

Sound Remuneration Practices for Licensed Banks

Volumes 1 & 2 – Conventional/Islamic bank licensees -- Islamic Banks

January 2014

Industry Comments		CBB Initiative
General Comments:		
<p>A bank noted that the directors raised serious concerns regarding the Consultation Paper. The following concerns are only high level and not intended to address the paper point-by-point:</p> <ul style="list-style-type: none"> • The proposed regulation will dramatically affect the policies and procedures of the licensed banks at the senior management and board levels, as well as any employees who receive variable compensation. This could seriously affect retention, recruitment and motivation, and the impact must be studied thoroughly by each affected institution. The paper involves many practices that if implemented may have legal repercussions and some measures may be difficult to implement, e.g. installing IT systems to monitor and report on compensation in such a detailed manner as outlined in the proposed regulation. • The new regulation shifts responsibility from Management and the Board to the external auditors, who are not responsible under company or CBB law, to define “fair compensation”. If the purpose is to avoid excesses among investment banks and some retail banks then that is the responsibility of those banks’ boards and should be dealt with on a case-by-case basis. Long established banks have always adhered to best practices and market norms per the CBB’s Code of Corporate Governance. Generalizing the issue is not justified and not fair. • The deadline for comment is impossibly short and should be extended by a minimum of six (6) months. The major reason is that the banks’ boards and various committees, including Remuneration, will not meet until next year. The extensive changes in the proposed regulation will require their review, placement on board agendas and subsequent approval. • During this period, the directors of the Association and other concerned chief executives of licensed banks would like to meet with the Central Bank to discuss such regulations and the consultative process, esp. given the very short time-frames within which they are expected to comment on quite complex regulations with far-reaching effects. • In general, the Association is very concerned that in this period of fragile economic recovery with 	G-1	<p>The comparison should be done against International standards which is mainly the latest Basel paper and not just on a regional basis. These proposed directives are required as a key component of an effective banking supervision framework.</p> <p>The responsibility for remuneration is not being “shifted” to the external auditor. The external auditor is simply stating whether the principles advocated were complied with.</p>

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<p>slow growth, such restrictive regulations will have a negative impact both to licensed organizations, newly-arrived entrants and those looking to enter the region. In light of other regional financial centers competing for business, this is a real threat.</p> <p>The Board of the association encourages the CBB to take these concerns very seriously and introduce more flexibility into the process. In the meantime we look forward to meeting with the CBB to discuss the above points further.</p>		
<p>A bank noted that the requirements in the consultation are a bit theoretical; therefore banks need more guidance on the subject.</p>	G-2	Disagree. The consultation is clear but there could be some guidance where confusion is caused.
<p>A bank noted that it is unclear whether these rules will be a rule / recommendation / mix of both. In addition it is unclear whether the paper applies to (Executive Directors / Non-Executive Directors / Senior Management), or whether the CBB Definitions are applicable (as it refers to employees / approved persons sometimes) CBB needs to define ‘Approved Persons’ and ‘Material Risk Takers’ in the consultation.</p>	G-3	The rules will be clearer in the final issuance. However, initially wherever a clause says “must” then it is a rule otherwise it is guidance. Agree, ‘approved persons’ is used as is currently defined in the Vol 1 Glossary and ‘material risk takers’ has been defined and is included as a new Glossary term.
<p>A bank noted that the paper is silent about the support functions and non-risk takers on business front and whether to apply the deferral concept to them or not. If it does apply to them, then the emphasis should be more on immediate remuneration and less on the deferred part.</p> <p>There is a clear trend to move towards variable compensation. Guidance on a minimum component would be helpful. With regard to existing compensation, some banks currently pay 13 month and 14 month salaries and some others don’t. In order to ensure a level playing field would banks that do pay be asked to treat this as variable (and potentially lose this) or will those who don’t pay 13 and 14 months be forced to fall in line with the others?</p>	G-4	<p>The paper covers approved persons and material risk takers; therefore, it does not apply to the support functions.</p> <p>Based on the type of employment contract, the 13/14 month compensation is considered as part of fixed remuneration, as these</p>

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		<p>amounts are known amounts when the contract of employment is awarded and do not vary based on the employee's or the bank's performance.</p>
<p>A bank noted that in principle, there can be no objection to the objectives of the proposed regulation. However, they are of the view that in general the proposed regulation is far too complex for the current state of the Banking industry in Bahrain. These principles are developed by FSB and BCBS in the context of large and complex banking organizations. Furthermore,</p> <ul style="list-style-type: none"> - These guidelines assume that there are at least a few employees who are members of the Board of Directors, which is generally not the case in Bahrain and/or in the region; - Bonus Pool or variable pay is a substantial part of compensation (which again may not be applicable to retail Banks in Bahrain) <p>Extending these to the Banks in Bahrain without substantial simplification will only result in additional costs (including for consultants and advisors), with marginal benefit to the system. Moreover, effective governance of remuneration is already covered by existing CBB guidelines and rules and in general there should be no major problem in implementing the broad principle/standard. However with respect to specific guidelines, some issues are likely to have implications for banks depending on the size and nature of business. In conclusion, while the goals of the consultation paper are praiseworthy, compliance with policies as suggested will be difficult. Therefore, it is their view that CBB should prescribe thresholds including size of the Bank and proportion of Bonus pool/ variable pay before making it mandatory for Banks to comply with these regulations.</p>	<p>G-5</p>	<p>Many of the Rules being suggested are principle-based and are a factor of risk and can therefore be tailored for the risk of each bank regardless of the size of the bank involved.</p> <p>A threshold amount has now been included whereby the remuneration rules now apply to all approved persons and material risk-takers whose total remuneration (as defined in the Glossary) is in excess of BD100,000.</p>
<p>A bank noted that the proposed rule certainly provides many insights that will augment the “Fiduciary Responsibilities” and the “Duty of Care” at the management level thereby enhancing corporate governance and risk controls of the banks. However, just like any other regulations, the proposed rules will result in some negative consequences on both shareholders as well as the management which need to be considered.</p>	<p>G-6</p>	<p>It is important to note that the methodology refers to the Financial Stability Board (FSB) Principles and Basel Standards as they set</p>

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<p>It goes without saying that risk and return go hand in hand; the amount of risk the management undertakes reflects (or equates to) the amount of return the shareholders want/expect. The higher the return expected by shareholders, the higher the risk the management will have to assume. It is, therefore, unfair to single-out and penalize the management team for their adherence to their “Duty of Obedience”. To maintain impartiality and ensure equitable treatment of all stakeholders (shareholders and management), an equivalent rule controlling divided payments should also be considered by CBB. One should also consider the consequences of the proposed paper on the economy, overall banking business, and the job market especially that the other regulatory authorities in the region have applied different degree of the same rule (for example the regulatory authorities in the Kingdom of Saudi Arabia and UAE have issued a more general version of these rules). In their view, possible material consequences of the proposed rules include the following:</p> <ol style="list-style-type: none"> 1- It will deter management from taking on risks thereby focusing on risk free transactions (for example, management will focus on secured financing and will neglect balance-sheet financing). This in turn will slow down the economy and, on the other hand, will hurt shareholders’ investment since the management will not be able to achieve the required returns. This may further lead to a decision by the shareholders to dismiss the Board and/or the management. For these reasons, it is very essential that CBB seeks shareholders’ views through the Ministry of Commerce and/or the Chamber of Commerce to have a common understanding between shareholders and the management. 2- It will lead to migration of skilled people from weaker banks to stronger banks and, subsequently, from Bahrain to other GCC markets where the rules are not so stringent (KSA for example) and where skilled bankers could make better money for themselves. 3- The management of banks at Board level (in particular for weak banks) will be severely affected since the proposed remuneration is extremely low for Non-Executive Independent Directors compared to the magnitude of their responsibilities especially that HC-5.5.1 does not allow paying any variable remuneration to Non-Executive Directors. 4- Managers will probably face a difficult time managing their team since employees may refuse unprofitable or bad assets being assigned to them (as it will impact their remunerations). <p>A major disparity caused by the proposed rule is that it penalizes the current management bad assets inherited from a team which may have already taken benefit from these assets and left the company. This actually will accelerate the migration of skilled people, as described in bullet point 2</p>	<p>internationally agreed objectives and high-level principles. In addition, the rules supplement existing requirements dealing with director’s duties (HC-5) and corporate governance in (PD-1.3).</p> <p>The remuneration practices will not make banks weaker; in fact, they sustain market confidence and promote financial stability by reducing inappropriate risk-taking by banks.</p> <p>The issue of legacy assets and appropriate transition rules has been considered.</p>
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<p>above. The proposed rule should, therefore, be revised to take into consideration this fact and apply its provisions to assets booked from the date of issuance of the rule (i.e. legacy assets should not be considered in the formula).</p> <p>Management of Islamic banks will probably be more affected by this rule since, unlike conventional banks, Islamic hedging techniques is still at its infancy level meaning that Islamic banks portfolio are naturally more risky than the conventional banks. For Islamic banks, the proposed rules may be considered at a future date.</p> <p>The proposed payment of shares as part of the variable remuneration has its own implications that must be considered by the proposed rule before its implementation for 2 reasons:</p> <ul style="list-style-type: none"> • Marketability of the shares may be weak due to various reasons (including the fact that shares may be held by a large shareholder) which would mean that the management will not be able to easily trade / sell these shares; • By acquiring shares, the management will eventually own the Bank. <p>It goes without saying, of course, that the proposed rules will have to give due considerations to the provisions of the “labor Law” for possible conflicts. Provisions of the “Commercial Companies Act” should also be considered.</p> <p>Enacting the rule will definitely have impacts on the contractual obligations banks may already have with their management. Implementing the proposed rule may prove to be a little challenging especially that it may require renegotiating employment contracts of certain managers/Board members.</p>	<p>However, it is hard to imagine a case where all of the people who had a say in booking such bad assets have left the bank.</p> <p>All banks operating in Bahrain, whether conventional or Islamic, should be treated in a consistent and fair manner when dealing with sound remuneration practices. There is absolutely no justification that warrants different treatment.</p> <p>The dilution of shares and the difficulty to grant shares as part of the variable remuneration in privately held banks has been considered and retained as other forms of non-cash compensation can be granted to comply with the rules</p> <p>There is nothing in the Labour Law nor in the Commercial Companies Act which conflicts with the proposal. However private law impediments may arise and can only be understood by examining the whole of the relationship between each and every employer and its employees. Contracts will have to</p>
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<p>Generally speaking, the proposed rule is more stringent than the Basel document itself and requires to be thoroughly reviewed, taking the above points into consideration. They highly advise CBB to consider applying these rules to “significant, large, and systematically important financial institutions” as per Basel’s own recommendations especially that Bahrain’s economy is small. In fact, they find the proposed rules to be more applicable to wholesale banks / investment banks instead of commercial banks.</p>		<p>be renegotiated as per the new Rules, within the 6-month transition period.</p> <p>Despite the initial Basel recommendations, a survey conducted by the BCBS found that in a significant number of jurisdictions, supervisors opted to make such rules applicable to all licensed banks, rather than providing a tiered approach. Bahrain is opting to follow a similar approach. Moreover, the European parliament on March 6 2013 agreed on a mandatory 1:1 ratio on variable pay relative to salary, which can rise to 2:1 with explicit shareholder approval. This new requirement is even more stringent than the proposed consultation and is applicable to all banks.</p>
<p>A bank noted that the implications of the paper’s requirements on banks are huge and require more time of consultation than one month. Also, the Executive management, members of the Remuneration Committee as well as the full Board of Directors should study this paper thoroughly as it has implications on the policies and resolutions already approved by them. It is suggested that the CBB can extend the period of consultation so the banks’ Boards of Directors and their executive managements could have adequate time assess the impact of the paper’s requirements on their current and future practices.</p>	G-7	<p>The period for consultation is practical and the licensees will have time to undertake a gap analysis and provide detailed steps and a timeline to comply. The CBB is providing a 6-month</p>

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<p>The bank has in place a Remuneration Policy and approved by its Board of Directors. They would like to assure the CBB that it would amend the existing policy to reflect the requirements of the CBB should the consultation paper get finalized and put into implementation.</p>		<p>transitional period for the implementation of the Rules and has met banks to discuss the proposals, therefore giving banks enough time to assess the impact of the paper.</p>
<p>A bank noted that the paper has a lot of good practice for banks. However, it is assessed to be highly technical and requires a special meeting with the CBB to understand the full spirit and content of it. Though there may be benefits to the banks in this paper, this paper, drafted considering internationally driven practices indulged into by the so called "too big to fail" banks, the perspective might be different when it comes to banks of the size that exist in Bahrain.</p> <ul style="list-style-type: none"> • There may be negative ramifications in the short term on Bahrain in terms of competitiveness, especially given the comparatively small size of local banks with those of other GCC banks. The average performance in terms of absolute value therefore will continue to lag behind those of the other GCC countries and hence less pay to attract and retain good talent. At this stage, the content of this consultation paper may be used as guidance rather than rules until the full practice is better comprehended. • Confidentiality of remuneration especially the salary and the bonus (other benefits may be disclosed) are of private nature and bankers should not be treated any differently from other members of society, e.g., officials of non-banking listed companies as well as high level government officials. • With respect to remuneration, the AGM should be aware of average pay made to employees and the average number of bonus (salary multiples) to be paid. The shareholders can then obtain comparative information of the local and regional banks of similar size to be well informed and better discuss these issues and related concerns. For example a holder of just a few shares would be aware of specific pay details and this may lead to misuse and possible misunderstanding of information. • Remuneration policy and pay are approved by the Remuneration Committee and the Board and are subject to internal, external and regulatory audit on a regular basis. We believe at this stage this is sufficient given the size and level of pay of Bahraini banks. 	<p>G-8</p>	<p>A meeting did take place with all the banks to discuss the proposals. Despite the initial Basel recommendations, a survey conducted by the BCBS found that in a significant number of jurisdictions, supervisors opted to make such rules applicable to all licensed banks, rather than providing a tiered approach. Bahrain is opting to follow a similar approach. Moreover, The European parliament on Wednesday 6th March agreed on a mandatory 1:1 ratio on variable pay relative to salary, which can rise to 2:1 with explicit shareholder approval. This new European requirement is even more stringent than the proposed consultation and is applicable to all banks.</p>

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<ul style="list-style-type: none"> • Some of the deferral and the claw back requirements may have Sharia implications that need to be considered. • Notwithstanding their above comments, for the past few years they have factored into remuneration calculation responsiveness to audit points and regulatory observations and they noticed that the consultation paper has useful ideas in such regards whereby they can enhance their practice once they better understand the suggestions in the consultation paper. This will also require system enhancements to capture the required information which they believe will require time to achieve. • They also believe that what needs to be issued here in terms of guidance and/or rules has to take into account the size of Bahraini banks and the competitive environment Bahrain needs to maintain to attract talent after quantifying the actual problem issues Bahrain has and whether this requires such a level of regulatory detail is a matter of discussion. They also need to see the reasonableness in terms of guidance and rules as opposed to administrative and bureaucratic burdens designed to address a problem outside of Bahrain addressing the too big to fail banks. This paper can improve practices but they need to take into account the above. • At this stage they need to sit with the CBB and the other banks to discuss the paper's content. As they have mentioned above, the paper may have good practices for banks but requires lots of explaining and understanding before a full and meaningful feedback can be given in the details required. 		<p>The disclosure requirements in the annual report are on an aggregate basis by different categories and preserve the confidentiality aspect.</p> <p>No Shari'a issues were raised on the proposals presented.</p>
<p>A bank inquired if the Basel form of regulating compensation practice in the GCC region is indeed relevant appropriate. They recognize the need for legislations in this regard but not in the form in which Basel has proposed. In their opinion, sufficient and detailed disclosure in the annual report will deter industry from adopting unhealthy remuneration practices. If such a course of action is pursued shareholders themselves will act as an effective check on management and boards. In this regard, they wish to note that remuneration Committee of banks act as first point of control with detailed checking on the performance and compensation packages of CEO and his/ her direct reports.</p>	G-9	Please refer to comment G-1.
<p>A bank strongly believe that in order to assure compliance feasible, it is important to bring certain amendments in these principles (customization in line with the local market/regional requirements); and also that the implementation must be phased over the period of time. Additional resources and system advancements will be required in order to implement the new arrangement/ requirements; hence the additional cost heads are also to be bought into account.</p>	G-10	Please refer to comment G-1 and G-7.

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<p>A bank noted that although most of the proposed principles appear to be sound at a high level, they do not seem to recognize the differences in the business models of Banks and seem to set certain standards based on an “envisaged model” rather than a test of how these standards may be applied in different situations.</p> <p>The principles laid down in the Consultation Paper are based on BIS paper issued in January 2010, which was in turn principally based on the FSB principles for Sound Practices. The FSB paper was in response to the impact of the financial crisis which was blamed on large “significant” listed financial institutions whose financial impact had the ability to destroy financial markets. These institutions were involved in complex structuring and securitizing of financial instruments whose risks were not clearly visible. These instruments produced short term gains for the banks and in turn the management and employees benefitted through large bonuses. As the hidden risks started to “mature” the devastation caused havoc in the global financial markets but the main players i.e. the management responsible for this destruction remained unharmed as they had already earned substantial wealth. The FSB and BIS papers are principally for regulating the compensation practices with huge trading desks with focus on short term trading profits and to ensure the compensation practices are aligned with the long term interests of the shareholders.</p> <p>Most Banks in Bahrain do not normally deal in products which are highly complex and whose risks may be hidden or unknown. Even retail banks are involved in offering standard products, the risks of which are historically known. Therefore, complete implementation as per the BIS and FSB principles will be inefficient and may have a negative performance impact on the banks in Bahrain. The Consultation Paper does not sufficiently recognize the different nature of Banks in Bahrain when compared to those in developed economies. Banks tend to be a lot smaller in size with mostly non-complex transactions. Except for a couple of large significant banks others are mostly small and unlisted financial institutions mainly owned by a few large shareholders. The administrative burden of the systems that the CBB is suggesting will be quite significant.</p> <p>Methodology and measurement must be more relevant and suitable for Banks in Bahrain. We totally agree with the view that the compensation practices need to be tightened and aligned in with the long term interest of the shareholders. However, in our view this can be best achieved by adopting the principles which are relevant to banks in Bahrain and to include other principles which may have to be customized for the issues impacting the practices in the country.</p> <p>One suggestion would be to require banks to prepare a detailed compensation policy for the bank which</p>	<p>G-11</p> <p>These proposed directives are required as a key component of an effective banking supervision framework. Please refer to comment G-6.</p> <p>Despite the initial Basel recommendations, a survey conducted by the BCBS found that in a significant number of jurisdictions, supervisors opted to make such rules applicable to all licensed banks, rather than providing a tiered approach. Bahrain is opting to follow a similar approach.</p> <p>The implementation of the proposed remuneration rules is required by international standard setting bodies as part of the Basel revised core principles of effective banking supervision which Bahrain is to be assessed against it in the upcoming FSB and IMF assessments. Noncompliance may results in downgrading Bahrain and therefore the cost of securing</p>
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<p>should identify the risks relevant to the specific bank and it must address how the policy aligns the interests of the management and employees with that of the shareholders. This policy must be reviewed by the external auditor to give assurance that policy is appropriate for the bank and all risks are covered in the underlying policy. In addition the Risk Management framework must be enhanced and strengthened which will in turn result in better risk alignment for remuneration systems instead of focusing on risk adjustments specifically for remuneration systems.</p> <p>An example of issues relating to compensation practices in Bahrain is provided below. A large number of banks, particularly Islamic investment banks are involved in investing in PE or real estate based transactions. Specifically, in Bahrain banks have previously faced problems because of the business model where they used to underwrite such investments and sell down to investors at high mark-ups. The sell down at high markups resulted in reporting substantial profits during the years which became the basis for computing bonus pool. There was no provision which required penalty or claw back if respective investment completely missed its return objectives. A large number of these investments performed badly, particularly in the aftermath of the financial crisis, and there was no clawback. In order to better align specific risks for banks in Bahrain CBB should link portion of the variable compensation on exits. Deferring a portion of variable compensation awarded at the time of acquisition and sell down would address a major shortcoming in the compensation practices relevant to Banks in Bahrain.</p> <p>It is therefore recommended that careful review of remuneration practices and how banks align both shareholders and employees interest must be carried out instead of implementing the Principles which are mainly meant for large significant banks in developed markets. These Principles are still evolving and may be changing. Therefore, it may be too early to implement these for banks in Bahrain.</p>		<p>finance in the international market would be higher for Bahraini banks.</p>
<p>A bank expressed their agreement with the underlying objectives of this consultation paper and support the CBB’s aim towards providing a transparent platform that allows the stakeholders to evaluate the quality of remuneration practices in comparison with the Banks’ risk taking strategy.</p> <p>Yet they strongly believe that the requirements stipulated in this consultation paper are very prescriptive and to some degree complicated both on a qualitative and quantitative aspect, taking into consideration the nature and size of the kingdom’s Banking industry. Moreover, these requirements are extremely detailed to a micro level and in some areas even went beyond the FSB and BCBS requirements.</p> <p>Therefore, it is strongly recommended that the CBB should embrace the regulatory evolution approach in implementing the proposed remuneration practices rather than the regulatory revolution approach.</p> <p>The following illustrative example clarifies the basis of the above recommendation.</p>	<p>G-12</p>	<p>To ensure local competitiveness, CBB believes that these principles should be applied to all banks operating in Bahrain or where banks are operating as foreign affiliates (and in some cases branches) they will need to satisfy the CBB that they meet the legal requirements of the host</p>

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By reexamining the following papers “Principles for Sound Compensation Practices” issued by FSB and “Compensation Principles & Standards Assessment Methodology” as well as “Range of Methodologies for Risk and Performance Alignment of Remuneration” issued by BCBS, it is clearly noticeable that all the above papers paid a great emphasis on distinguishing large and significant financial institutions from small and mid-sized financial institutions (i.e. the terminology ‘**Large Banks**’ and ‘**Significant Financial Institutions**’ have been repeated several times) more over the FSB clearly defined its objective and targeted Financial Institutions, this was clearly stated in the introductory paragraph, “The FSF Principles for Sound Compensation Practices are intended to apply to significant financial institutions, but they are especially critical for large, systemically important firms”.

The Below numerical example intended to reflect the size of the Kingdom’s Banking industry with a particular attention to its Islamic sector.

Top 10 Banks & Banking Groups Ranked by Total Assets (2011)

Rank	Bank Name (Europe)	Trillion USD	Bank Name (GCC)	Trillion USD	Bank Sector in Bahrain	Trillion USD
1	Deutsche Bank	2.803	Qatar National Bank	0.083	Entire Banking Sector in Bahrain	0.197
2	HSBC Holdings	2.556	National Commercial Bank	0.080	Islamic Banking Sector in Bahrain	0.025
3	BNP Paribas	2.545	Emirates NBD	0.077		
4	Crédit Agricole Group	2.435	National Bank of Abu Dhabi	0.070		
5	Royal Bank of Scotland	2.506	Al Rajhi Banking Corporation	0.059		
6	Barclays PLC	2.431	Samba	0.051		
7	ING Group	1.817	National Bank of Kuwait	0.049		
8	Santander Group	1.622	Kuwait Finance House	0.048		
9	Société Générale	1.53	Riyad Bank	0.048		
10	UBS	1.51	Abu Dhabi Commercial Bank	0.048		
		21.755		0.614		



jurisdiction with respect to compensation.
Please refer to comment G-11.

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From the above we can see that the asset size of the top Ten GCC Bank is less than the asset size of one of the European top Ten Banks. On the GCC level we can see that the entire Banking sector in the kingdom of Bahrain (i.e. 118 financial institutions) is less than the total asset size of the GCC's top three Banks (i.e. QNB, NCB & Emirates NBD). Moreover, the total asset of the entire Islamic Banking Sector in Bahrain is less than the GCC's 10th ranked Bank (i.e. ADCB). It is worth mentioning, that within the kingdom's Islamic Banking industry, one Banking group reported total asset of around USD 17 billion during 2011 out of the total asset that reported by 26 Islamic Financial Institutions during the same period (i.e. total asset size of 26 Banks is around USD 25 billion). This gives a quantifiable illustration for the meaning of significant financial institutions which are the main target of the FSB recommendation.

On the profitability level we can scale the level of Significant Financial Institution based on their Net Profit as illustrated in the below example.

(Top 10 Banks and Banking Groups in Europe, Ranked by Net Profit FY-2011)

Rank	Bank Name	EUR billion
1	HSBC Holdings	12.971
2	BNP Paribas	6.05
3	ING Group	5.766
4	Santander Group	5.351
5	Deutsche Bank	4.3
6	Barclays	3.6
7	UBS	3.51
8	BBVA	3.004
9	Groupe BPCE	2.647
10	Nordea	2.634

For example, If we will apply the 5% threshold as been suggested by the CBB, on the lowest ranked bank (i.e. 5% of 2.6 billion), this will give us around 132 million EUR which is indeed a material amount to be distributed as remuneration for the Board. Therefore, the FSB as well as BCBS requirement can serve its true purpose in such example.

However, if we will apply the same CBB's suggested threshold within the Bahraini Islamic Banking Sector we will end up with a different scenario for some relatively small financial institutions

Randomly selected Islamic Banks and Banking Group in Bahrain – Net Profit - FY-2011)

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Bank Name	USD Million
Khaleeji Commercial Bank	1.4
KFH	25.0
BANK Alkhair	1.2
Capinnova Investment Bank	2.5
Capinvest	12.4
Seera Investment Bank	61.4
First Energy Bank	3.5
Al Baraka Banking Groups	212

For example, if we will take KHCB as an example, and will apply the suggested threshold (5% of 1.4 mn) we will end up with approximately USD 70,000 as an eligible Board's remuneration pool.

In other word, the amount of remuneration pool which is eligible for distribution for the BOD of one financial institution does not even count as a fraction to the remuneration of one top ranked official in one of the European significant financial institution.

The above numerical illustration was intended to provide a true picture of the size of the Kingdom's Banking industry

(more precisely the size of the Islamic Banking Industry), at the same time to reflect the main objective of the FSB paper.

In principle we totally support and endorse the 8 principles stated in the CBB consultation paper, yet we tend to feel that the stated criteria by the CBB towards assessing the level of the Banks compliance under each principle will require a huge time, effort and resources to administer such requirements.

With respect to the disclosure requirements, we are not sure if this detailed level of the disclosure requirements will meaningfully help the stakeholder in assessing the quality of the Banks remuneration practices and their prudent alignment to the risk management framework, on the contrary it might create some negative results.

Even if we will assume that the level of the disclosure requirements will help the stakeholders in their assessment process, we still don't know the level of the negative implication of such disclosure on the Banking Industry in term of the competitiveness. The availability of such sensitive qualitative disclosure to the public might open an aggressive competition within the Banking industry not just within the Kingdom but even from the GCC to attract talented candidates. Great attention should be paid to this issue.

We believe that linking the remuneration practices only to the risk taking behavior will not lead to the ultimate objective of embracing sound and prudent remuneration behavior. Therefore, the scope of this consultation paper should become wider to account for other aspect such as the competitions in the Banking industry, the management performance in the overall cost reduction process, the management

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<p>action in stabilizing the business during difficult times, etc.</p> <p>It is clearly obvious that the remuneration practices and methodologies are still evolving even on the International scale, therefore, we strongly recommend that the implementation of such requirement should be based on a realistically phased approach, with some modification with respect to the limits and disclosure requirements, at the same time to provide some level of flexibility in varying the level of these detailed requirements for different Banking class (i.e. Small, Midsized, Large, Significant and Systemically Important Financial Institutions) taking into consideration the size of the Kingdom's Banking industry.</p> <p>The bank appreciates the opportunity to comment on this important consultation paper and would be happy to discuss with the CBB any of the comments described above. The CBB is requested to reconsider and redraft the proposed consultation paper taking into consideration the size of the Kingdom's banking industry (i.e. for such issues they strongly support the idea of conducting a round table by inviting the Banking Sector's CEOs as well as the Chairman' of the remuneration committees so that the discussion yielded of such meeting can be incorporated in a 2nd Consultation round).</p>	<p>Meetings were held with all the banks to discuss the industry's feedback and significant changes were made to the Rules issued in November 2013.</p>
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Specific comments			
Proposed Rule	Bank's comments		CBB Initiative
1.4 Banks will be provided with transitional arrangements for the implementation of these measures.	A bank noted that no timelines for implementation has been set out. It is suggested that effective date of the proposed regulation, if any, and transition period for adoption should be clearly specified to avoid ambiguities.	SP-1	The 26 th November letter issued to all banks noted that a transition period would be allowed until the end of June 2014.
2.6 The CBB believes that deferred remuneration can work to reduce imprudent or excessive risk-taking, if it is implemented without limiting appropriate and reasonable risk-taking for banks.	A bank noted that deferred remuneration should only be applied to only set of staff whose actions have a material impact on the risk exposure. But the consultative paper should give clear guidelines/exemptions of junior staff, staff that no relation with the risk taking. In case of investment banks placement staff and advisory staff who have achieved their annual targets and due to the short term nature of their project should be exempted from this principle.	SP-2	It is stated in 2.4 that remuneration practices cover approved persons as defined in the CBB Rulebook as well as material risk-takers. Therefore, staff that have no relation with risk taking are not covered. However, the CBB can't exempt placement staff if they have impact on the risk exposure.
	The bank noted that 'Claw-back' remuneration policy should be added; a requirement that requires Executive directors to return the bonus taken on previous years if it is proven that some misconduct / wrong doing was done by them.	SP-3	The concept of 'clawback' has been included in HC-5.4.26 to HC-5.4.28. The term 'clawback' has also been defined in the updated Glossary.
3.1 Banks typically apply conceptually different strategies when defining their remuneration policies.	A bank noted that CBB may want to clearly define remuneration. It should clarify whether the definition and the respective policies include discretionary bonuses or only defined incentive plans for future performance. Discretionary bonuses are normally for past performance achieved by the bank. The principles in the Consultation Paper now include policies relating to distribution of all	SP-4	Remuneration is defined under Volume 2 Glossary. Remuneration Means all types of compensation including but not limited to salary (fixed and variable bonus), fee and non-cash benefits such as health

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	<p>incentives including bonuses but current rules under HC-5 do not explicitly cover discretionary bonus payments.</p>	<p>insurance, car housing, education, grants of stock, stock options or pension benefits.</p> <p>By virtue of the above definition, also used in Module HC, discretionary bonus payments are covered in Module HC as well.</p>
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<p>3.2 In a “top-down” or “award-focused” strategy, a bank chooses the amount of its overall bonus pool for a given year depending on the bank’s performance and then allocates the pool among employees, with the allocation depending to a greater extent, but not entirely, on the contributions of business units and employees to short-term profit. A portion of bonuses may be deferred, and a portion of deferred bonuses may be paid in equity-linked instruments such as stocks or options. The award-focused architecture does not reliably reduce bank-wide employee remuneration when large losses are experienced on legacy assets. This is because bonus awards depend on activity during the performance year, not on legacy losses, and deferred payouts are reduced for poor performance only if the portion paid in equity-linked instruments is large and if the bank’s stock price falls.</p>	<p>A bank noted that this rule suggests that banks adopt deferred bonus payment/award in equity-linked instruments such as shares or options. Section 5.17 suggests that 50% of the variable compensation is awarded in shares or shares-linked instruments. Section 5.18 puts a cap on common shares to be a maximum of 10% of the total issues shares outstanding of the bank. For unlisted banks (i.e. closed and privately held), deferred cash should be the applicable method with claw-back options when losses are made or assets become non-performing.</p> <p>A bank noted that regulations need to be outlined for stock options and employee equity-linked instruments. In addition, paragraph 3.2 is not clear.</p> <p>A bank agrees that award focused architecture may not reliably reduce losses on legacy assets. The example mentioned above in (3.1) for most of the Islamic investment banks is quite relevant here. The performance of the bank must be broken down between the income generated on realized or exited investments and income generated on placement or mark-up. Bonus pool on income earned on exits should not be deferred as it is based on actual performance and there is no remaining risk whereas portion of income on mark-up/placement fees may be deferred for a period of 3 years or exit whichever is earlier.</p>	<p>SP-5</p> <p>SP-6</p> <p>SP-7</p>	<p>HC-5.4.33 allows for the payment of variable remuneration in other non-cash instruments.</p> <p>HC-5.4.33 provides the rule for the payment of variable remuneration in shares or share-linked instruments.</p> <p>Noted.</p>
<p>3.3 To make bank-wide remuneration more flexible, including the introduction of a variable downward and/or a ‘claw-back’</p>	<p>A bank noted that where investments as mentioned in 3.2 above have suffered permanent impairment the deferred amount may be clawed back.</p>	<p>SP-8</p>	<p>Noted.</p>

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<p>element, a strategy that takes the award-focused architecture as given must change either the way awards are calculated and distributed so that legacy losses are an integral element of bonus awards, or must change deferral arrangements to make ultimate payouts more sensitive to subsequent poor firm-wide performance, or both.</p>			
<p>3.4 In a “bottom-up” or “payment-focused” strategy, incentives operate at the level of individual employees. If unsound risk-taking incentives due to an excessive focus on short-term results are the problem, then individual employees’ remuneration arrangements must be altered so that risk influences the amount of remuneration that employees ultimately receive, not just short-term profit. Employee risk-taking behaviour is more likely to change if employees expect their remuneration to be reduced if they take undue risk. The bank-wide bonus pool will not necessarily be fixed at some fraction of net revenue. The size of the pool will be the sum of individual employees’ awards. That is, the awards will determine the pool rather than the pool determining the awards.</p>	<p>A bank noted that “bottom-up” or “payment focused” strategy is mainly geared towards banks with large trading desks dealing in complex instruments, risks for which may be not clear. As mentioned above only very few banks in Bahrain have large trading desks. Even these banks do not normally deal with complex instruments. They are mainly involved with plain vanilla instruments, risks of which are historically known. It is recommended that CBB may want to look at each bank’s strategy and approve the policy relevant for them.</p>	<p>SP-9</p>	<p>Agree; CBB will approve each bank’s remuneration policy.</p>
<p>Principle 1: The bank’s board of directors must actively oversee the remuneration system’s design</p>	<p>A bank noted that principle 1 requiring the entire committee to be composed of independent non-executives could pose a problem particularly in Bahrain; the requirement that this committee not include any</p>	<p>SP-10</p>	<p>This was amended and the following applies.. HC-5.3.2 states: The committee should include</p>

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<p>and operation for approved persons as well as material risk-takers. The chief executive officer and management team should not primarily control the remuneration system. Members of the remuneration committee must have independence of any risk taking function or committees, and it therefore follows that they must be non-executive, independent, directors.</p>	<p>members of all other committees is very onerous – some latitude is required here.</p> <p>A bank noted that to have non-executive independent director on the remuneration committee would be very difficult for small banks. It is suggested that the requirement should be changed to majority independent directors.</p> <p>A bank noted that this principle stipulates that all members of the remuneration committee be non-executive and independent directors. While it is understandable that members of the remuneration committee be non-executive directors, there are practical difficulties in implementation of the requirement of all members being independent given the fact that many of the institutions in Bahrain are closed and/or family owned or influenced. It is therefore suggested that the rule be restricted to majority of members being independent directors (others being non-executive directors) and the Chairman being an independent director.</p> <p>A bank noted that board committee members will typically not have the expertise to provide any meaningful input to the HR systems particularly relating to Remuneration systems. To be value added and</p>	<p>SP-11</p> <p>SP-12</p> <p>SP-13</p>	<p>only <u>independent directors</u> or, alternatively, only <u>non-executive directors</u> of whom a majority are <u>independent directors</u> and the chairman is an <u>independent director</u>.</p> <p>See comment SP-10.</p> <p>See comment SP-10.</p> <p>The whole purpose of having a remuneration committee with majority independent members is to have an independent review of the banks remuneration which should take into consideration the senior</p>
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	<p>effective, the level of involvement recommended by the Principles 1 and 2 boils down to the Board Committee members being able to assess the risk measurement criteria for remuneration systems which would require them to be well versed in risk-measurements and also have enough sense of the history of risk realizations. This expertise is not normally available on most boards and will make the process very inefficient. This will further cause disputes and may impact the performance of the bank.</p> <p>It is agreed that the HR Remuneration System should not be completely delegated to CEO/Senior Executives, however, this may be more efficiently achieved if the external auditors are required to review the system independently at least annually and provide their report to the Remuneration Committee that the systems are operating as per approved policies and the total annual remuneration recommendations are adequate with respect to the specific risks of the bank.</p> <p>A bank noted that this principle is even stricter than Basel paper as well as the CBB requirement stipulated in the High Level Control Module. The word <u>must</u> as indicated above disagree with the requirement stated in Basel paper ‘Compensation Principles & Standards Assessment Methodology’ under section Additional Supervisory Guidance point (e) on page 7 which state the following“(e) <i>In order that the board remuneration committee is able to operate independently from the senior executives, it <u>should</u> be composed, at a minimum, of a <u>majority</u> of independent, non-executive members).</i></p>	SP-14	<p>management recommendation however the final decision should not be influenced by the senior management especially if their recommendations are not in line with the remuneration rules issued by the CBB. (These are board members of banks and are supposed to be qualified enough to understand the bank’s business and the risk involved) and to judge accordingly.</p> <p>See comment SP-10.</p>
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	<p>In addition the word must in the above principle contradict the CBB guidance as stated in paragraph HC.5.3.2 which state the following; “<i>HC-5.3.2 The committee should include only independent directors or, alternatively, only non-executive directors of whom a majority are independent directors and the chairman is an independent director. This is consistent with international best practice and it recognizes that the remuneration committee must exercise judgment free from personal career conflicts of interest.</i>”</p> <p>Accordingly, this principle needs to be modified to be in line with the spirit of both CBB as well as BCBS requirement.</p> <p>It is understood why the member of the remuneration committee must have independence of any risk taking function. However, they don't support imposing a restriction on the member of the remuneration committee of being a member in other Board committee even if the risk taking element is involved.</p>		
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<p>Principle 2:</p> <p>The bank’s board of directors must approve, monitor and review the remuneration system to ensure the system operates as intended. The remuneration system must include effective controls. The practical operation of the system must be regularly reviewed for compliance with regulations, internal policies and bank procedures. Remuneration outcomes, risk measurements, and risk outcomes must be regularly reviewed for consistency with the Board approved risk appetite.</p>	<p>A bank noted that this contradicts with the provisions of the HC-Module which requires remunerations to be approved by shareholders. This is especially true since Board cannot approve its own remuneration.</p>	<p>SP-15</p>	<p>Agreed. The remuneration policies must be approved by the shareholders as outlined in Paragraph HC-5.2.1 and the remuneration committee must review the remuneration policies which have been approved by the shareholders and be consistent with the corporate values and strategy of the bank</p>
<p>4.3 The Remuneration Committee must approve the remuneration package of all approved persons, and all material risk takers.</p>	<p>A bank noted that the definition or guidance on what constitutes ‘material risk takers’ would be very helpful. This is not a concept used in the FSF Principles/FSB Standards.</p> <p>A bank noted that some guidelines should be provided on what is material risk and who in the bank should be treated as a material risk taker. For example, should the banks treat Head of placement as a material risk taker?</p> <p>A bank noted that it will be very inefficient for the Remuneration Committee to approve the remuneration packages of all approved persons and take away the negotiating powers of CEO/Senior Management in attracting skilled and experienced professionals. It is recommended that, instead, the Remuneration Committee may approve CEO’s remuneration package and set a band of remuneration packages for approved persons</p>	<p>SP-16</p> <p>SP-17</p> <p>SP-18</p>	<p>Agree, “material risk takers” has been included in the updated glossary.</p> <p>See comment SP-16 above</p> <p>Disagree; the CEO/ Senior management should not control the remuneration system as stated under principle 1.</p>

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	leaving room for the CEO/Senior Executives to negotiate.		
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<p>4.4 The external auditor must conduct an annual remuneration audit that is conducted independently of management and submitted directly to the CBB. The audit must assess compliance with the CBB principles on remuneration, and the results must be disclosed in the annual report. An example of a positive audit may be one that outlines how the bank’s remuneration payout schedules are sensitive to the time horizon of risks and variable remuneration is adjusted accordingly. An example of a negative audit may be one that notes that the bank has failed to implement the requirement that a minimum of 50% of the variable compensation must be awarded in shares or share-linked instruments.</p>	<p>A bank noted that clarification on how this would apply to banks that do not have an Employee Stock Ownership Plan in place or when the entity is a closed joint stock company is required.</p> <p>A bank noted that CBB should provide clear scope of annual audit of remuneration to the external auditors/banks. Otherwise it would be difficult to report on every principle due to qualitative nature of some principles.</p> <p>A bank noted that although it is noted as an example but it implies that part of the variable compensation must be awarded in shares or share-linked instruments. The implications of such an approach are discussed later but we would request CBB to leave the mode of payment at the discretion of the bank’s board as long as its method adequately aligns the interests/risks of the employees and the shareholders.</p> <p>A bank requested more details on the scope of the external auditors as well as the procedures to handle the process of such audit and its findings. At the outset, it is believed that the remuneration audit is a challenging task to undertake for all reasons indicated in their comments. It is suggested that if such external audit becomes imperative, the audit report to be discussed by the CBB with the executive management of the licenses to justify any discrepancies in such report, and the said report remain confidential with the CBB.</p>	<p>SP-19</p> <p>SP-20</p> <p>SP-21</p> <p>SP-22</p>	<p>See Comment under SP-5.</p> <p>The CBB is currently consulting with external audit firms on draft agreed upon procedures tailored to the issued remuneration rules. This will provide auditors with a clear template of the CBB’s expectations.</p> <p>See comment under SP-5</p> <p>Please refer to the comment SP-20 above.</p>
<p>4.5 The Board’s remuneration must be</p>	<p>A bank noted that the consultation says that the Board</p>	<p>SP-23</p>	<p>HC-5.5.2 states:</p>

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<p>fixed so that total remuneration (including sitting fees) must not exceed 5% of the bank's net profit in any financial year. Board sitting fees must be limited to a maximum of BD500 per person for attending each meeting.</p>	<p>remuneration must be fixed so total remuneration (including sitting fees) must not exceed 5% of the bank's Net Profit, whereas the Commercial Companies' Law (Article 188) stipulates that the company's articles of association shall specify the manner of determining the remuneration of the chairman and members of the board, the total of which shall not exceed 10% of the net profits after deducting the legal reserves and distributing a profit of not less than 5% of the company's paid-up capital. Clarifications needed on how to handle the discrepancy?</p> <p>A bank noted that guidance on how "net profit" would be calculated for these purposes would be useful (bearing in mind that the Articles of Association of some banks already deal with this and might have to be altered as a result).</p> <p>A bank noted that this applies to non-executive directors only. What about shareholders' approval of employee stock options / employee incentive schemes?</p> <p>A bank noted that this has to be viewed in the context of local market where all or most Directors are non-executive (only a few Boards have CEOs as Directors). A sitting fee of BD 500 per meeting with the above cap will make it difficult to attract independent directors and will ultimately hinder CBB's objective of having more independent directors. This of course will affect smaller banks more than larger ones. They believe that a sitting</p>	<p>SP-24</p> <p>SP-25</p> <p>SP-26</p>	<p>The Board of Directors' remuneration must be fixed so that total remuneration (excluding sitting fees) must not exceed 5% of the bank's net profit, after all the required deductions outlined in Article 188 of the Company Law, in any financial year. There is no contradiction with the Law. The CBB has the right to set more stringent rules for its licensees.</p> <p>"Net profit" is clear; it is considered as net profit as reported in the PIRI</p> <p>Disagree. Applies to all directors. HC-5.4.38 states: All share incentive plans must be approved by the shareholders.</p> <p>The cap for sitting fees has been removed.</p>
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	<p>A bank noted that the minimum Board setting fees of BD 500 as well as the percentage threshold of net profit must take into consideration the remuneration norm in the GCC due to the fact that several Banks have Board members from the GCC, in addition it is not practical nor attractive for the Board members to see that the regulatory requirements are rapidly evolving and placing a great responsibility on their shoulder and at the same time the restriction on their remuneration is getting tighter. Linking the Board remunerations only to a percentage of the net profit should not be the only elements that decide the remuneration pool (i.e. there should be a minimum fixed reputable remuneration pool in order to retain and attract experienced Board members).</p>	SP-31	See comment SP-23 and SP-26.
	<p>A bank noted that fixing the Board's remunerations to a cap of 5% of the bank's net profit is reasonable. Having this threshold set, they do not see the need to stipulate, on a micro-level, the maximum amount for the attending fees. Also, it should be noted that the proposed limit would be a hindrance for banks to attract independent directors (which is encouraged by the CBB), of high caliber and dedication to their rule on the board since the compensations are not commensurate with their experience, qualifications, time and dedications. From a macro-level, it would also impact all banks in Bahrain, and subsequently the reputation of Bahrain as financial center in attracting high-caliber independent directors.</p>	SP-32	See comment SP-26 above.

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<p>h. Whether the Board Remuneration Committee has formally stress tested and back-tested the remuneration policy on an annual basis; and</p> <p>i. Whether the external auditors, through their annual audit of remunerations made or to be made, have assessed the remuneration policy’s compliance with the CBB’s principles on remuneration including:</p> <p>i. Ensuring that all material remuneration plans/programs (including those for senior managers and employees whose actions have a material impact on the risk exposure of the bank) are covered;</p> <p>ii. Assessing the appropriateness of the plans/programs relative to organisational goals, objectives and risk profile of the bank; and</p> <p>Assessing the appropriateness of remuneration payouts in relation to the risks in the business undertaken.</p>			
<p>4.8 The following criteria will be used by the CBB in assessing whether the bank complies with Principle 3:</p> <p>a. The remuneration structure of control function personnel must not compromise their independence or create conflicts of interest in either carrying out an advice function to the Board Remuneration</p>	<p>A bank noted that many institutions are minimizing the fixed compensation obligation and are resorting to higher variable compensation based on performance of the institution itself. A higher fixed remuneration may mean higher fixed costs and will work against the concept of offering competitive wages commensurate with responsibility and prevailing wages for similar positions. A higher fixed wage also means higher associated costs such as end of service obligations. They urge the CBB to be a</p>	<p>SP-35</p>	<p>The CBB is lenient as it has stated that the mix has to be weighted in favor of fixed remuneration for staff involved in control functions. It did not state that there is no variable compensation.</p>

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<p>Committee or their control functions;</p> <p>b. Whether the remuneration of control function personnel was based on function-specific objectives and not determined by the individual financial performance of the business areas they monitor;</p> <p>c. Whether control function personnel have been placed in a position where, for example, approving a transaction, making decisions or giving advice on risk and financial control matters could be linked to their performance-based remuneration;</p> <p>d. Whether the control function management, as opposed to business line management, had the responsibility for the performance appraisal process, including preparation and sign off on the performance appraisal documents, for control function personnel;</p> <p>e. Whether the Board Risk Management, Audit, Remuneration and Nominating committees have been actively engaged in control function personnel performance reviews in relation to their responsibility;</p> <p>f. Whether the remuneration levels of control function personnel, as compared to those of the professionals of the monitored business areas, are sufficient to carry out their function effectively;</p>	<p>little lenient in this regard.</p> <p>A bank noted the following:</p> <ul style="list-style-type: none"> • Subparagraph (e) is not clear what constitutes “...have been actively engaged in control function personnel performance reviews...”. Would this entail the performance review for all control functions such as financial control, Risk and Compliance to be done by Board Remuneration or other respective committees? In practice this will not work. It would be an inefficient process with little or no value addition for the banks in Bahrain. As long as the performance review is done in accordance with a laid down policy (that has been approved by the board) it should be sufficient. The system and process should be subject to internal or external audit review. • Subparagraph (g) is implied that control function personnel’s remuneration should mainly be fixed i.e. no variable or discretionary bonus. This would be a major de-motivational aspect and will no doubt lead to lower performance of the personnel in such posts leading to potential adverse impact for the bank <p>-</p> <p>- Remuneration of control function personnel has to have some linkage to the performance of the business</p> <p>-</p> <p>-</p>	<p>SP-36</p>	<p>The “Independent review” of remuneration to be done by the “remuneration committee”. Audit is allowed to review the internal audit performance for example and so the risk committee is allowed to assess risk management personnel, and submit their assessment for the independent review by the remuneration committee. The board committees role and responsibilities are discussed in detail in the HC Module.</p> <p>See comment SP-35 above. This is the only way to ensure true independency and judgement from personnel involved in control functions.</p>
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<p>g. Whether the mix of fixed and variable remuneration for control function personnel has been weighted in favour of fixed remuneration; and</p> <p>h. Whether the control function personnel have the appropriate level of authority.</p>	<p>–</p> <p>Remuneration of control function personnel has to some linkage to the performance of the business area.</p> <p>– Controlled functions defined as per CBB Rule LR-1A.1.2 & LR-1A.1.8 include: a Senior Manager who is under the direct authority of CEO, and therefore will include Heads of business units. The definition needs to be accordingly adjusted</p> <p>– The Principle should be focused on control functions that have oversight on business units such as risk, compliance and financial control.</p>		<p>There is a difference between ‘control function</p> <p>There is a difference between ‘control function personnel’ and ‘controlled functions’ as defined in the CBB Glossary – these have 2 very different meanings. ‘Control function personnel’ refer to an individual involved in risk management, compliance or internal audit, independent of the business lines. To have a clear definition of the scope of this paper. Principle 3 is talking about the Policing people described above, however the scope of this paper covers all approved persons as defined in the LR Module, the policing people such as internal audit, compliance and risk management which Principle 3 is about and other material risk takers.</p>
<p>Principle 4: Remuneration must be adjusted for all types of risk. Two employees who generate the same short-run profit but take different amounts of risk on behalf of their bank should not be treated the same by the remuneration system. In general, both quantitative measures and human judgement should play a role in determining risk adjustments. Risk adjustments should account for all types of risk, including</p>	<p>A bank noted that given the nature, size and complexity of retail banking business in Bahrain, the requirements are onerous and is really not relevant except at a very high level (as a broad principle). While this is a laudable goal, it is very difficult from an implementation point of view. You are aware that measuring some risks on a standalone basis itself is fraught with great complexity and linking with remuneration policy is even more difficult. This will ultimately result in involvement of more consultants and adoption of methodologies which may not be relevant for most of the retail banks in</p>	<p>SP-37</p>	<p>Principle 4 provides a sound basis for remuneration and recognises that banks must evaluate employees on an individual basis, which is essential to properly link remuneration to risk, which is at the cornerstone of the remuneration rules being introduced.</p>

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<p>intangible and difficult-to-measure risks such as reputation risk, liquidity risk, and the cost of capital.</p>	<p>Bahrain. They agree that payouts should be sensitive to time horizon of risks and a mix of equity, cash etc. However, this has to be considered with a sense of proportion. In case variable pay is a significant component of the overall pay this is a valid argument However, in the current scenario in Bahrain, especially for retail banks, there is no need to make the process more complex.</p>		
	<p>A bank noted that quantitative risk adjustment for business activities generating short term profits such as equity or FX trading desks are relatively easy. However, it would be an extremely challenging task to adjust for risk for longer term investments, particularly those which are illiquid and unlisted. Furthermore, risk adjustment for remuneration alignment even for larger banks in developed economies is evolving, and banks are still experimenting as to clear methodology for risk-adjusted compensation systems. Therefore, to implement this system at such an early stage for banks in Bahrain is not recommended as it can create confusion and as a consequence a de-motivated team who may consider the remuneration system to be unfair.</p> <p>Further, risk measurement for liquidity or reputation risk is at early stages and would be extremely difficult and challenging to come up with an adequate method to incorporate these risks.</p> <p>We strongly recommend that till risk adjustment techniques for remuneration have properly evolved, focus should remain with the management in exercising judgment in allocating a firm-wide bonus pool to business units or even individual employees. Executive</p>	<p>SP-38</p>	<p>See comment SP-37.</p> <p>There is a need to start somewhere in implementing such sound practices. One cannot keep on using excuses to delay the implementation of sound remuneration practices.</p>

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	<p>management, in doing so, may make themselves aware of the applicable risk as far as practical but the decisions would not be driven by such measures. Emphasis should be to stress on a strong risk management culture within the bank and the resultant remuneration system would be fair and applicable to the respective bank.</p>		
	<p>A bank noted that the principle indicated that human judgment should play a role in determining risk adjustments. Which they do understand and agree with in addition they do believe that the remuneration as a whole embrace a level of subjectivity, which they don't see how the External Audit can challenge, (i.e. the same remuneration practices by one Bank might be challenged differently by two different Audit firms due to the subjectivity issue.)</p>	SP-39	<p>The agreed upon procedures being consulted on with external auditors will take these factors into consideration.</p>

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<p>5.7. Subdued or negative financial performance of the bank should generally lead to a considerable contraction of the bank’s total variable remuneration, taking into account both current remuneration and reductions in payouts of amounts previously earned, including through malus or clawback arrangements¹. Banks should however recognise the performance of staff who have achieved their targets or better, by way of deferred compensation, which may be paid once the bank’s performance improves.</p>	<p>A bank noted that there could be situations where the bank as a whole is incurring losses for a 2-3 year period although one division records above average profits. The people generating these profits will not stick around until the bank as a whole is profitable. The danger here is the only profitable division would then walk away leaving the bank even worse off than previously.</p> <p>A bank noted that the “clawback” should be exercised within a reasonable specific period (i.e. 3 years) and to be exercised only if the management has committed frauds.</p>	<p>SP-40</p> <p>SP-41</p>	<p>Disagree, this will reward the people generating profit as in this case, the division which records above average profits will have the highest share of the variable remuneration, even though this may be deferred. The bank cannot justify paying variable remuneration when it does not have funds or the necessary liquidity to do so.</p> <p>Disagree; clawback should be exercised when the decision of an employee results in a negative financial performance. If the management has committed fraud, management should be reprimanded accordingly, or even dismissed or depending on the nature of the fraud, prosecuted.</p>
<p>5.8. For senior management as well as other employees whose actions have a material impact on the risk exposure of the bank:</p> <p>(a) A substantial proportion of remuneration must be variable and paid on the basis of individual, business-unit and bank-wide measures that adequately measure performance; and</p> <p>(b) These proportions must increase</p>	<p>A bank requested deleting – more or less the same thing seems to be covered in 5.13 (though 5.8 relates to senior management while 5.13 targets approved persons). Also, 5.8(b) appears to refer to the proportions of <u>all</u> variable compensation, whereas the corresponding FSB provision (6) is aimed only at the part of the variable compensation of which <u>payment is deferred</u>.</p>	<p>SP-42</p>	<p>The CBB interprets senior management as equivalent to approved persons and therefore this is consistent with the detailed rules covered under 5.13.</p> <p>The CBB does not believe that the FSB provisions apply only to deferred remuneration – this related to all compensation.</p>

¹ A “clawback” requires that an employee (or ex-employee) return to the bank the remuneration that was previously paid out to him/her. A “malus” is a feature of a remuneration arrangement that reduces the amount of a deferred bonus, so that the amount of the payout is less than the amount of the bonus award. What is important is that banks’ remuneration policies include practical and enforceable ways to reduce amounts of awards of variable pay that are ultimately paid to, and retained by, employees when risk outcomes are worse than expected.

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significantly along with the level of seniority and/or responsibility.			
5.9. Guaranteed remuneration is not consistent with sound risk management or the pay-for-performance principle and must not be a part of prospective remuneration plans and policies. Exceptional minimum variable compensation must only occur in the context of hiring new staff and be limited to the first year.	A bank noted that this needs elaboration whether it includes the 13 th salary.	SP-43	The 13 th salary is considered part of fixed remuneration as it is not an amount linked to risk or performance of the employee. It is paid regardless.
5.10 Existing contractual payments related to a termination of employment should be re-examined, and kept in place only if there is a clear basis for concluding that they are aligned with long-term value creation and prudent risk-taking; prospectively, any such payments must be related to performance achieved over time and designed in a way that does not reward failure.	A bank noted this contravenes the letter and spirit of both the old and the new Bahraini Labour Laws.	SP-44	CBB disagrees and its General Counsel believes that banks can find a way to amend such contracts.
	A bank inquired if this is related to severance payments or severance agreements?	SP-45	Related to all contract terms.
	A bank noted that this needs elaboration whether it includes leaving indemnities.	SP-46	Absolutely. Includes all contract items and payments made.
	A bank noted that this is outside the ambit of these rules because it is contractual, not connected with risk taking and will harm the financial sector competitiveness in the region in terms of attracting talent.	SP-47	Disagree. This is clearly related to remuneration and must be addressed.
5.11 Banks must demand from their employees that they commit themselves not to use personal hedging strategies or remuneration- and liability-related insurance to undermine the risk alignment effects embedded in their remuneration arrangements. To this end, banks must, where necessary, establish appropriate	A bank noted this is unreasonable – employees should be allowed to do whatever they can to minimize the impact of the new provisions as long as their actions are not illegal and do not jeopardize the firm in any way.	SP-48	This needs to be put in place so that the bank adheres to sound remuneration practices regardless of actions taken by its employees to impede the implementation of such practices. This should be enforced in the same way as banks enforce their code of ethics.
	A bank inquired about Directors’/ Officers’ insurance.	SP-49	Such insurance is linked to liability

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compliance arrangements.			and is not related to remuneration aspects.
<p>Principle 6:</p> <p>Remuneration payout schedules must be sensitive to the time horizon of risks. Profits and losses of different activities of a bank are realised over different periods of time. Variable remuneration payments must be deferred accordingly. Payments must not be finalised over short periods where risks are realised over long periods. Management must question payouts for income that cannot be realised or whose likelihood of realisation remains uncertain at the time of payout.</p>	<p>A bank noted that in case of loss, how do you pay the board expenses (sitting fees, per diem, accommodation etc...)?</p> <p>A bank noted that it is important that this principle is not applied as a blanket to cover all banks' variable remuneration.</p>	<p>SP-50</p> <p>SP-51</p>	<p>The bank may have to divest itself of certain assets to meet such obligations or take other necessary actions to revert back to a profitable scenario, such as using other cost cutting measures. In addition for directors, where a loss occurs Article 188 of the CCL applies.</p> <p>Disagree. There is no justification why such an approach should not be adopted for all variable remuneration.</p>

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<p>5.13 For approved persons as well as other employees whose actions have a material impact on the risk exposure of the bank:</p> <p>(a) At least 40% of the variable remuneration, must be payable under deferral arrangements over a period of at least 5 years; and</p> <p>(b) The proportions of variable remuneration must increase significantly along with the level of seniority and/or responsibility. For the CEO, his deputies and the other 5 most highly paid business line employees, at least 60% of the variable remuneration must be deferred for at least 5 years.</p>	<p>A bank noted that many senior employees are expats. There are two aspects to consider. The first is this could adversely affect Bahrain’s ability to attract top-quality talent. Secondly, there would have to be safety nets in place to ensure that employers do in fact pay the rightful dues to employees who left the island 5 years previously. Furthermore, this contradicts sections 5.14 and 5.19. Section 5.13 states that the variable remuneration must be deferred for at least 5 years and section 5.14 states that the deferral period must not be less than 3 years. Section 5.19 states that the deferred remuneration can be paid in cash over a minimum period of 3 years. This should be clarified.</p> <p>A bank noted that there appears to be a typo mistake in subparagraph (b) which states that 60% of the variable remuneration must be deferred <u>for at least 5 years</u>. This means that CEOs and their deputies can cash their deferred remunerations after 5 years (during which risks will definitely change). Probably the sentence meant that the remuneration be deferred over 5 years.</p> <p>A bank noted that as banks are of different size, rules that apply to the CEO and other 5 most highly paid business line employees look a bit arbitrary and it is better be replaced by another criterion such as most senior or the like (based on responsibilities) because in some larger banks, this number may only result in distorting the outcome of the exercise.</p> <p>A bank noted that results of recent study/survey reveal</p>	<p>SP-52</p> <p>SP-53</p> <p>SP-54</p> <p>SP-55</p>	<p>Note that this provision only applies to applies for the remuneration of all approved persons and material risk-takers whose total annual remuneration (including all benefits) is in excess of BD100,000. (Ref HC-5.4.2). The deferral period has been corrected to 3 years (HC-5.4.31)</p> <p>This has now been changed and the wording remains <u>for at least 3 years</u>.</p> <p>If the 5 most highly paid are under the BD100,000 floor noted in HC-5.4.2, this will not apply.</p> <p>The rules says at least 60% of the variable remuneration to be</p>
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	<p>that, highly skilled talent needs larger proposition as fixed compensation. It will be very difficult to attract the skilled and talented people with more uncertainty in variable pay; having 60% as variable compensation for CEO and 40% for others seems very high for startups and smaller banks.</p> <p>A bank noted that they are not clear as to the rationale or basis for the 40% and 60% (for CEO) deferral? It is recommended that this should be left at the discretion of the Board of Directors of the respective bank. Furthermore, the deferral for 5 years is an extremely long period and not recommended. Banks in Bahrain have some specific factors (or have some specific factors which are special in nature) that need to be considered some of which have been pointed out in the ‘General Comments’ section.</p> <p>The deferral period appears to have been set without reflection of the business model employed. Some bank’s business models have a much shorter investment cycle than 5 years and therefore delaying the variable remuneration beyond a reasonable timeframe may only serve to de-motivate staff. This should be aligned with each business model however, the overarching principle should still be remuneration aligned with shareholder value. A good example is carried interest which many private equity firms use to compensate their staff. In that case, it would not be necessary to set a timeline as staff remuneration is tied to the success of that particular investment.</p>	SP-56	<p>deferred, it is not saying that 60% of the total remuneration is to be variable. This rule has nothing to do with limiting the amount of fixed pay.</p> <p>Please refer to comment SP-55 above. Also the deferral period has been changed to 3 years.</p> <p>Deferral period has been changed to 3 years.</p>
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<p>5.14 The deferral period referred to above must not be less than three years, provided that the period is correctly aligned with the nature of the business, its risks and the activities of the employee in question. Remuneration payable under deferral arrangements should generally vest no faster than on a pro rata basis.</p>	<p>A bank noted that this seems to be a contradiction to 5.13. Does CBB mean to say that the deferral period should be between 3 to 5 years? Clarification required.</p>	<p>SP-56</p>	<p>This has been changed. The deferral period has been changed to 3 years.</p>
<p>5.15 In the event of negative contributions of the bank and/or relevant line of business in any year during the vesting period, any unvested portions are to be clawed back, subject to the realised performance of the bank and the business line.</p>	<p>A bank suggested that the unvested portions be (adjusted) rather than (clawed back) since these have not yet vested.</p>	<p>SP-57</p>	<p>According to the definitions contained in the glossary, a ‘clawback’ applies when a remuneration has been paid. ‘Malus’ applies to deferred remuneration.</p>
<p>5.16 The following criteria will be used by the CBB in assessing whether the bank complies with Principle 6:</p> <p>(a) Whether the value of ultimate payouts was sensitive to risk outcomes, as well as to performance, during the whole of the deferral period. Such arrangements might increase payouts if risk outcomes are unusually good, but they should substantially reduce payouts if risk outcomes are unusually bad. The criteria for increased payouts should be sufficiently demanding to ensure that the payouts are not disproportionate to the improved risk and performance outcomes;</p> <p>(b) Whether the deferral period and the</p>	<p>A bank noted that points 5.13 & 5.16 (c) are inconsistent in terms of whether the 5 years period is a minimum or maximum.</p>	<p>SP-58</p>	<p>Please refer to comment SP-56.</p>

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<p>manner in which payouts are spread over time match the time horizons of risks and the objective of a particular deferred remuneration instrument.</p> <p>(c) Whether the deferral arrangements of variable remuneration are in line with the minimum 5-year deferral period and consider the crystallisation of risks over several years;</p> <p>(d) Whether deferral arrangements have both top-down and bottom-up elements, with the relative importance of the two elements depending upon the employee’s organisational level, functional level, and pay level. The top-down elements will link payouts to the performance of risk outcomes for the individual employee’s activities or those of the employee’s specific business unit; and</p> <p>(e) Whether the variable compensation for the CEO and his deputies and the 5 most highly paid employees is in line with the minimum 60% requirement of total remuneration and minimum 40% requirement for other positions covered by these requirements.</p>			
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<p>Principle 7: The mix of cash, equity and other forms of remuneration must be consistent with risk alignment. The mix will vary depending on the employee’s position and role. The bank should be able to explain the rationale for its mix to the CBB.</p>	<p>A bank noted that a mix of cash and equity remuneration cannot work with the un-listed banks due to the illiquid nature of bank's equity; it would be very difficult to implement this principle.</p>	<p>SP-59</p>	<p>See comment under SP-5.</p>
<p>5.17 As a minimum, 50 percent of variable remuneration (including both the deferred and undeferred portions of the variable remuneration) must be awarded in shares or share-linked instruments (or, where appropriate, other non-cash instruments). These instruments create incentives aligned with long-term value creation and the time horizon of risk. Awards in shares or share-linked instruments must be subject to a minimum share retention policy of 5 years from the time the shares are awarded.</p>	<p>A bank noted that 5 years is too long an interval. Long deferrals AND a clawback are too severe – perhaps one or the other could be introduced in stages.</p> <p>A bank noted that this should be governed by the Bank’s employee share option scheme. They inquired if this applies to annual remuneration/ total shares ownership scheme approved by shareholders.</p> <p>A bank noted that stock based compensation has become less popular now in the wake of the current financial crisis. Unless institutions are able to offer longer fixed term employment contracts, it will not be possible to attract competent resources if a large portion of the compensation is deferred compensation. In the entire GCC a significant number of the industry executives are expatriates with 2-3 years contracts. Given this situation, they are not sure if this regulation is suitable to banks in Bahrain at all.</p> <p>A bank noted that given the recent performance of capital markets and high uncertainty associated with it, minimum retention of 5 years from the award date does not seem practical. Employees will be uncertain of their</p>	<p>SP-60</p> <p>SP-61</p> <p>SP-62</p> <p>SP-63</p>	<p>This has been reduced to 3 years.</p> <p>This rule also applies to any share remuneration paid to approved persons and material risk-takers above the BD100,000 floor.</p> <p>The share retention policy has now been reduced to 3 years which will allow to take into consideration the shorter contracts in Bahrain.</p> <p>Please see comment SP-62.</p>

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	<p>interest protection and the readdress mechanism.</p> <p>Seera noted that the mix and decision of variable percent to be paid in shares or share linked instruments must remain with the bank’s board. Majority of the banks in Bahrain are not listed and therefore issuing or granting of shares to employees may be challenging. Further, determining the market price of the shares would be subject to judgment. To allocate shares to employees new shares will need to be issued and determining the correct price will be subjective and also dilute the holdings of the existing shareholders. With no active trading or liquidity for such shares, employees will not be able to monetize these shares which may act as a demotivational factor. Banks will have to come up with a buy-back mechanism which may be inefficient and counterproductive.</p> <p>Further issues that may arise:</p> <ul style="list-style-type: none"> → Price – market price or book value? → Determination of vesting criteria. → Process to determine vested shares if employee resigns or employment is terminated. → Vesting period of employees who have already completed 5 years is too long and should be left with the bank to determine for existing employees. 	SP-64	Please see comment under SP-5 and SP-62.
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<p>remuneration, split into cash, shares and share-linked instruments and other forms; and (u) Total amount of deferred remuneration awarded during the financial year, paid out and reduced through performance adjustments. Disclosure of remuneration practices must cover approved persons (Board members approved persons in business lines and approved persons in control functions) and material risk takers and must be broken down between these four categories.</p>			
<p>6.3 For items (n) to (u) in item 6.2, the information must be provided for the current as well as for the previous financial year.</p>	<p>A bank noted that it is mentioned to refer to 6.2, there is no 6.2; should be 6.1.</p> <p>A bank noted that the numerical comparison between the years which actual implementation of the CBB’s requirements takes effect with the preceded year will create meaningful results (i.e. no point of comparing apple to orange).</p>	<p>SP-68</p> <p>SP-69</p>	<p>Noted; this has been corrected in Module PD..</p> <p>The situation the bank is explaining will only happen one time i.e. for the first year; therefore, no change required.</p>
<p>6.4 The quantitative information required under items 6.2 (o) and (p) may be presented in a table format (see below) split between members of the Board and other approved persons, as well as other material risk takers:</p> <p>Table A to be completed separately for (a) members of the Board, (b) approved persons other than board members and (c)</p>	<p>A bank noted that Non-Executive Directors’ remuneration should not be linked to performance</p>	<p>SP-70</p>	<p>The reporting form under Appendix BR-14 covers aggregate remuneration for all directors, without distinguishing between executive and non-executive directors.</p>

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other material risk takers.			
<p>6.5 Banks must provide to the CBB details of total remuneration including the mix of fixed and variable remuneration as per Appendix 1. The report must be submitted semi-annually for the period covering 1st January to 30th June and 1st July to 31st December. This report must be provided within 2 months of the end of the semi-annual period.</p>	<p>A bank noted that details as per appendices 1 and 2 should be presented annually instead of semi-annually.</p> <p>A bank noted that the report being provided on this twice a year seems too frequent. It is suggested to be changed to annually.</p>	<p>SP-71</p> <p>SP-72</p>	<p>Has been changed to annually.</p> <p>See comment SP-71..</p>
<p>6.6 Banks must provide to the CBB details of its top 12 highly remunerated employees semi-annually for the period covering 1st January to 30th June and 1st July to 31st December. This report must be provided within 2 months of the end of the semi-annual period and must be in the format as outlined in Appendix 2.</p>	<p>A bank strongly believes that paragraph 6.6 is not within the scope or objectives of neither the FSB nor BCBS, and not even within the CBB objective as stated in paragraph 2.5. Therefore, it is strongly recommended to remove the requirement stated in paragraph 6.6 (i.e. appendix -2). At the same time, the disclosure of such sensitive issue, if decided to be applied at a future date should be implemented in parallel with a strong legislative tools as well as strict regulatory requirements towards protecting the confidentiality of such information.</p> <p>A bank considers this requirement to be challenging and cumbersome. It is understandable that the CBB would like to align the remuneration of the executive management of the banks to the risks and values but that should be done taking into considerations the implicated staff right of confidentiality. The CBB could ensure that the remuneration policy is present, approved, adhered to and audited as well as risk-based without such disclosure. It is worth mentioning that the CBB is also requested to observe the social costs of implementing such disclosure</p>	<p>SP-73</p> <p>SP-74</p>	<p>The requirement has been changed to annually and the information is to be retained at the bank’s premises for CBB review when requested, taking into consideration the confidential nature of the information requested. (See BR-4A.4).</p> <p>See comment under SP-73</p>

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	requirements taking into considerations the social and political situations of the Kingdom.		
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