

**COMMISSION de SURVEILLANCE
du SECTEUR FINANCIER**

Luxembourg, 1 February 2010

To all entities subject to
the CSSF's prudential supervision

CIRCULAR CSSF 10/437

Re: Guidelines concerning the remuneration policies in the financial sector

Ladies and Gentlemen,

Among the efforts made at international level to stabilise the economic and financial environment, specific attention has been paid to the remuneration policies and practices in the financial sector which have been identified as factors capable of encouraging excessive risk-taking.

Certain initiatives have therefore been taken at a European and international level to establish principles on sound remuneration policies and practices. Given the competitive pressures, the objective of these initiatives is to apply the defined principles globally.

This concern was raised in particular by the G20, the Council on Financial Stability, the Committee of European Banking Supervisors (CEBS) and the European Commission.

On 20 April 2009, CEBS published a finalised set of principles for remuneration policies in banking institutions, following a public consultation and hearing, entitled “High-level principles for Remuneration Policies” which is available on the CEBS website (www.cebs.org). These principles address key aspects of remuneration policies and aim to support the sound implementation thereof in the day-to-day operation of banks.

Without prejudice to these general principles, the specific purpose of this Circular is to implement Commission Recommendation 2009/384/EC of 30 April 2009 on the remuneration policies in the financial sector, published in the Official Journal of the European Union of 15 May 2009. This Recommendation aims at improving the taking, managing and controlling of risks within financial institutions by defining guidelines on the structure of remunerations and on the process of drawing up and setting up remuneration policies. For sake of completeness, it should be borne in mind, with respect to financial undertakings referred to in point 1.1 and whose securities are admitted to trading on a regulated market in one or more Member States, that these undertakings also have to comply with Commission Recommendation 2004/913/EC of 14 December 2004 fostering an appropriate regime for the remuneration of directors of listed companies and Commission Recommendation 2009/385/EC of 30 April 2009 complementing Recommendations 2004/913/EC and 2005/162/EC as regards the regime for the remuneration of directors of listed companies.

Gradually, as the Commission Recommendations are taken up by sectoral Directives, the provisions laid down in this Circular shall be taken over by the implementation of these Directives into Luxembourg law.

SECTION I

Scope

1.1 This Circular applies to all entities, legal and natural persons, subject to the CSSF's prudential supervision, including their branches set up abroad as well as to the branches of similar entities set up in Luxembourg whose registered office or central administration is located outside the European Economic Area. For the purposes of this Circular, all these entities shall hereafter be referred to as "financial undertakings". Financial undertakings include, but are not limited to, credit institutions, investment firms, pension funds and collective investment schemes.

1.2 This Circular covers the remuneration of persons who are members of the administrative and management bodies of financial undertakings as well as those categories of staff whose professional activities have a material impact on the risk profile of financial undertakings.

1.3 This Circular applies on an individual and on a consolidated basis. Principles on sound remuneration policy shall apply at group level to the parent undertaking and to its subsidiaries, including those established abroad.

Exclusions and exemptions

1.4 Financial undertakings which exclusively grant the persons referred to in point 1.2 a fixed remuneration are exempt from the scope of this Circular.

1.5 When taking measures to ensure the implementation of this Circular, financial undertakings may take into account the nature, the size as well as the specific scope of their activities. The CSSF will take into account the size of the financial undertaking, the nature and the complexity of its activities when monitoring compliance with this Circular.

1.6 This Circular does not apply to fees and commissions received by intermediaries and external service providers in case of outsourced activities.

SECTION II

Remuneration policy

General information

2.1 Every financial undertaking shall establish, implement and maintain a remuneration policy which is consistent with and promotes sound and effective risk management and which does not induce excessive risk-taking.

2.2 The remuneration policy shall be in line with the business strategy, objectives, values and long-term interests of the financial undertaking, such as sustainable growth prospects, and be consistent with the principles relating to the protection of clients and investors in the course of services provided.

Structure of the remuneration policy

2.3 Where remuneration includes a variable component or a bonus, granted in accordance with performance criteria, the remuneration policy shall be structured with 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 undertaking operates. The remuneration policy of a financial undertaking shall set a maximum limit on the variable component.

2.4 The fixed component of the remuneration shall represent a sufficiently high proportion of the total remuneration allowing the financial undertaking to operate a fully flexible bonus policy. In particular, the financial undertaking shall be able to withhold bonuses entirely or partly when performance criteria are not met by the individual concerned, the business unit concerned or the financial undertaking seen as a whole. The financial undertaking shall also be able to withhold bonuses where its situation deteriorates significantly, in particular where it can no longer be presumed that it can or will continue to be able to carry out its business as a going concern.

2.5 Where a significant bonus is awarded, the main part of the bonus shall be deferred with a minimum deferment period. The amount of the deferred part of the bonus shall be determined in relation to the total amount of the bonus as compared to the total amount of the remuneration.

2.6 The deferred element of the bonus shall take into account the outstanding risks associated with the performance to which the bonus 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 measures of future performance to which the deferred element is linked shall be risk adjusted as set out in points 2.10 to 2.14.

2.7 Payments related to the early termination of a contract which are awarded on a contractual basis, shall be related to performance achieved over time and designed in a way that does not reward failure.

2.8 The board of directors of a financial undertaking shall be able to require staff members to repay all or part of the bonuses that have been awarded for performance based on data which was subsequently proven to be fraudulent.

2.9 The structure of the remuneration policy shall be updated over time to ensure that it evolves to meet the changing situation of the financial undertaking concerned.

Performance measurement

2.10 Where remuneration is performance-related, its total amount shall 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 undertaking.

2.11 The remuneration policy shall aim at aligning the personal objectives of staff members with the long-term interests of the financial undertaking concerned. The assessment of the performance-based components of remuneration shall be based on longer-term performance and take into account the outstanding risks associated with the performance.

2.12 The assessment of performance shall be set in a multi-year framework, for example three to five years, in order to ensure that the assessment process is based on longer-term performance and that the actual payment of performance-related components of remuneration is spread over the business cycle of the undertaking.

2.13 The measurement of performance, as a basis for bonus or bonus pools, shall include an adjustment for current and future risks related to the underlying performance and shall take into account the cost of the capital employed and the liquidity required.

2.14 In order for the remuneration policy to be in line with the objectives, the business strategy, the values and the long-term interests of the financial undertaking, other factors, apart from financial performance, shall be considered, such as compliance with systems and

controls of the financial institution, as well as compliance with the standards governing the relationship with clients and investors.

Governance

2.15 The remuneration policy shall include measures to avoid conflicts of interest. The procedures for determining remuneration within the financial undertaking shall be clear and documented and shall be internally transparent.

2.16 The **board of directors** shall fix the remuneration of the members of the administrative and management bodies of the financial undertaking. The remuneration of the directors other than those who participate in the daily management of the undertaking or who represent the staff shall not be linked to the short-term results of the undertaking but shall take into account other factors such as the time dedicated to their function and their respective responsibilities.

2.17 In addition, the **board of directors** shall establish the general principles of the remuneration policy of the financial undertaking and be responsible for its implementation. In the elaboration of this policy, the board shall take into account all elements regarding the strategy of the financial undertaking as well as the strategy regarding risk taking, the nature, scale and complexity of the undertaking's activities. Within the scope of its supervisory mission, the board of directors shall make sure, on a regular basis, that the financial undertaking has appropriate policies and procedures in place.

2.18 The board of directors may be assisted by a **remuneration committee** made up of directors other than those who participate in the daily management of the undertaking or who represent the staff.

2.19 **Control functions**, i.e. risk management, internal control, compliance and similar functions within a financial undertaking as well as the **human resources department** shall be part of the design of the remuneration policy. They may be assisted by **external experts**.

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

2.21 The financial undertaking's **authorised management** is responsible for implementing the remuneration policy. It shall elaborate procedures to this effect and submit them to the board of directors for approval.

2.22 Without prejudice to the overall responsibility of the board of directors set out in point 2.17, the implementation of the remuneration policy shall be subject, at least on an annual basis, to central and independent internal review by **control functions** for compliance with policies and procedures defined by the board of directors. The control functions shall report on the outcome of this review to the board of directors. A copy of said reports shall be put at the disposal of the CSSF.

2.23 Staff members engaged in control processes shall be independent from the business units they oversee, have appropriate authority, and be compensated in accordance with the achievement of the objectives linked to their functions, independent of the performance of the business areas they control.

2.24 The **authorised management** shall inform the relevant personnel of the policies and procedures required by this Circular, and any change thereto. The general principles of the remuneration policy shall be accessible to staff members to whom they apply. Those staff

members shall be informed in advance of the criteria that will be used to determine their remuneration and of the appraisal process. The appraisal process and the remuneration policy shall be properly documented and transparent to the individual staff members concerned.

SECTION III

Disclosure

3.1. 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 shall be disclosed by the financial undertaking in a clear and easily understandable way to relevant stakeholders. Such disclosure may take the form of an independent remuneration policy statement, a periodic disclosure in annual financial statements or any other form.

3.2. 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 the link between pay and performance;
- c) information on the criteria used for performance measurement and risk adjustment;
- d) information on the performance criteria on which the entitlement to shares, options or variable components of remuneration is based;
- e) the main parameters and rationale for any annual bonus scheme and any other non-cash benefits.

3.3. The level of the information to be disclosed may take into account the nature, the size as well as the specific scope of activities of the financial undertakings concerned.

SECTION IV

Supervision

4.1. This Section only applies to financial undertakings which are credit institutions or investment firms incorporated under Luxembourg law as well as Luxembourg branches of credit institutions and investment firms whose registered office or central administration is situated outside the European Economic Area.

4.2. In the context of the supervisory review process, as defined by Circular CSSF 07/301 and in application of Circulars CSSF 06/273 and CSSF 07/290, the CSSF assesses the risks which financial undertakings to whom this section applies are or may be exposed to, including the risks associated with the remuneration policy and practices and examines to what extent internal processes as well as internal and prudential own funds of such undertakings ensure an adequate management and coverage of these risks.

4.3. The adoption of a sound remuneration policy in financial undertakings subject to this Section is to be seen as an element of internal governance of such undertakings. To this effect, the assessment of such policy is an integral part of the supervisory review process.

4.4. The *réviseur d'entreprises* (statutory auditor) shall make a report to the board of directors or the audit committee of any material deficiencies uncovered during the assessment of the implementation of the remuneration policy. To this end, the long-form report to be drawn up by the *réviseur d'entreprises* (statutory auditor) pursuant to Circulars CSSF 01/27 and 03/113 shall include an appraisal of the rules set up in accordance with this Circular and their

implementation. The first report that must take this into account is the report on the annual accounts for the financial year closing after 31 December 2010.

4.5. Financial undertakings referred to in this Section shall disclose their remuneration policy to the CSSF, no later than 30 September 2010, indicating in particular whether the principles contained in this Circular have been complied with in the form of a declaration on the remuneration policy which is to be updated as need be.

SECTION V

Entry into force

5.1. The authorised management of the financial undertaking shall implement the principles of its remuneration policy at the latest by 30 June 2010 in order to develop and apply them starting from the financial year 2011.

5.2. The CSSF recommends, in this context, that the renegotiation of existing contracts, if necessary, be done as soon as possible, although it recognises that this renegotiation may not be completed before 31 December 2010.

Yours faithfully,

COMMISSION DE SURVEILLANCE DU SECTEUR FINANCIER

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