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Draft high-level principles of Remuneration Policies

Introduction

1. The recent market turbulences have, amongst other things, highlighted the risks inherent in firms' having inadequate remuneration policies and structures. The absence of a coherent and adequate remuneration policy generates potential risks for the financial institution that need to be adequately analysed and contained. The following list of principles aims to address some aspects that are critical to a well functioning remuneration policy, while recognising that the responsibility for the policy rests ultimately with the institutions themselves and, where applicable, the shareholders.

Scope

2. In line with the internal governance work, the resulting guidelines will be addressed both to regulators and regulated firms. Within the firms, the guidelines are aimed at the entirety of the remuneration policy, including members of the management body, with special emphasis on senior employees and other risk -takers and -managers in the company. The remuneration policy should include all levels of the organisation and all categories of employees.

3. The implementation of these guidelines and thus the exact form of a firm's remuneration policy should take account of its nature and scale, and of the complexity of its activities.

4. Further consideration will be given on how the supervisory review and evaluation process (SREP), which includes an assessment of all risks to a company, can address those risks emanating from the remuneration policy. Within this process supervisors will consider the range of measures, available under Pillar 2, to address and mitigate these risks.

5. The set of principles are as follows:

General

i. ***The financial institution should adopt an overall remuneration policy that is in line with its business strategy and risk tolerance,***

objectives, values and long-term interests. It should not encourage excessive risk-taking. The remuneration policy should cover the institution as a whole and contain specific arrangements that take into account the respective roles of senior management, risk takers and control functions. Control functions should also be adequately rewarded to attract skilled individuals.

This principle is aimed at a key objective of a firm's remuneration policy: Any policy should aim at aligning personal and company objectives with a view to the long-term. This must include the overall business strategy as well as other company values such as compliance culture, ethics, behaviour towards customers, measures to avoid conflicts of interest, etc... This also implies that the remuneration policies should not induce excessive risk taking. A company should not reward individuals for taking risks in excess of the company's risk tolerance and at all times give due considerations to the longer term.

Control functions should be adequately compensated in accordance with their own objectives and not in relation to the performance of the business units they control.

Where the remuneration policy captures severance pay or pay related to other scenarios such as mergers and acquisitions, it should be related to achieved performance over time and designed in such a way as to not be a reward for failure.

ii. The remuneration policy should be transparent internally and adequately disclosed externally.

The remuneration policy should be accessible to all employees. The employees should know in advance the criteria that will be used to determine their remuneration. The appraisal process should be properly documented and transparent to the employee concerned.

Whilst respecting confidentiality, relevant information on the remuneration policy should be disclosed in a clear and easily understandable way to relevant external stakeholders.[1]

A company should be able to clearly articulate its remuneration policy to its supervisory authority upon request. This could, for example, take the form of a remuneration policy statement which is subject to regular review.

GOVERNANCE

iii. The management body, in its supervisory function, should determine the remuneration of the management body, in its

[1] In particular, listed companies should apply the European Commission's Recommendation on 'fostering an appropriate regime for the remuneration of directors of listed companies' - http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2004:385:0055:0059:EN:PDF

management function[2]. In addition it should have oversight of the overall remuneration policy of the firm. The implementation of the remuneration policy should be subject to central and independent review.

This principle addresses firms' oversight and decision-making regarding pay and bonus.

Ultimate oversight of the remuneration policy should rest with the company's management body (supervisory function). One way of achieving this could be by setting up an independent Remuneration Committee or other relevant committees which report to the management body (supervisory function).

Centralised decision-making bodes will be better able to align individual pay-out with the company's overall performance.

Any policy should be subject to regular (at least annual) and independent internal review, with specific attention to preventing incentives for excessive risk taking and other adverse behaviours.

In addition to the management body's general responsibility for overall remuneration, an adequate involvement of the shareholders, control functions (Risk Controls, Compliance and Internal Audit) and, where appropriate, of Human Resources is required. A commercial business unit should therefore not be able to determine remuneration of control functions as this would create a potential conflict of interest.

MEASUREMENT OF PERFORMANCE AS A BASIS FOR REMUNERATION

iv. Where the pay award is performance related, remuneration should be based on a combination of the individual performance's assessment, the performance of the business unit and the overall results of the company or group. When defining the individual performance other factors apart from financial performance should be considered. The measurement of performance, as a basis for bonus awards, should include an adjustment for risks and cost of capital.

This principle targets the measurement of performance as the basis of the pay and bonus award. This may not be applicable to all categories of employees. The measurement of employees' performances is central to a good remuneration policy. Defining the pay-out should not be a purely mechanical process based on measurable performance criteria, but include the ability to exercise judgement.

Any performance measure should include variables relating to individual, business unit and company wide performance. Whilst the overall company

[2] For a definition of the management board in either its supervisory or management capacity, please refer to the definition provided on page 6 of CP03. The definition is designed to address both single and dual tier structures within the EU.

performance is important, this does not mean that remuneration policies cannot vary in nature depending on the business unit to reflect the objectives of the specific area.

For individual performance measurement, whilst financial aspects may be one dimension of determining performance, other non-financial factors should also be considered such as acquired skills, personal development, compliance with the company's systems and controls, and contribution to the performance of the team. Where it is appropriate, poor performance in the non-financial variables should override the good performance in terms of profit generation; i.e. unethical or non-compliant behaviour cannot be compensated for by good financial performance.

Bonuses or bonus pools should be calculated using a measure of performance which is adjusted for risks and the cost of capital. Where possible, this should be based on a firm’s economic capital model. The aim of such an adjustment is to ensure that the longer term interests of the company or group are fully taken into account such as the sustainable growth prospects of the company.

The remuneration of non-executive directors should not be linked to the financial institution's short term results but take into account other factors, such as the time invested and their respective responsibilities.

FORM OF REMUNERATION

v. There should be a proportionate ratio between base pay and bonus. Where a significant bonus is paid, the bonus should not be a pure upfront cash payment but contain a flexible, deferred component; it should consider the risk horizon of the underlying performance.

The relation between base pay and bonus should be of reasonable proportion. Employees should not have to rely on bonuses.

This principle targets the form of the pay-out. Whilst cash pay awards may be appropriate for base pay, where bonus payments are of significant size the award should at least include a deferred component (for example company shares, options and other funds held in a trust or escrow account) to take into consideration the risk horizon of the underlying performance. The deferred payment should therefore be linked to measures of future performance. In such a situation, it would be desirable if these measures are risk adjusted as set out in principle iv.

Big bonuses should not be awarded purely in upfront cash.

Whilst taking into account all legal and fiscal constraints, any upfront bonus payment should be subject to a claw back if it resulted from established fraudulent activities.