to prevent opportunistic behavior. This is in line with Bannier et al. (2013) who argue that regulations restricting compensation are needed in order to avoid excessive risk-taking. Further, Orusts Sparbank believes that the new regulation creates a certain level of quality within the financial sector. Thus, both Sparbanken Alingsås AB and Orusts Sparbank consider the regulation to be relevant to their context. On the other hand, Sparbanken Lidköping AB and Tjörns Sparbank do not perceive the regulation to be relevant to their context since they believe that it is aimed at larger banks. However, all savings banks emphasize the importance of complying with regulations, even though they perceive that they had well-functioning risk management practices concerning remunerations prior to the launch of the new regulation. Due to the new regulations, the savings banks had to review their risk management practices and construct the required documents, but except for this the regulation has not resulted in any significant changes in the savings banks' operations or remuneration system. Even though some of the savings banks expressed that it was worthwhile to review their risk management, the over all impression for all banks was that their banks had not become more secure since the launch of the new regulations.

According to Cäker (2013) it can be difficult to assess the employees' performance, which could complicate the construction of a well-functioning incentive system. This difficulty is pointed out by Tjörns Sparbank and Sparbanken Alingsås AB, who explain that it was difficult to find a suitable goal for the control function. For instance, Tjörns Sparbank states that the goal has to be measurable and possible to follow up. However, Tjörns Sparbank and Sparbanken Alingsås AB claim that they could not find a suitable separate goal for the control

function, and therefore the control function is evaluated on the same goals as the rest of the employees. Orusts Sparbank and Sparbanken Lidköping AB on the other hand, have separate goals for their control function. Orusts Sparbank evaluates their control function according to its ability to report in time, while Sparbanken Lidköping AB assesses if the control function has carried out the work in a satisfactory manner. Therefore, it can be seen that the savings banks have handled the issue differently, which might indicate that it is difficult to assess employees' performance. Moreover, the findings that the savings banks have established different goals for the control functions implies that there is an uncertainty regarding the interpretation of the regulation.

### **5.3 Reaction and consequences of regulations concerning remuneration policies**

Wahlström (2013) states that new regulations concerning risk measurement are continuously launched upon banks. This view is shared by all savings banks, who perceive that the number of regulations concerning risk management has increased since the latest financial crisis. For instance, Tjörns Sparbank perceives that several new extensive regulations have been launched since the latest financial crisis, which in turn have made it more difficult to operate a smaller bank. All four savings banks agree that it has become more resource-intensive and time-consuming to interpret and implement new regulations, and Sparbanken Alingsås AB claims that it has become more complex. This is in line with Silver's (2011) view, that it is more difficult and more expensive to operate a savings bank today. It can also be seen that the increased regulatory pressure can have a greater negative impact on savings banks, which is a similar finding to the one by Chilton & Weidenbaum (1982). Furthermore, Silver (2007, 2011) discusses that new regulations are forced upon savings banks, despite the fact that the regulations generally are perceived to be aimed at the larger banks. Three of the interviewed savings banks have the same point of view as Silver and believe that FFFS 2011:1 is aimed at larger banks. Nevertheless, all savings banks emphasize the importance of complying with regulations.

All savings banks reflect on whether to have a separate regulatory framework for smaller financial institutions or not. However, all banks conclude that it is important that all financial institutions have one common regulatory framework. Tjörns Sparbank and Sparbanken Lidköping AB discuss that the principle of proportionality can be considered to a greater extent when designing new regulations. However, Sparbanken Lidköping AB says that the principle of proportionality is visible to a certain extent in FFFS 2011:1. Furthermore, the respondent from Sparbanken Alingsås AB discusses that the society has become more egoistic today and that regulations are needed in order to avoid opportunistic behavior. The view that regulations are needed in order to reduce opportunistic behavior is shared by Shlomo et. al. (2013). Moreover, Orusts Sparbank stresses the importance of having one regulation for all actors in the banking sector in order to achieve a certain level of quality. The respondent from Orusts Sparbank explains that if savings banks had lower legal requirements on them, it could be turned against them and one could argue that the savings banks would be less secure than other banks. Despite the fact that the savings banks consider the regulation concerning remuneration policies to be primarily aimed at larger banks, they are all keen to

comply with it. This implies that the savings banks strive to have a high quality in their operations and gain legitimacy.

#### **5.4 Interpretation of regulations concerning remuneration policies**

New extensive regulations require more knowledge within the savings banks in order to interpret the regulations. The regulations can cause uncertainty regarding how to interpret specific issues, and therefore a greater need for collaboration and sharing of knowledge between the savings banks and The Swedish Savings Banks Association can be assumed. According to our findings, all of the banks usually discuss the interpretation of new regulations with external parties, such as other savings banks and The Swedish Savings Banks Association. In addition, Sparbanken Alingsås AB discussed with their internal auditors and a compliance network. It is clear that all of the banks have a close relationship with other savings banks as well as The Swedish Savings Banks Association, which is in line with Körberg's (2003) and Eriksson's (2005) findings.

Furthermore, Shlomo et. al. (2013) emphasize that remuneration packages have to be more transparent. From the empirical material it is noticeable that the savings banks have different views regarding what and how much information to publish regarding their remunerations. Tjörns Sparbank, Orusts Sparbank and Sparbanken Alingsås AB do not publish more information than they perceive is necessary; instead they aim to publish sufficient information. The respondent from Sparbanken Alingsås AB discusses that in the future the published information could be based on what information the bank's stakeholders requests. Finally, Sparbanken Lidköping AB emphasizes the importance of being transparent and publishes as much information as possible. As the empirical material shows, the savings banks have different views on what information that is required to publish. Worth noticing is that all savings banks perceive that they publish at least sufficient information regarding remuneration. However, our empirical findings show that the four savings banks publish different information, which implies that the regulations cause uncertainties regarding what information to publish and to what extent.

##### **5.4.1 Risk management and judgment**

Power (2009) presents two approaches of risk management, namely rule-based compliance and critically imagination of alternative futures. Based on our empirical material, the interviewed savings banks seem to use more of the critically imagination of alternative futures approach, rather than solely rule-based compliance. Power states that some organizations can perceive that critically imagination of alternative futures can cause uncertainty within the organization, but this is not something that the savings banks perceive. The respondent from Orusts Sparbank discusses that some people in the industry perceive rule-based compliance and quantitative measures to be easier to comply with. Therefore, the critically imagination of alternative futures can be seen to cause uncertainty. However, the respondent stresses that quantitative measures must be adjusted to each individual bank and explains that just reaching a pre-set level of risk measures can cause a false sense of security.

Since the latest financial crisis, it has been argued that critically imagination of alternative futures should be used instead of rule-based compliance (Power, 2009). The respondent from

Orusts Sparbank perceives that the latest regulations require more own assessment and evaluation of risks, which is in line with the thoughts that critically imagination of alternative futures should be used. Further, Orusts Sparbank's view corresponds to Shlomo et. al's (2013) conclusion that many of the new regulations regarding remuneration are primarily principle-based which allows for interpretations. In addition, Power (2004b) discusses that there has been a rise of risk management and a strive to manage everything, and Wahlström (2013) discusses that this strive might decrease the use of judgment. For instance, the respondent from Sparbanken Alingsås AB stresses the importance of past experiences that guide what to focus on and that it is impossible to control everything and refers to the concept of materiality. He explains that when deciding which risks to focus on and what to convey to the organization, he considers which risks that could have the most significant consequences for the bank.

Mikes (2011) builds on Power's ideas and investigates risk management in the banking sector. Mikes finds two main ways of dealing with risk management in this sector, namely quantitative enthusiasm and quantitative skepticism. Our empirical material shows that the savings banks use risk measures to some extent. For instance, Tjörns Sparbank has a measure regarding how much credit losses that are accepted, while Sparbanken Lidköping AB uses the equity to debt ratio as a quantitative measure. However, all savings banks emphasize the importance of using past experience and judgment in their risk management and when interpreting new regulations. Sparbanken Alingsås AB states that past experience guides what measures to focus on and that common sense and intuition are used when interpreting new regulations. Both Tjörns Sparbank and Orusts Sparbank base and adjust their quantitative measures on past experience and judgment. The respondent from Orust Sparbank perceives that quantitative measures and judgment are closely interlinked. It can be seen that all savings banks combine initial risk measurement with experience, which is in line with Mikes' view of risk skepticism. Further, all savings banks agree that judgment and experience is needed in order to complement formal rules, which is in line with Schiller's (2013) ideas.

#### **5.4.2 4I framework**

Crossan et. al. (1999) describe organizational learning in a four step process, involving intuiting, interpreting, integrating and institutionalizing. We perceive that the process of implementing a new regulation can be regarded as a form of organizational learning, starting on the individual level and ending on the organizational level. Among the studied savings banks, the process of interpreting and implementing the regulation in Sparbanken Alingsås AB seems to follow the four step process described by Crossan et. al. (1999). The respondent from Sparbanken Alingsås AB explains that when a new regulation is launched he uses common sense and intuition when he interprets it, which is in line with the first process in the framework presented by Crossan et. al. (1999). Then the respondent explains his view of the regulation to other savings banks and his compliance network, and receives their views. This is seen as an example of the second process, interpreting, where the respondent explains his intuition to other people.

Moreover, the respondent tries to find a mutual understanding and interpretation of the regulation with the other savings banks, his compliance network and the CEO of Sparbanken Alingsås AB. This is in line with the third process, integrating, where the aim is to find coherence within the group. It can be seen that the respondent from Sparbanken Alingsås AB aims to find a mutual understanding beyond his own organization. Fourthly, after finding a mutual understanding the respondent from Sparbanken Alingsås AB creates the required documents, which the organization has to comply with. This is a development from the respondent's learning into routinized practices and structures, which is in line with the fourth process, namely institutionalizing. Finally, the remaining interviewed savings banks show some example of the processes presented by Crossan et. al. (1999). For instance, Tjörns Sparbank and Orusts Sparbank discuss their interpretation of the regulation with external parties, such as other savings banks, in order to gain a mutual understanding. This is in line with the third process, namely integrating. As seen, the savings banks must thoroughly go through and interpret new regulations, which can be seen as an organizational learning process. Even though this learning process has resulted in the creation of remuneration documents, it has not led to any significant changes in the banks' operations or remuneration systems.

## Chapter Six: Final discussion

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*In this final chapter we draw conclusions based on our analysis. Finally, we provide two suggestions for further research.*

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### 6.1 Conclusions

Before presenting our conclusions, our research question is once again stated.

*How have savings banks interpreted regulations concerning remuneration policies?*

Our findings show that there are two parallel phenomena regarding how savings banks interpret regulations regarding remuneration policies. Firstly, all of the savings banks emphasize the importance of complying with existing and new regulations, which is both resource intense and require much effort. By complying with regulations, legitimacy is created and it is a way for the savings banks to show that they are serious actors in the financial sector. All savings banks also emphasize the importance of having one regulatory framework for all financial institutions. One savings bank discusses that savings banks should have the same legal requirements on them as the entire financial sector to avoid to be considered less secure than other banks, as well as to achieve a certain level of quality within the sector. Hence, our findings show that the savings banks are keen to comply with regulations and be legitimate.

At the same time as the savings banks emphasize the importance of complying with regulations, our findings show that the regulation concerning remuneration policies is not perceived to be aimed at the savings banks. The implementation of the regulations has resulted in the creation of remuneration documents and a review of the savings banks risk management practices. However, the regulations have not resulted in any significant changes in the savings banks' operations nor in their remuneration systems. The savings banks perceive that they had a well-functioning risk management concerning remunerations prior to the launch of the new regulations and therefore the general perception is that the regulation has not made their banks more secure.

To sum up, we draw the conclusion that the savings banks emphasize the importance of complying with regulations in order to gain legitimacy, but at the same time the regulations concerning remuneration have not resulted in any significant changes in the savings banks' operations or remuneration system. Hence, two parallel phenomena regarding how savings banks interpret regulations regarding remuneration exist.

### 6.2 Suggestions for further research

During our thesis process we have encountered numerous interesting areas connected to our field of study, and we perceive that there are opportunities for further research. Firstly, when



conducting interviews with the savings banks, all respondents discussed a new regulation launched by The Swedish Financial Supervisory Authority called *FFFS 2014:1 Finansinspektionen's Regulations and General Guidelines regarding governance, risk management and control at credit institutions*. For instance, this regulation requires that the control functions in financial institutions should be separated from each other, which has had great impact on the relatively small savings banks and their organizations. Therefore, it would be interesting to gain a deeper understanding of the consequences of this regulation for savings banks.

Another suggestion for further research is to conduct a case study at one or several savings banks in order to gain a deeper understanding of the organization's risk management. When conducting the interviews at the savings banks, we got the impression that risk thinking permeates their entire organizations. With this background, it would be interesting to get an understanding of how employees at different positions in the saving bank perceive and work with risk management.

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## Appendix 1 – Interview guide

### Introduction

1. Please tell us a bit about yourself and your professional background.
2. For how long have you worked within the bank?
3. Can you give us a shorter description of the bank?
4. Can you describe the bank's control function?
  - a. How does your bank work with risk management?
  - b. Generally when working with risk management, do you perceive that your bank uses quantitative measures or do you use own experiences and assessments?

### Remuneration

5. Can you give a shorter description of the bank's remuneration system?
6. Are all employees entitled to the remuneration system? Please explain.
  - a. Is the management entitled to the remuneration system? Please explain.
  - b. Is the control function entitled to the remuneration system? Please explain.

### Regulation

The Swedish Financial Supervisory Authority has launched regulations concerning remuneration policies and variable remuneration. In 2009 the first version was launched (FFFS 2009:6), and in 2011 it was replaced by a new version, namely FFFS 2011:1.

### Reaction

7. How did your bank react when FFFS 2011:1 replaced FFFS 2009:6?
  - a. Do you perceive that the regulation is relevant in your bank's context? Please give examples.
8. How did your bank reason when implementing the new regulation?
9. Who was responsible for the interpretation and implementation of the regulation?
  - a. What professional background does this person have?
10. The regulation aims to create a long-term thinking, do you perceive that your bank has had any problems with short-term thinking in the past? Please elaborate.

### Consequences

11. How has your remuneration policy changed due to FFFS 2011:1?
  - a. Which were the main changes? Please give examples.
12. How did the new regulation affect the distribution between fixed and variable remuneration?
13. Did the breaking point of 100 000 SEK concerning variable remuneration for specially regulated staff affect your bank?



- a. If yes, how?
- b. If no, how come?

***Interpretation***

- 14. Did your bank perceive any difficulties with interpreting the new regulation?
  - a. Which were the main challenges when interpreting and implementing the regulation?
  - b. How did you handle these?
  
- 15. Did your bank have to make own assessments based on own experience? Please exemplify.
  
- 16. What do you think about using own reasoning and intuition when interpreting new regulations?
  
- 17. Did you discuss different ways of interpreting and implementing the regulation with external parties, such as other savings banks, consultants or your auditor?
  - a. If yes, with who and what was the contribution of this?
  - b. If no, how come?
  
- 18. How did your bank reason concerning the categorization of employees?
  - a. For instance concerning risk takers and specially regulated staff.
  
- 19. How did your bank reason regarding whether to name the aforementioned employees in your remuneration policy or not?
  
- 20. How did your bank reason concerning the publication of information regarding your remuneration policy (FFFS 2011:1) and remuneration system (FFFS 2011:3)?
  - a. Which documents to publish
  - b. Where to publish the documents
  
- 21. How have your bank appointed a specific member of the board/remuneration committee, that shall conduct an independent assessment of the firm's remuneration policy and remuneration structure
  - a. What professional background does this person have?
  
- 22. Has media influenced the interpretation and implementation of FFFS 2011:1?
  - a. If yes, how?
  - b. If no, how come?
  - c. Have any other stakeholders influenced your interpretation and implementation?
  
- 23. Do you perceive that the association form savings bank/limited company has influenced how you interpret and implement new regulations?
  - a. How?

**Finally,**

- 24. Would you like to add something?