Sound Remuneration Practices for Licensed Banks

Volumes 1 & 2 – Conventional/Islamic bank licensees –Other Comments
January 2014

Industry Comments		CBB Initiative
General Comments:		
An audit firm noted that the CBB is the first regulator in the GCC that has issued requirements relating to remuneration practices for licensed banks. The absence of similar requirements in other GCC jurisdictions could put the licensees at a competitive disadvantage and the licensees may find it difficult to attract and retain the required talent. Therefore, it is recommended that CBB consults with other regulators in the GCC region prior to issuing these requirements in final form in order to ensure that there is a level playing field for all banks in the region.	G1	SAMA has already issued rules on Compensation Practices in May 2010 and these rules have been discussed at the "Banking Supervision Committee" of the Gulf Cooperation Council-Secretariat General. Kuwait has also issue remuneration rules.
The term "remuneration" is being used in the consultation paper. It is recommended that CBB clarifies if the scope of the term "remuneration" would cover fees, commission, transaction driven incentives paid to employees and board members.	G2	Remuneration is a defined term under the Glossary in Volumes 1 and 2 of the CBB Rulebook: Means all types of compensation including but not limited to salary (fixed and variable bonus), fee and non-cash benefits such as health insurance, car housing, education, grants of stock, stock options or pension benefits.

An audit firm noted that in general, they support the paper's principles of independent governance of remuneration, and risk based awards linked to performance and time-scale of ability to assess performance. The audit firm would be happy to meet and discuss their views further if this would be of assistance.		Noted.
A microfinance institution noted that they don't have any comments as none of the Bank Board of Director is entitled to receive sitting fees, for the bank staff there is only an annual bonus scheme based on their performance subject to the Board of Directors approval.	G3	If they are, then any Board Remuneration is limited to 5% of the bank's net profit, including sitting fees. If no sitting fees are paid then any other payment to board members is subject to the 5% limit. If the total remuneration package is over BD100,000, any staff bonus scheme must comply with the proposal meaning that it must be distinguish between staff engaged in control functions (such as internal audit and compliance) and must be aligned to risk and where applicable must be sensitive to the time horizon of risk.

Specific comments			
Proposed Rule	**Bank's comments**		**CBB Initiative**
1.4 Banks will be provided with transitional arrangements for the implementation of these measures.	An audit firm noted that no details of such transitional arrangements have been set out in the consultation paper. In addition, they understand that the licensees have set out the incentive formula in their articles of association which renders the role of the proposed remuneration committee redundant. Therefore, it is recommended that details of the transitional arrangements and related guidance would be required in order for the licensees to prepare for adoption of these new requirements. On implementation of the proposal, the licensees would need to make amendments to their articles of association	SP1	The November 2013 cover letter when the finalised rules were issued noted that the CBB will allow for a transition period until the end of June 2014 for the implementation of these rules. This means that the subject rules will be effective from the 1st July 2014. The cover letter also addressed the issue of updating the articles and memorandum of association.
2.1 The proposed Principles and standards outlined in this Consultative document incorporate the Principles and standards outlined by the FSB and are fully endorsed by the BCBS. These principles and standards will be incorporated as Directives in the CBB Rulebook and issued under Article 38 of the Central Bank of Bahrain and Financial Institutions Law 2006 ('CBB Law').	An audit firm noted that the time line and effective date for mandatory application of these principles and standards have not been set out in the consultation paper. Therefore, it is recommended that CBB should advise the licensees of the effective date for mandatory application of these principles and standards and provide adequate time to enable the licensees for ensuring compliance and to gather information required for disclosure.	SP2	Please refer to the comment SP-1.

2.4 The remuneration practices cover approved persons as defined in the CBB Rulebook as well as material risk-takers.	An audit firm noted that no definition or guidance has been provided for the identification of "material risk-takers". Therefore, in order to ensure consistent implementation of remuneration practices CBB should consider defining the term "material risk-takers".	SP3	Material risk-takers has been defined and included in the Glossary for Volumes 1 and 2 of the CBB Rulebook.
2.7 Head offices should ensure that their foreign affiliates and branches take steps so that the remuneration practices are compliant with the policy defined at the group level. Such steps should include controlling compliance with local rules that apply to the remuneration schemes of their affiliates and branches.	An audit firm noted that licensees could have foreign affiliates that are not controlled by the Banks licensed in Bahrain. Their understanding is that these requirements apply to the licensee and all its controlled units outside Bahrain (subsidiaries and branches) as it is noted elsewhere in the same consultation paper [section 6.1 (c) (iii)]. It would be useful if CBB can clarify this point. It needs to be clarified if these requirements apply to the branches of foreign banks and if so, to what extent since all aspects explained in the consultation paper may not apply to them. For instance, the Head office located in a foreign jurisdiction may not be required to have an independent remuneration committee drawn out of its Board of Directors. A clarification in this respect would be useful for such branches of foreign banks operating under volume 1 and 2 of the rulebook.	SP4 SP5	Where banks licensed in Bahrain and operating as foreign affiliates (and in some cases branches) in other jurisdictions, they will need to satisfy the CBB that they meet the legal requirements of the host jurisdiction with respect to compensation. Overseas banks operating in Bahrain must comply with HC-5.4.4.
4.2 The Remuneration Committee must carefully evaluate practices by which remuneration is paid for potential future revenues whose timing and likelihood remain uncertain. In so doing, it must demonstrate that its decisions are consistent with an assessment of the bank's financial condition and future prospects.	An audit firm noted that it is unclear as to what is considered as "future revenues". [need to discuss if a clarification should be sought on the treatment of unrealized fair value gain even though this does not fit in to the term "future revenues"] Therefore, it is recommended that the CBB should preclude remunerating employees in relation to any future revenues.	SP6	Disagree; what is meant by future revenues is clear. This is all about adjusting the remuneration for all type of risk where the concept of deferral of variable remuneration is introduced. Please refer to section 5- effective alignment of remuneration with Prudent risk taking and in specific 5.4 (i) • Performance measures should take into account the quality of

			revenues that are used in constructing these measures, and, in particular, special attention must be paid to cases in which the performance measures have the effect of accelerating future revenues forward in time. Treating uncertain, long-term revenues as though they are certain and already received can increase the tendency of performance measures to give employees incentives to take long-term risk. In that case, stronger risk adjustments are needed;
4.3 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	An audit firm noted that the time that the assessment is made is not documented and could be made clearer. A point in time assessment could be required, for example at the year end, or the assessment could cover practices throughout the whole reporting period. The paper asks that the "results be disclosed in the annual report'. This phrase could be more precise, and at present would imply a summary table stating whether the bank complies or does not comply with each principle. Paragraph 4.4 requires the external auditor to report on compliance with the Principles, not the entire paper. The paragraph gives the following examples: "An example of a positive ……….a minimum of 50% of the variable compensation must be awarded in shares or share-linked instruments." However, the Principles do not require "a minimum of 50% of the variable compensation must be awarded in shares or share-linked instruments". This requirement is mentioned in the paper outside of the definition of each of the principles. So their	SP7 SP8	The Rules have been clarified in Section AU-3.6 and there is no longer disclosure required for this item in the annual report. Detailed agreed upon procedures are currently being consulted with the external audit firms.

implement the requirement that a minimum of 50% of the variable compensation must be awarded in shares or share-linked instruments.	recommendation is for the CBB to carefully link the audit report to precisely what independent verification is sought from the auditors. It is suggested that the auditors should be asked to report on the principles using the criteria within the paper under which the CBB would assess compliance. An audit firm noted that although the term "audit" is mentioned, it is also stated that it should be to assess compliance with the CBB principles on remuneration. Also, the example of a negative audit finding noted therein appears to be the result of an agreed upon procedures engagement. Therefore, it would be helpful if CBB could clarify the scope of work, i.e., whether a full scope audit is required under the International Standards on Auditing or specific agreed upon procedures are to be performed in accordance with International Standard on Related Services.	 SP-9	 The scope has been clarified to a 'review engagement' (See BR-4A.3.2)
4.5 The Board's remuneration must be 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.	A financing company noted that limiting maximum to BD 500 per person for meeting may not work for larger institutions considering the range of issues which Board may have to deal with. Perhaps overall restriction for remuneration only should be considered. An audit firm noted that a flat fee limit on all applicable licensees without considering the nature and complexity of the business could result in licensees with complex operations face difficulty in attracting experienced independent Board members. It is recommended that the CBB could consider a tiered sitting fee structure based on certain criteria that classifies in to different categories depending on nature, size and complexity of operations. Bahrain Commercial Companies Law (BCCL) limits the Board remuneration to a maximum of 10% of the net profits. The	SP10 SP11 SP12	The restriction on sitting fees has been removed in the final rules. Please refer to comment SP-10 The CBB requirements do not contradict the CCL – they are simply more stringent which considering the nature of banking operations, such Rules are allowed

	proposed limit on Board remuneration (5% of net profit) in the consultation paper contradicts the limit set out in the BCCL. It is recommended that the CBB addresses this contradiction prior to issuing the requirements in final form.		to be put in place

4.8 The following criteria will be used by the CBB in assessing whether the bank complies with Principle 3: 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 Committee or their control functions; 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; 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; d. Whether the control function management, as opposed to business line management, had	An audit firm noted that subparagraph (g) seems to suggest that CBB expects at least 50% of the total remuneration of the control function personnel should be fixed. It would give more clarity to the licensees if this is clarified by the CBB.	SP13	(g) actually says that.the CBB will consider whether the bank has complied with principle 3 by looking at the mix of fixed and variable remuneration to 'control function' staff to ensure that at least 50% of their remuneration is fixed. This is quite clear.

the responsibility for the performance appraisal process, including preparation and sign off on the performance appraisal documents, for control function personnel; 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; 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; g. Whether the mix of fixed and variable remuneration for control function personnel has been weighted in favour of fixed remuneration; and h. Whether the control function personnel have the appropriate level of authority.			

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 intangible and difficult-to-measure risks such as reputation risk, liquidity risk, and the cost of capital.	An audit firm noted that since human judgment could vary depending on the person exercising it, this could lead to inconsistencies in the application of the principle. In order to ensure reasonably consistent application of CBB's requirements, it is recommended that CBB stipulates that the licensees should document the criteria, as approved by the remuneration committee, based on which human judgment will be exercised in making the risk adjustments. Also, it is recommended that the licensees disclose the level of risk adjustments made to the remuneration determined.	SP14	Disclosure of the risk adjustment methodologies is required under PD-1.3.8B(d).
5.4 The following criteria will be used by the CBB in assessing whether the bank complies with Principle 4: i. Whether performance measures take into account the quality of revenues that are used in constructing these measures, and, in particular, special attention must be paid to cases in which the performance measures have the effect of accelerating future revenues forward in time. Treating uncertain, long-term	An audit firm noted that in subparagraph (i) the accounting standards require fair value accounting, particularly for financial instruments. This could mean that the licensees may need to adjust for the unrealized fair value income in determining the remuneration. The CBB should provide specific guidance in this respect.	SP15	It is quite clear that remuneration should NOT be linked to accounting rules, particularly due to the recognition of market values which are not always achievable. Subparagraph (i) is perfectly clear on this item. Please refer to comments SP6.

revenues as though they are certain and already received can increase the tendency of performance measures to give employees incentives to take long-term risk. In that case, stronger risk adjustments are needed;			
Principle 5: Remuneration outcomes must be symmetric with risk outcomes. Remuneration systems must link the size of the bonus pool to the overall performance of the bank. Employees' incentive payments must be linked to the contribution of the individual and business to such performance. Bonuses must diminish or be deferred in the event of poor bank, divisional or business unit performance.	An audit firm noted that "Remuneration outcomes must be symmetric with risk outcomes." is an absolute statement and will be one that an auditor could not conclude was complied with except in a few uncomplicated cases. It is suggested that the wording is modified to "Remuneration outcomes must broadly be symmetric with risk outcomes." and that CBB assessment criteria is developed for this Principle.	SP16	Disagree. The introduction of the term 'broadly' waters down the intent of this Rule and banks will need to clearly demonstrate that remuneration is symmetric with risk outcomes.
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.	An audit firm noted whilst they agree that the assessment can be made, they believe that views may differ on the alignment of mix between parties, and whilst there is some guidance provided on what the CBB considers as minimum levels of mix, they believe additional and more precise guidance would result in more consistent practices being followed in respect of this Principe.	SP17	Paragraphs HC-5.4.31 to HC-5.4.37 provide the necessary guidance. Banks must exercise some judgement in this regard and should not be spoon fed on how to comply. Banks should be in a position to explain their rationale for their mix.

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.	An audit firm noted that although this requirement is in line with the industry practice, the market and liquidity for trading of such instruments is very limited compared to the markets in the west and this could pose a challenge for the licensees in attracting the required talent. It is recommended that CBB reviews this requirement in the light of the issue noted, and make necessary changes including reduction of the minimum level of non-cash remuneration.	SP18	This has been discussed and since other forms of non-cash remuneration (other than shares) can be used, the requirement has been maintained.
6.1. Banks must disclose in their annual report qualitative and quantitative information about their remuneration practices and policies covering the following areas: (a) …; (b) …; (l)Description of the ways in which the bank seeks to adjust remuneration to take account of longer term performance. Disclosures must include; i) A discussion of the bank's policy	An audit firm noted that in subparagraph (l) requires only disclosure of claw back policies and criteria and not actual adjustments that were made in any financial period. It is recommended that the CBB requires the licensees to disclose the events leading to the application of the claw back arrangement and the amount of deferred remuneration claw back that was made during the financial period by applying the Banks' policies and criteria. For the last paragraph, there seems to be some confusion in presenting information relating to approved persons, whether it should be broken further down between approved persons in business lines and approved persons in control functions. The CBB should clarify this point.	SP19	The actual amounts of malus or clawback adjustments are not required to be publicly disclosed at this stage. Yes, approved persons is broken between two categories; therefore, a total of four categories. The last paragraph is clear and there is no need to clarify. The 4 categories are: 1. Board members; 2. Approved persons in

on deferral and vesting of variable remuneration and, if the fraction of variable remuneration that is deffered differs across employees or groups of employees, a description of the factors that determine the fraction and their relative importance; ii) A discussion of the bank's policy and criteria for adjusting deferred remuneration before vesting and after vesting through clawback arrangements; ……… …….. 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.			business lines; 3. Approved persons in control functions; and 4. Material risk takers. PD-1.3.8F will be amended accordingly.
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.	An audit firm noted that the current references to section 6.2 in the consultation paper should read as section 6.1.	SP20	Noted. Numbering issue corrected .