BANKING, FINANCE AND INSURANCE COMMISSION

Circular CBFA_2009_34 of 26 November 2009

Recommendation on sound remuneration policies in financial institutions

Scope:

The principles contained in this circular apply to Belgian credit institutions, insurance companies, reinsurance companies, investment firms, management companies of undertakings for collective investment, settlement institutions and institutions equivalent to settlement institutions. These principles also apply, within the framework of supplementary or consolidated group supervision, to the parent companies of financial groups established in Belgium and subject to the supervision of the CBFA, and to the Belgian branches of institutions not governed by the law of a Member State of the European Union.

Summary/Objectives:

The objective of the circular is to provide financial institutions with principles on a sound remuneration policy. The circular addresses the remuneration policy of a financial institution as an element of its good governance, and is intended to ensure appropriate and effective risk management. The remuneration policy is to be included in the institution's governance memorandum. If, in the course of its prudential supervision and in light of the requirement that financial institutions should have an adequate organization, the CBFA observes that an institution has an inappropriate remuneration policy, it may use all the instruments made available to it under the supervision laws.

Dear Sir or Madam,

Rationale

The issue of remuneration has, since the outbreak of the financial crisis, become a top prudential priority. Since the beginning of 2009, a number of international initiatives have been taken in the area of remuneration policy, including by the G20, the FSB, CEBS, CEIOPS and the European Commission. This circular is closely aligned with those international initiatives.

This recommendation offers explanations of the way in which the CBFA intends to interpret the obligation on the part of financial institutions to have an appropriate organization as regards their remuneration policy. Financial institutions are expected to work out the details of implementing this circular in such a way that the objectives of the remuneration policy principles are efficiently and effectively achieved. The principles are formulated as general guidelines, allowing for adjustments to be made in light of changing circumstances, among other things.

The fact that the CBFA's prudential expectations are set out in a recommendation does not, of course, preclude the legislators from establishing norms regarding the remuneration policies of financial institutions. It is in fact very likely that the transposition of the European directives addressing this matter will require the passage of legislation.

Whilst financial institutions' remuneration policies were not the direct cause of this crisis, they nonetheless contributed to determining its gravity and scale. It is generally recognized that excessive remuneration in the financial sector fuelled a risk appetite that was disproportionate to the capacity of financial institutions and of the financial sector as a whole.

SECTION I - SCOPE AND DEFINITIONS

1. Scope

1.1. This circular lays down principles applicable to the remuneration policy of a financial institution, regarded as an element of its sound governance.

Nevertheless, in view of the need to practice sound and effective risk management, it is up to the financial institution itself, when establishing and elaborating the principles of its remuneration policy, to define the categories of persons to whom that policy applies, in the light of the institution's nature, size and specific activities. Generally speaking, these principles on remuneration policy ought to apply to, among others:

- the members of a financial institution's governing body;
- the persons responsible for day-to-day management, that is, the members of the management committee of a financial institution where such a body exists;
- employees who perform key functions or independent control functions;
- employees whose professional activities – either individually or as members of a group such as a unit or part of a department – (can) exert influence on the financial institution's risk profile, and in particular, employees who are active in granting credit, in the market room, or in the areas of private banking, private equity or investment management.

Notwithstanding the scope of the remuneration policy as defined above, the CBFA expects the remuneration policy for all employees to be treated as part of sound risk management and, as such, to be consistent with the financial institution's overall governance policy.

1.2. The principles contained in this circular apply to Belgian credit institutions, insurance companies, reinsurance companies, investment firms, management companies of undertakings for collective investment, settlement institutions and institutions equivalent to settlement institutions.

These principles also apply, within the framework of supplementary or consolidated group supervision, to the parent companies of financial groups established in Belgium and subject to the supervision of the CBFA, and to the Belgian branches of institutions not governed by the law of a Member State of the European Union.

1.3. In implementing and following up on this circular, account should be taken of the nature, the size and the specific activities of the financial institutions in question.

1.4. The circular is to be applied at both solo and group levels.[1] The principles of a sound remuneration policy should be applied at group level to both the parent company and its subsidiaries.

1.5. This circular does not address fees or commissions received by intermediaries or external service providers in the case of outsourced activities. Nor does it concern the application of conduct of business rules by financial intermediaries.

[1] With regard to the application of the principles contained in this circular to Belgian institutions that belong, as subsidiaries, to an international group, see points 78 to 95 of Circular PPB-2007-6-CPB-CPA of 30 March 2007 on the CBFA's prudential expectations on financial institutions' sound governance.

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2. Definitions

2.1. "Financial institution(s)" or "institution(s)": regulated institution(s) subject to supervision by the CBFA which fall(s) within the scope of this circular.

2.2. "Independent control functions": functions such as internal audit, compliance, risk management and the actuarial function, carried out as a rule by persons employed by the institution, whose controls, assessments and advice provide management with the instruments necessary to fulfil their responsibility for governing the financial institution

2.3. "Variable remuneration" or "variable component of remuneration": a component of remuneration which is awarded on the basis of performance criteria, including bonuses.

2.4. "Senior management": the group of persons, whether or not members of the board of directors, whose function within the institution implies that they exercise at the highest level a direct and decisive influence on the institution's management.

2.5. "Key staff": any person, other than a senior manager, who fulfils a key function (secretary general, legal affairs, human resources, communications) or is in charge of independent control functions.

SECTION II - PRINCIPLES OF REMUNERATION POLICY

3. General

3.1. Financial institutions should establish a general remuneration policy which is consistent with and promotes sound and effective risk management. The remuneration policy should not induce excessive risk-taking.

3.2. Remuneration policy should be in line with the business strategy, risk tolerance, objectives, values and long-term interests of the financial institution, such as sustainable growth prospects.

The remuneration policy should, moreover, be consistent with the principles governing the protection of clients and investors in the context of the provision of services.

4. Structure of the remuneration policy

4.1. Where remuneration includes a variable component, remuneration policy should strive to achieve an appropriate balance of fixed and variable remuneration components. The appropriate balance of remuneration components may vary across staff members, according to market conditions and the specific context in which the financial institution operates. A maximum limit should be set on the variable component of remuneration.

4.2. The fixed component of the remuneration should represent a sufficiently high proportion of the total remuneration package that employees do not have to rely on variable remuneration in order to receive appropriate compensation, thus allowing each financial institution full freedom in its remuneration policy. In particular, the financial institution should be able to withhold the variable remuneration entirely or partly when performance criteria are not met by the individual concerned, the business unit concerned or the institution as whole. The financial institutions should also be able to withhold the variable remuneration where its situation deteriorates considerably.

4.3. Where a significant variable remuneration is awarded, the major part of that remuneration should be deferred with a minimum deferment period.

4.4. The deferred element of the variable remuneration should take into account the outstanding risks associated with the performance to which the remuneration relates and may consist of equity, options, cash or other funds the payment of which is postponed for the duration of the deferment period. The payment of the deferred amount, spread over a reasonable period of time, should be linked to criteria for measuring the future consequences of the performance for which a variable remuneration was awarded. These criteria should be risk adjusted, as set out in point 5.

4.5. The board of directors of a financial institution should adopt measures to require staff members to repay (all or part of) variable remuneration that has been awarded for performance based on data which has subsequently proven to be manifestly incorrect or misleading, or where it is the result of fraudulent activities.

4.6. Contractually agreed payments related to the early termination of a contract and compensation related to mergers or takeovers should be related to performance achieved over time and should not be a reward for failure.

4.7. The structure of the remuneration policy should be updated over time in order to ensure that it evolves to meet the changing situation of the financial institution in question.

5. Performance measurement

5.1. Where remuneration is performance related, this amount should be based on a combination of the assessment of the performance of the individual and of the business unit concerned and of the overall results of the financial institution.

5.2. The assessment of performance should be based on objectives set in a multi-year framework, in order to ensure that the assessment is based on longer-term performance, taking into account the economic cycle of the institution.

5.3. The measurement of performance, as a basis for variable remuneration or pools of such remuneration, should include an adjustment for current and future risks related to the underlying performance and should take into account the cost of the capital employed and the liquidity required.

5.4. When assessing individual performance, non-financial criteria, such as skills acquired and personal development, should also be taken into account. Provided these aspects are not aimed purely at increasing sales of financial instruments or providing financial services, the following assessment criteria may also be applied: following the business strategy, compliance with internal rules and procedures, compliance with the standards governing the relationship with clients and contributing to team performance. Where appropriate, lower performance in terms of these non-financial criteria shall offset good performance in generating profit.

6. Governance

6.1. The remuneration policy is also aimed at preventing conflicts of interest. The financial institution's procedures for determining remuneration should be clear, well documented and internally transparent.

6.2. It is recommended that the board of directors set up an independent remuneration committee composed of non-executive directors, and that it rely on the help of this committee in fulfilling the tasks referred to in points 6.3. and 6.4.

6.3. The board of directors should determine the remuneration of senior managers and directors, on the advice of an independent remuneration committee, where appropriate.[2] It is preferable that the remuneration of non-executive directors not be linked to the financial institution's results but be based instead on other factors, such as the time invested in working for the financial institution and the responsibilities borne by the non-executive director concerned.

[2] On 14 December 2004, the European Commission adopted Recommendation 2004/913/EC fostering an appropriate regime for the remuneration of directors of listed companies (OJ L 385 of 29 December 2004, p. 55) and, on 15 February 2005, Recommendation 2005/162/EC on the role of the non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board (PB L 52 of 25.2.2005, p. 51). These Recommendations were supplemented by the Recommendation of 30 April 2009.

6.4. In addition, the board of directors should, where applicable upon the advice of an independent remuneration committee, establish the general principles of the remuneration policy of the financial institution and monitor its implementation. In accordance with the general principles established by the board of directors, the senior management and, where applicable, the management committee, are responsible for implementing the remuneration policy for the rest of the staff.

6.5. Independent control functions and, where appropriate, human resources departments and external experts should also be involved in the design of the remuneration policy.

6.6. Members of the board of directors responsible for the remuneration policy and members of the remuneration committees and staff members who are involved in the design and implementation of the remuneration policy should have relevant expertise and functional independence from the business units they control and thus be capable of forming an independent judgment on the suitability of the remuneration policy, including the implications for risk and risk management.

6.7. Without prejudice to the overall responsibility of the board of directors as described in point 6.3., the implementation of the remuneration policy should be addressed in the annual review of internal control functions by senior management, in accordance with the Circulars of 9 May 2008 (CBFA_2008_12) and 24 June 2009 (CBFA_2009_26). Senior management should be assisted in this review by the independent control functions, and in particular in testing the implementation of the remuneration policy against the policy and procedures established by the board of directors. In so doing, particular care should be taken to avoid incentives to excessive risk-taking and other unconstructive behaviour.

6.8. Staff members engaged in control processes should be independent from the business units they control and should have an appropriate level of authority and remuneration. These staff members should be remunerated in a manner commensurate with their accomplishment of the goals linked to their function, independent of the performance of the business areas they control.

6.9. The general principles of the financial institution's remuneration policy should be accessible to the staff members to whom they apply. Those staff members should be informed beforehand of the criteria that will be used to determine their remuneration and of the appraisal process. The appraisal process and the remuneration policy should be properly documented and transparent to the individual staff members concerned.

SECTION III - PRUDENTIAL EXPECTATIONS REGARDING DISCLOSURE

7. Without prejudice to confidentiality and data protection provisions, relevant information on the remuneration policy referred to in Section II and any updates in case of policy changes should be disclosed by the financial institution in a clear and easily understandable way to relevant stakeholders, including shareholders of the financial institution. Such disclosure may take the form of an independent remuneration policy statement, a periodic disclosure in annual financial statements or any other form.

8. Bearing in mind the nature, size and specific activities of the financial institutions in question, the following information should be disclosed:

(a) information concerning the decision-making process used for determining the remuneration policy, including, if applicable, information about the composition and the mandate of a remuneration committee, the name of the external consultant whose services have been used for the determination of the remuneration policy and the role of the relevant stakeholders;

(b) information on linkage between pay and performance;

(c) information on the criteria used for performance measurement and the risk adjustment;

(d) information on the performance criteria on which entitlement to shares, options or variable components of remuneration is based;

(e) the main parameters and the justification for a possible annual settlement of variable remuneration and other potential non-cash benefits.

SECTION IV - MONITORING AND CONTROL

9. Financial institutions are requested to establish the principles of their remuneration policy by 31 January 2010 and to implement these principles, after they have been further elaborated, as from 30 June 2010. It is recommended in this regard that renegotiations of existing contracts which cannot be expected to be completed by 30 June 2010 should be concluded as soon as possible.

10. The remuneration policy of a financial institution is an element of its good governance, as referred to in points 96 to 99 of Circular PPB-2007-6-CPB-CPA of 30 March 2007 on the CBFA's prudential expectations on financial institutions' sound governance.

In accordance with the aforementioned Circular PPB-2007-6-CPB-CPA, significant changes to a financial institution's governance memorandum are to be communicated to the CBFA via the e-Corporate platform. It is recommended in this regard that financial institutions inform the CBFA by 15 March 2010 of the principles of their remuneration policy and of the more detailed elaboration of these principles. In so doing, they should indicate the degree to which they have taken into account the principles contained in this circular.

11. In light of the requirement that financial institutions should have an adequate organization[3], the CBFA may also, in accordance with the above-mentioned Circular, use its powers as laid down in the supervision laws to oblige a financial institution that has an inappropriate remuneration policy to design and implement an appropriate remuneration policy.

As provided for in the various sectoral supervision laws, the CBFA has as its disposal a wide range of prudential measures which it can use to intervene in the case of an inappropriate remuneration policy. Depending on the type of matter involved, 'qualitative' measures (in view of revising or adjusting the remuneration policy) may be preferable. However, if these measures appear not to be effective (enough) or in order to be able to act quickly in exceptional circumstances, the CBFA reserves the right to impose 'quantitative' measures in the form of additional capital requirements.

12. Lastly, the CBFA recommends that financial institutions draw inspiration, when elaborating the aforementioned principles, from the international standards currently under development, and in particular those issued on 25 September 2009 by the Financial Stability Board at the request of the G20. These standards will significantly influence future European directives; it is thus recommended that institutions prepare for these in good time and develop as of now a policy that is in line with those standards. This applies in particular to the elaboration of specific policy measures based on the provisions contained in points 4.1 (division between fixed and variable remuneration components), 4.2 and 4.4. (amount, withholding and components of variable remuneration, modes of payment and appraisal criteria for variable remuneration), point 4.3 (establishing the waiting period for payment of variable remuneration) and the policy regarding 'guaranteed bonuses' or 'minimum guaranteed payments'.

Yours sincerely,

Jean-Paul SERVAIS
Chairman

[3] See Article 20, § 1, of the Law of 22 March 1993 on the legal status and supervision of credit institutions and comparable provisions in other supervision laws.