

RECOMMENDATIONS

COMMISSION

COMMISSION RECOMMENDATION

of 30 April 2009

on remuneration policies in the financial services sector

(Text with EEA relevance)

(2009/384/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community, and in particular the second indent of Article 211 thereof,

Whereas:

- (1) Excessive risk-taking in the financial services industry and in particular in banks and investment firms has contributed to the failure of financial undertakings and to systemic problems in the Member States and globally. These problems have spread to the rest of the economy and led to high costs for society.
- (2) Whilst not the main cause of the financial crisis that unfolded in 2007 and 2008, there is a widespread consensus that inappropriate remuneration practices in the financial services industry also induced excessive risk-taking and thus contributed to significant losses of major financial undertakings.
- (3) Remuneration practices in a large part of the financial services industry have been running counter to effective and sound risk management. These practices tended to reward short-term profit and gave staff incentives to pursue unduly risky activities which provided higher income in the short term while exposing financial undertakings to higher potential losses in the longer term.
- (4) In principle, if risk management and control systems were strong and highly effective, the risk-taking incentives provided by remuneration practices would be consistent with the risk tolerance of a financial undertaking. However, all risk management and control systems have limitations and, as the financial crisis has

shown, can fail to deal with the risks created by inappropriate incentives, due to the increasing complexity of the risks and the range of ways by which risk may be taken. Consequently, a simple functional separation between business units and staff responsible for risk management and control systems is necessary but no longer sufficient.

- (5) Creating appropriate incentives within the remuneration system itself should reduce the burden on risk management and increase the likelihood that these systems become effective. Therefore, there is a need to establish principles on sound remuneration policies.
- (6) Given the competitive pressures in the financial services industry and the fact that many financial undertakings operate cross-border, it is important to ensure that principles on sound remuneration policy are applied consistently throughout the Member States. However, it is acknowledged that to be more effective, principles on sound remuneration policy would need to be implemented globally and in a consistent manner.
- (7) In its Communication to the Spring European Council 'Driving European Recovery' ⁽¹⁾, the Commission presented its plan to restore and maintain a stable and reliable financial system. In particular, the Communication announced that a new Recommendation on remuneration in the financial services sector would be presented in order to improve risk management in financial firms and align pay incentives with sustainable performance.
- (8) 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.

⁽¹⁾ COM(2009) 114.

- (9) Those general principles may be of more relevance to certain categories of financial undertakings than others, in the light of existing regulations and common practices in the financial services industry. These principles should apply in parallel to any rule or regulation governing a specific financial sector. In particular, fees and commissions received by intermediaries and external service providers in case of outsourced activities should not be addressed, since the compensation practices relating to such fees and commissions are already partially covered by particular regimes, in particular Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments ⁽¹⁾ and Directive 2002/92/EC of the European Parliament and of the Council of 9 December 2002 on insurance mediation ⁽²⁾. Furthermore, this Recommendation is without prejudice to the rights, where applicable, of social partners in collective bargaining.
- (10) With respect to financial undertakings whose securities are admitted to trading on a regulated market within the meaning of Directive 2004/39/EC in one or more Member States, this Recommendation apply in addition to and together with Commission Recommendation 2004/913/EC of 14 December 2004 fostering an appropriate regime for the remuneration of directors of listed companies ⁽³⁾ 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 ⁽⁴⁾.
- (11) The remuneration policy of a particular financial undertaking should also be linked to the size of the financial undertaking concerned, as well as the nature and the complexity of its activities.
- (12) A risk-focused remuneration policy, which is consistent with effective risk management and does not entail excessive risk exposure, should be adopted.
- (13) Remuneration policy should cover those categories of staff whose professional activities have a material impact on the risk profile of the financial undertaking. In order to avoid incentives for excessive risk-taking, special arrangements should be adopted with regard to the remuneration of these categories of staff.
- (14) Remuneration policy should 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 should be based on longer-term performance and take into account the outstanding risks associated with the performance. The assessment of performance should be set in a multi-year framework, for example of 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-based components of remuneration is spread over the business cycle of the company.
- (15) Financial undertakings should be able to reclaim variable components of remuneration that were awarded for performance based on data which has subsequently proven to be manifestly misstated.
- (16) As a general principle, payments related to early termination of a contract which are awarded on a contractual basis should not be a reward for failure. For directors of listed financial undertakings, specific provisions on termination payments set out in Recommendation 2009/385/EC should apply.
- (17) In order for remuneration policy to be in line with the objectives, the business strategy, the values and the long-term interests of the financial institution, other factors, apart from financial performance, should 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.
- (18) Effective governance is a necessary condition for the remuneration policy to be sound. The decision-making process regarding the remuneration policy of a financial undertaking should be internally transparent and should be designed in such a way as to avoid conflicts of interest and ensure the independence of the persons involved.
- (19) The governing body of the financial undertaking should have the ultimate responsibility for establishing the remuneration policy for the whole financial undertaking and monitoring its implementation. In order to provide necessary expertise, control functions and, where appropriate, human resources departments and experts should be involved in the process. In particular, control functions should also be involved in the design and the review of the implementation of the remuneration policy, and should be adequately rewarded so as to attract skilled individuals and to ensure their independence from the business units they control. The statutory auditor, within the limits of current reporting duties, should report on material weaknesses in the review of the implementation of the remuneration policy to the (supervisory) board or to the audit committee.

⁽¹⁾ OJ L 145, 30.4.2004, p. 1.

⁽²⁾ OJ L 9, 15.1.2003, p. 3.

⁽³⁾ OJ L 385, 29.12.2004, p. 55.

⁽⁴⁾ See page 28 of this Official Journal.

- (20) Control of the design and implementation of the remuneration policy is more likely to be effective if the stakeholders of the financial undertaking, including, where applicable, employee representatives, are properly informed of and engaged in the process of setting up and monitoring remuneration policy. For that purpose, financial undertakings should disclose the relevant information to their stakeholders.
- (21) The implementation of the principles laid down in this Recommendation should be reinforced through supervisory review at the national level. Therefore, supervisor's overall assessment of the soundness of the financial undertaking should include the assessment of compliance of the remuneration policy of the financial undertaking with the principles laid down in this Recommendation.
- (22) Member States should ensure that branches of financial undertakings having their registered office or their head office in a third country and which operate in the territory of a Member State should be subject to similar principles on remuneration policy which apply to financial undertakings having their registered office or their head office in the territory of a Member State.
- (23) This Recommendation should apply without prejudice to measures which might be adopted by Member States with respect to remuneration policies of financial undertakings which benefit from State assistance.
- (24) The notification of measures by Member States in accordance with this Recommendation should include a clear timeframe for financial undertakings to adopt remuneration policies consistent with the principles set out in this Recommendation.
- 1.3. When taking measures to ensure that financial undertakings implement those principles, Member States should take into account the nature, the size as well as the specific scope of activities of the financial undertakings concerned.
- 1.4. Member States should apply the principles contained in sections II, III and IV to financial undertakings on an individual basis and on a consolidated basis. Principles on sound remuneration policy should apply at group level to the parent undertaking and to its subsidiaries, including those established in offshore financial centres.
- 1.5. This Recommendation does not apply to fees and commissions received by intermediaries and external service providers in case of outsourced activities.
2. *Definitions for the purposes of this Recommendation*
- 2.1. 'Financial undertaking' means any undertaking, irrespective of its legal status, whether regulated or not, which performs any of the following activities on a professional basis:
- (a) it accepts deposits and other repayable funds;
 - (b) it provides investment services and/or performs investment activities within the meaning of Directive 2004/39/EC;
 - (c) it is involved in insurance or reinsurance business;
 - (d) it performs business activities similar to those set out in points (a), (b) or (c).

HEREBY RECOMMENDS:

SECTION I

Scope and definitions

1. *Scope*
- 1.1. Member States should ensure that the principles contained in sections II, III and IV apply to all financial undertakings having their registered office or their head office in their territory.
- 1.2. Member States should ensure that the principles contained in sections II, III and IV apply to the remuneration of those categories of staff whose professional activities have a material impact on the risk profile of the financial undertaking.
- 2.2. 'Director' means any member of the administrative, managerial or supervisory bodies of financial undertakings.
- 2.3. 'Control functions' means risk management, internal control and similar functions within a financial undertaking.
- 2.4. 'Variable component of remuneration' means a component of remuneration entitlement which is awarded on the basis of performance criteria, including bonuses.

A financial undertaking includes, but is not limited to, credit institutions, investment firms, insurance and reinsurance undertakings, pension funds and collective investment schemes.

SECTION II

Remuneration policy

3. General

3.1. Member States should ensure that financial undertakings 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.

3.2. Remuneration policy should 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.

4. Structure of the remuneration policy

4.1. Where remuneration includes a variable component or a bonus, remuneration policy should 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. Member States should ensure that remuneration policy of a financial undertaking sets a maximum limit on the variable component.

4.2. 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. In particular, the financial undertaking should 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. The financial undertaking should 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.

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

4.4. 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. The measures of future performance to which the deferred element is linked should be risk adjusted as set out in point 5.

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

4.6. Member States should ensure that the (supervisory) board of a financial undertaking can require staff members to repay all or part of bonuses that have been awarded for performance based on data which has subsequently proven to be manifestly misstated.

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

5. Performance measurement

5.1. 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.

5.2. The assessment of performance should be set in a multi-year framework in order to ensure that the assessment process is based on longer term performance and that the actual payment of bonuses is spread over the business cycle of the company.

5.3. 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.

5.4. When determining individual performance, non-financial criteria, such as compliance with internal rules and procedures, as well as compliance with the standards governing the relationship with clients and investors should be taken into account.

6. Governance

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

- 6.2. The (supervisory) board should determine the remuneration of directors. In addition, the (supervisory) board should establish the general principles of the remuneration policy of the financial undertaking and be responsible for its implementation.
- 6.3. Control functions and, where appropriate, human resources departments and external experts should also be involved in the design of the remuneration policy.
- 6.4. Members of the (supervisory) board 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 should 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.
- 6.5. Without prejudice to the overall responsibility of the (supervisory) board as set out in point 6.2, the implementation of the remuneration policy should, at least on an annual basis, be subject to central and independent internal review by control functions for compliance with policies and procedures defined by the (supervisory) board. The control functions should report on the outcome of this review to the (supervisory) board.
- 6.6. Staff members engaged in control processes should 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. In particular, with regard to insurance or reinsurance undertakings, the actuarial function and the responsible actuary should be remunerated in a manner commensurate with her or his role in the insurance or reinsurance undertaking and not in relation to the performance of the undertaking concerned.
- 6.7. The general principles of the remuneration policy should be accessible to staff members to whom they apply. Those staff members should 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 should be properly documented and transparent to the individual staff members concerned.

SECTION III

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 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.

8. 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 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.
9. When determining the level of the information which should be disclosed, Member States should take into account the nature, the size as well as the specific scope of activities of the financial undertakings concerned.

SECTION IV

Supervision

10. Member States should ensure that competent authorities take into account the size of the financial undertaking and the nature and the complexity of its activities when monitoring whether the principles contained in sections II and III are followed.
11. Member States should ensure that financial undertakings are in a position to communicate the remuneration policy covered by this Recommendation to their competent authorities, including an indication of compliance with the principles set out in this Recommendation, in the form of a remuneration policy statement subject to appropriate updates.

12. Member States should ensure that competent authorities may request and have access to all information they need to evaluate the extent to which the principles contained in sections II and III are followed.

SECTION V

Final provisions

13. Member States are invited to take the necessary measures to promote the application of this Recommendation by 31 December 2009 and to notify the Commission of the measures taken in accordance with this Recommendation, in order to enable the Commission to monitor closely the situation and, on that basis, to assess the need for further measures.
14. This Recommendation is addressed to the Member States.

Done at Brussels, 30 April 2009.

For the Commission

Siim KALLAS

Vice-President
