

## Remuneration policy in the financial services sector

On 30 April 2009 the Commission of the European Communities adopted a Recommendation on remuneration policies in the financial services sector addressed to the countries from the European Economic Area.

A Recommendation allows the Commission to provide a framework for setting out principles or best practices. Member States are free to decide whether to implement the Recommendation or not (e.g. by legislative regulation). The Commission nevertheless invites Member States to inform it by 31 December 2009 of what they are doing to promote the application of the Recommendation.

This Recommendation sets out general principles applicable to remuneration policy in the financial services sector and should apply to all financial undertakings operating in the financial services industry.

The Recommendation was followed by a legislative proposal of the Commission to revise the Capital Requirements Directive.

According to this proposal home Member States competent authorities shall require that every credit institution have remuneration policies and practices that are consistent with and promote sound and effective risk management.

The Committee of European Banking Supervisors (CEBS) also adopted principles on remuneration policy on 20.04.2009. The principles shall apply to all credit institutions and must be implemented before the end of the third quarter of 2009.

### Scope of the Recommendation

Member States are invited to ensure that the principles contained in the Recommendation apply to the remuneration of those categories of staff whose professional activities have a material impact on the risk profile of the financial undertaking (e.g. key executives and senior management, brokers, portfolio managers).

The Recommendation does not apply to fees and commissions received by

intermediaries and external service providers in case of outsourced activities.

### What does financial undertaking mean according to the Recommendation?

Financial undertakings are credit institutions, investment firms, insurance and reinsurance undertakings, pension funds, collective investment schemes and other institutions with professional activities in the financial services industry (this excludes those institutions who exercise activities of the financial sector only occasionally or on an ancillary basis).



## Remuneration policy

Financial undertakings 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.

## Structure of the remuneration policy

- Where remuneration includes a variable component or a bonus, remuneration policy should be structured with an appropriate balance of fixed and variable remuneration components. Remuneration policy of a financial undertaking shall set a maximum limit on the variable component.
- The fixed component of the remuneration should represent a sufficiently high proportion of the total remuneration allowing the financial undertaking to operate a fully flexible bonus policy, including the possibility to pay no bonuses.
- Where a significant bonus is awarded, the major part of the bonus should be deferred with a minimum deferment period.
- The deferred element of the bonus should 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.

- Payments related to the early termination of a contract reflect performance achieved over time and designed in a way that does not reward failure.
- Financial institutions should also be able to claim back already paid bonuses, where data has been proven to be manifestly misstated.

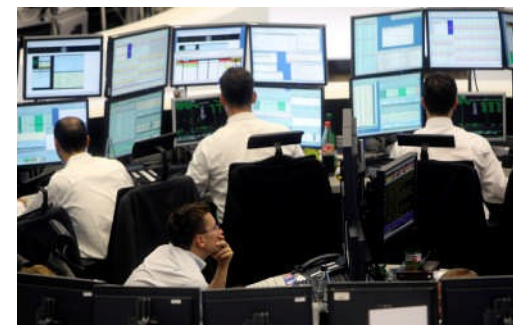
## Performance measurement

- Where remuneration is performance related, its total 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 undertaking.
- The assessment of performance should be set in a multi-year framework (e.g. performance assessment on a moving average of results).
- The measurement of performance, as a basis for bonus or bonus pools, 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.

- When determining individual performance, non-financial criteria also should be taken into account (e.g. adherence to effective risk management and compliance with the regulatory system).

## Governance

- The remuneration policy should include measures to avoid conflicts of interest (e.g. relying on line managers to set bonuses for their own divisions is not acceptable and should be avoided).
- The management or the supervisory board should determine the remuneration of directors should establish the general principles of the remuneration policy and be responsible for its implementation.
- The general principles of the remuneration policy should be accessible to staff members to whom they apply.



## Disclosure

The financial undertakings should disclose some information on the remuneration policy to the relevant stakeholders, e.g. information on the criteria used for performance measurement and the risk adjustment, information on linkage between pay and performance, etc.

Although the principles of the Recommendation are not implemented in the Bulgarian legislation, BNB has indicated its expectation that the credit institutions will comply with the principles. The practice in other EU Member States has already given many models of application of the Recommendation.

The question of remunerations in the financial services sector keeps developing and is subject of discussion worldwide, especially within G-20.



## How can we help

We may assist you by:

- Consulting you in detail about the provisions of the Recommendation;
- Providing you with information about the measures taken by Bulgaria to promote the application of the Recommendation;
- Review of your current remuneration policy and its compliance with the Recommendation;
- Developing a remuneration policy compliant with the Recommendation;
- Development of performance measuring criteria which link remuneration policy to desired performance;
- Review and development of a comprehensive performance management system.

We will also follow all global developments in the topic and will update this newsletter.

For more information please contact:

Kamena Valcheva  
kamena.valcheva@bg.landwellglobal.com  
Boncho Bonchev  
boncho.bonchev@bg.pwc.com

For additional information or assistance in connection with the aforesaid please contact:

Tsvetkova Bebov & Partners (Landwell)  
Attorneys-at-law  
9-11 Maria Louisa Blvd., 7th floor  
1000 Sofia, Bulgaria  
Telephone +359 2 93 55 100  
Facsimile +359 2 93 55 166  
<http://www.tbp.bg>

PricewaterhouseCoopers Bulgaria EOOD  
9-11 Maria Louisa Blvd.,  
1000 Sofia, Bulgaria  
Telephone +359 2 91 003  
Facsimile + 359 2 98 03 228  
<http://www.pwc.com/bg>

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*This newsletter was prepared by Kamena Valcheva, expert with the Financial Services Law Team, Tsvetkova Bebov and Partners (Landwell Bulgaria).*