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OFFICIAL INFORMATION OF THE CZECH NATIONAL BANK

of 18 September 2014

on the performance of the activities of banks, credit unions and investment firms - remuneration

I. Scope and purpose

1. This Official Information¹ contains information relating to the remuneration requirements for the employees of banks, credit unions and investment firms² (hereinafter the “liable entity”).
2. The intention of the Czech National Bank is to provide factual explanations and additional information to the more detailed definition of some remuneration requirements included in Annex 1 of Decree 163/2014 Coll., on the activities of banks, credit unions and investment firms (hereinafter the “Decree”).

II. Background, objectives, principles

3. The Czech National Bank follows the relevant legal regulations and relevant documents of European³ and international organizations⁴.

¹ Article 49a of Act No 6/1993 Coll., on the Czech National Bank, as amended.

² Article 8a (1), (2) and (3) of Act No 256/2004 Coll., on capital market undertakings, as amended.

³ Commission Delegated Regulation (EU) No 604/2014 of 4 March 2014 supplementing Directive 2013/36/EU of the European Parliament and of the Council with regard to regulatory technical standards with respect to qualitative and appropriate quantitative criteria to identify categories of staff whose professional activities have a material impact on an institution's risk profile.

[http://eur-lex.europa.eu/legal-](http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:JOL_2014_167_R_0003&qid=1400593328648&from=EN)

[content/EN/TXT/PDF/?uri=OJ:JOL_2014_167_R_0003&qid=1400593328648&from=EN](http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:JOL_2014_167_R_0003&qid=1400593328648&from=EN)

General EBA guidelines on the applicable notional discount rate for variable remuneration (EBA), 2014.

<http://www.eba.europa.eu/documents/10180/456620/EBA+CP+2013+40+%28CP+on+draft+Guidelines+on+the+discount+factor+for+variable+remuneration%29.pdf>

Commission Delegated Regulation (EU) No 527/2014 of 12 March 2014 supplementing Directive (EU) No 2013/36/EU of the European Parliament and of the Council with regard to regulatory technical standards specifying the classes of instruments that adequately reflect the credit quality of an institution as a going concern and are appropriate to be used for the purposes of variable remuneration.

<http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32014R0527&from=EN> Guidelines on Remuneration Policies and Practices, CEBS, 2010.

<http://www.eba.europa.eu/documents/10180/106961/Guidelines.pdf/a3ab77c9-980f-4994-b2cd-397413b77084?version=1.0>

⁴ Range of Methodologies for Risk and Performance Alignment of Remuneration, Basel Committee on Banking Supervision (BCBS), 2011; FSB Principles for Sound Compensation Practices, Financial Stability Board (FSB), including implementation methodologies, 2009; Compensation Principles and Standards Assessment

4. The objective of the regulation of remuneration is to ensure that the remuneration practices are consistent with effective risk management. For this purpose, the liable entity shall establish and maintain a system of remuneration which does not motivate employees to excessive risk-taking, is consistent with the long-term interests of the liable entity, avoids conflicts of interest and ensures that remuneration does not limit the ability of the liable entity to strengthen the capital. The remuneration principles form part of the requirements for the system of governance.
5. The remuneration principles apply to all other employees of the liable entity in addition to employees whose activities have a significant impact on the overall risk profile of the liable entity.
6. The Czech National Bank, when performing supervision over compliance with the relevant rules for remuneration, will proceed on an individual basis, taking into account the particular conditions of the focus and organization of the activities of the liable entity. Within the liable entities the principle of proportionality is applied, i.e., the principles are applied in different ways and different scope with respect to the size, organizational structure, nature, scope and complexity of the activities of the liable entity.
7. If the principles of the remuneration policy or specific remuneration practices of the liable entity are not in accordance with remuneration regulations, the Czech National Bank may impose qualitative and quantitative remedial measures on the liable entity. Qualitative remedial measures will be used as a priority, including in particular the possibility of requiring a reduction in the risks arising from activities, products or systems, changes in the structures of remuneration, or the possibility of requiring that the liable entity limit the variable remuneration components to a percentage of its total net profit. Quantitative remedial measures are understood to be, in particular, additional capital requirements based on assessing whether the arrangement, strategies, processes and mechanisms implemented by the liable entity and the capital of the liable entity ensure the safe and reliable performance of activities of the liable entity.

III. Final Provisions

8. The interpretation of the remuneration requirements is set out in the Annex to this Official Information.
9. On the date of announcement of the Official Information in the Bulletin of the Czech National Bank, the validity of Official Information of the Czech National Bank of 5 May 2014 on the performance of the activities of banks, credit unions and investment firms - remuneration No 11 of the Bulletin of the Czech National Bank (Issue 11/2014) - will expire.
10. This Official Information is to be complied with from the date of its announcement.

Vice-Governor
Ing. Mojmír Hampl, MSc., Ph.D., duly signed

Annex: Interpretation of the requirements for remuneration.

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Annex**Interpretation of the requirements for remuneration.*****1. Scope of application****(quoted from the text of point 1 and 2 of Annex 1 to the Decree)*

1. A liable entity shall apply
 - a) the general and other remuneration policies to the liable entity's total remuneration system and to the remuneration of all employees;
 - b) the special remuneration principles and procedures to the selected areas of the liable entity's total remuneration system, and at least to the remuneration of the selected employees, and to the groups of employees consisting of such selected employees, whose activities have a significant effect on the liable entity's overall risk profile (hereinafter the "selected employees"), unless the application of the procedures pursuant to paragraphs 13 to 20 below would not be proportionate to the effect of the selected employee or of the group of such selected employees on the liable entity's overall risk profile; the foregoing shall be without prejudice to the provisions of subparagraph c) below; the liable entity is responsible for the introduction, maintenance and exercise of the criteria for stipulating the selected employees.
 - c) if a liable entity's position on the relevant market is significant, the liable entity shall apply all of the special principles and procedures, as appropriate; for such purposes, a liable entity's position shall always be regarded as significant if its share in the total balance sum of all the liable entities on the relevant market reaches or exceeds 5 %.
2. The remuneration principles pursuant to point 1 shall be appropriately taken into account by a liable entity when remunerating other legal entities or natural persons, if they factually perform activities for the liable entity and such activities have a significant effect on the liable entity's overall risk profile, or if their remuneration is analogous to that of the selected employees pursuant to point 1 b) of points 2 and 4, regardless of their formal-law relationship with the liable entity, legal form and geographical location.

- 1.1. The liable entity's remuneration system is on an individual and consolidated basis in accordance with Annex 1 of the Decree. The principles for group remuneration shall apply to all persons covered by the prudential consolidation. Group-wide remuneration principles will also take into account the different responsibilities of persons involved in the prudential consolidation resulting from their placement and the nature of the activities carried out by them.
- 1.2. **Employee** under Article 7(3) d) of the Decree **means** a person who has a basic employment relationship or similar relationship with a liable entity, or another person who is a member of a body or committee of a liable entity.
- 1.3. **Remuneration** under Article 7(2) f) of the Decree **means** wages, monetary and non-monetary benefits and other income of an employee. Remuneration is divided into a fixed component and a variable component, which is characterized in that it depends on the fulfillment of certain criteria. Remuneration may take various forms; some kinds of remuneration can be exempt from the rules of remuneration if they are provided on the basis of general company-wide principles and do not provide motivation for risk-taking⁵.

⁵ Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (CRD IV) explicitly demonstrates this rule in special pension benefits that are not considered to be contributions to occupational pension insurance, supplementary pension insurance with state contribution supplementary pension savings, pension insurance or contributions of a similar nature customary for the employees of the liable entity.

- 1.4. On the basis of criteria stipulated through a directly applicable regulation⁶ the liable entity identifies the selected employees, and the groups of employees they make up, whose activities have a significant impact on the overall risk profile of the liable entity (hereinafter the “selected employees”). The principles of remuneration under Annex 1 of the Decree fully **apply** to the selected employees whose activities have a significant impact on the overall risk profile of the liable entity. In accordance with point 4 of Annex 1 of the Decree the management body in its supervisory function approves and evaluates the aggregate remuneration principles for the selected employees or their groups; this activity is considered to be a specific control activity of the management body in its supervisory function.
- 1.5. The liable entity also applies some basic principles (the principles set out in points 3 and 28 of Annex 1 of the Decree) to all other employees. This requirement follows from Article 18(1) c) of the Decree, imposing on the management body in its managerial function the obligation to approve and evaluate the human resources strategy, including the overall system of remuneration, and from Article 17(3) of the Decree, imposing on the management body in its managerial function the obligation to ensure establishment of the principles of human resources management, including the principles for the selection, remuneration, evaluation and motivation of employees in accordance with the overall remuneration system it has approved, and their implementation and maintenance.
- 1.6. The requirements for the system of governance and its components are implemented according to the **principle of proportionality**⁷. In justified cases, some specific principles (e.g., under points 13 and 14 of Annex 1 of the Decree) need not be applied to certain selected employees. The liable entity will properly justify the non-application of the principles in terms of the *comply or explain* principle.
- 1.7. Proportionality can be applied at **institutional level** given the size (e.g., value of assets, liabilities, risk exposure, number of employees, number of branches, share in the financial system of a Member State and the European Union), organizational structure (e.g., legal form, listing), the nature, scale and complexity of the activities required of the liable entity (e.g., the type of activities performed, the clientele, the proportion of risky activities to total activities, international operations, stability, the measurability and predictability of risk activities, the time horizon and significance of the risks, the use of internal models to calculate capital requirements, and the complexity of the products offered).
- 1.8. Proportionality is also applied at the **employee level**, where in addition to the above criteria, is taken into account also the status of employee within the organizational structure of the liable entity, the size of the commitment that the employee may accept for the institution, the number of other employees in the group with significant impact on the risk profile, the business model, the total remuneration of the employee, etc. The liable entity may therefore prescribe completely different rules for some groups of

⁶ Commission Delegated Regulation (EU) No 604/2014 of 4 March 2014 supplementing Directive 2013/36/EU of the European Parliament and of the Council with regard to regulatory technical standards with respect to qualitative and appropriate quantitative criteria to identify categories of staff whose professional activities have a material impact on an institution's risk profile.

⁷ The proportionality principle is expressed in Article 9 of the Decree (“A liable entity shall comply with the requirements stipulated for the system of governance and for components thereof with regard to its size, its business model, the complexity thereof and the risks inherent therein, its organizational structure, the nature, scale and complexity of the activities that it performs or intends to perform. In doing so, a liable entity shall also take into account the development of the environment in which it operates, including the development in the field of sound corporate governance.”).

employees.

- 1.9. The principle of proportionality is also reflected **at the level of individual principles**. The strict implementation of certain principles can justify milder or less sophisticated use of others⁸. The principles of remuneration cannot be viewed individually and must be evaluated in context with regard to the comprehensive operation of the whole system.
- 1.10. From the scope of the remuneration policy described above, it is clear that the principles can be divided into:
- **general and other principles** (group I) - all liable entities apply them to all employees
 - **special principles, that**
 - **must be applied** (group II) - all liable entities apply them to all employees, unless the application of the procedures referred to in points 13 to 20 would not be proportionate to the influence of the selected employee
 - **may be disapplied** (Group III) - only some liable entities apply them only to some of the selected employees with a significant impact on the risk profile of the liable entity.

2. *GROUP I - General and other remuneration principles*

2.1. *Introduction*

2.1.1. All liable entities apply general and other principles in relation to all their employees.

2.1.2. These remuneration principles are characterized by the fact that they stipulate the principal objectives of the regulation of remuneration and give space to the liable entity to assess its own situation and implement the principles in an appropriate and proportionate manner.

2.2. *General remuneration policies*

(quoted from the text of point 3 of Annex 1 of the Decree)

3. The general remuneration principles and procedures

- a) promote the sound and efficient risk management and be consistent with it;
- b) not encourage risk-taking that exceeds the level of risk accepted by a liable entity;
- c) be in line with the strategy, objectives, values and long-term interests of a liable entity;
- d) incorporate measures to avoid conflicts of interest in relation to remuneration; and
- e) ensure that the variable remuneration components as a whole do not restrict a liable entity's ability to strengthen its capital base.

2.2.1. The aforementioned remuneration principles are the main objectives of the regulation. The liable entity will therefore not select such remuneration for any employee that would be in conflict with these objectives.

2.2.2. The principle contained in letter e) of point 3 of Annex 1 of the Decree is crucial because it is designed to promote the long-term stability of the liable entities. The Liable entity should ensure that the determination, granting or payment of remuneration will not impair its ability to strengthen its capital.

⁸ A liable entity that, for example, thoroughly applies the principles of letters c) and d) of point 9 of Annex 1 of the Decree, i.e., *ex ante* risk adjustment, need not apply the rule of point 13 of Annex 1 of the Decree, i.e., deferring remuneration, so thoroughly. Another example of this kind of proportionality is the relationship between the length of the assessed period and the length of the deferral/vesting period, when shortening the assessment period implies the introduction of a longer period for deferment and vice versa.

2.3. *Selected prerequisites for and the arrangement of the total remuneration system*

(quoted from the text of point 7 of Annex 1 of the Decree)

7. The employees engaged in internal control functions shall be remunerated in line with the achievement of the objectives stipulated for the relevant control function, independently of the performance of the sections controlled by them.

2.3.1. The liable entity rewards members of the management body in its supervisory function with fixed and variable remuneration components, which are only associated with the control tasks. If the liable entity also rewards the members of the management body in its supervisory function with non-cash instruments, these instruments should be retained (see point 15 of Annex 1 of the Decree) until the end of their mandate⁹.

2.3.2. The variable component of employee remuneration in internal control functions (in particular risk management, compliance and internal audit) is associated with the control tasks and is independent of the performance of the controlled sections.

2.4. *Prevention of potential circumvention of the purpose of regulation in respect of remuneration*

(quoted from the text of points 22 and 24 - 26 of Annex 1 of the Decree)

22. The variable remuneration component may not be paid out by means of instruments or in a form that would make it possible to circumvent the requirements of this Decree or of other legal regulations.

24. A variable remuneration component that is guaranteed irrespective of performance, may be provided in exceptional cases only and solely if the liable entity maintains a sufficient capital base, and shall be permitted only in the context of acquiring new selected employees; this method of remuneration shall be limited to a period of the first year following the start of the new selected employee.

25. A contractually guaranteed variable remuneration component shall not be deemed consistent with sound risk management or with the pay-for-performance principle, and shall thus not form part of future remuneration schemes.

26. A contractual severance payment, provided to the selected employees in connection with a premature termination of the relationship, shall reflect their performance achieved in the course of the relevant period, and shall be designed in a manner that does not reward failure.

2.4.1. The liable entity may not pay remuneration in such instruments or form that would make it possible **to circumvent remuneration requirements**. The understanding of the concept of employee and remuneration is closely linked with point 22 of Annex 1 of the Decree, which emphasizes that the variable remuneration component is not paid in instruments or in a form that would allow circumvention of the requirements of the Decree. For example, the targeted use of off-shore centers¹⁰, respectively the formal employment of employees of the liable entity in unregulated institutions, including those that are located in off-shore centers, some cases of the use of outsourcing arrangements (point 2 of Annex 1 of the Decree emphasizes particularly significant outsourced activities) or the conversion of variable components of remuneration into non-monetary benefits that would not fall within the definition of remuneration would be considered as circumvention,

2.4.2. **Guaranteed variable remuneration component** means guaranteed remuneration, starting remuneration, minimum guaranteed variable remuneration, etc. An exception to the general ban on guaranteed remuneration is remuneration for new employees for one

⁹ If a liable entity complies with these principles, it need no longer apply special principles of remuneration to members of the management body in its supervisory function (see groups of principles II and III).

¹⁰ These are countries (also known as so-called tax havens) that specify income tax through a lump sum, regardless of the actual profits/revenues of the company. Publicly accessible indexes also usually do not contain information about the owners of a company. For more details see <http://www.imf.org/external/np/mae/oshore/2000/eng/back.htm#box1>.

year¹¹, contractual severance pay and remuneration for employees in exceptional situations (e.g., an impending merger) intended to motivate them to continue working for the liable entity.

2.4.3. **Contractual severance pay** (the so-called golden parachute) is a contractual arrangement related to the length of the period of notice, the non-competition clause or the termination of employment by the liable entity (e.g., a change in the strategy of the liable entity, mergers, acquisitions, etc.) The liable entity should determine the procedure and criteria for the assessment and approval of severance pay.

2.5. *Special provisions on remuneration in the case of public support*

(quoted from the text of point 28 of Annex 1 of the Decree)

28. If an liable entity has been exceptionally provided with public support,
- a) it shall limit the variable remuneration component to a certain percentage of its net revenues, so that it is consistent with capital maintenance and with the timely termination of the provision of state aid,
 - b) it shall reassess the overall remuneration system so that it is consistent with sound risk management and with long-term growth, and, where appropriate, shall stipulate limits on the remuneration of the members of the management body, and
 - c) shall only grant the variable remuneration component to members of the management body if this is justifiable.

2.5.1. An example of justifiable allocation of the variable remuneration component is, for example, the recruitment of new employees for the purpose of leading the liable entity out of problems.

3. *GROUP II - Special remuneration principles that must be applied at least to selected employees.*

3.1. *Introduction*

3.1.1. **Special remuneration principles indicated in group II are applied by all liable entities at least for the remuneration of selected employees** [according to letter b) point 1 of Annex 1 of the Decree]. The application of the principle of proportionality allows a less important liable entity to apply the principles to these employees in a reasonable (e.g., less sophisticated) manner.

3.2. *Selected prerequisites for and the arrangement of the total remuneration system*

(quoted from the text of points 4 - 6 and point 8 of Annex 1 of the Decree)

4. The management body in its supervisory function shall approve and regularly evaluate the overall policies governing the remuneration of the selected employees or groups thereof; such activities shall be regarded as special control activities of the management body in its supervisory function.
5. The application of the policies governing the remuneration of the selected employees or groups thereof shall be, at least once a year, subjected to a comprehensive and independent internal review in terms of compliance with the overall policies governing the remuneration of the selected groups of employees, as approved by the management body in its supervisory function.
8. The remuneration of managers in risk management, internal audit and compliance shall be directly overseen by the remuneration committee or by the management body in its supervisory function.

3.2.1. As part of its special control activities the management body in its supervisory function should

¹¹ However, an employee who has changed his job within the same liable entity is not considered to be a new employee.

- determine and evaluate the remuneration principles of the liable entity (cooperate with other functional units of the liable entity, especially with the internal control functions),
- identify and oversee the individual remuneration of the members of the management body in its managerial function (unless such decision-making is reserved for the general meeting or meeting of members¹² by the Articles of Association or legislation),
- oversee the individual remuneration of the top management, of employees with the highest remuneration and managers in risk management, the internal audit function and compliance functions, and give recommendations to the management body in its managerial function concerning their remuneration.

3.2.3. The functioning of the remuneration principles, in particular the implementation of approved principles and plans, the adequacy of the remuneration in view of the risk profile and long term objectives of the institution and compliance with national and international regulations and standards, are subject to independent internal control. The management body in its supervisory function is always responsible for taking remedial measures and ensuring the proper functioning of the system.

3.3. *Measuring the performance in relation to remuneration*

(quoted from the text of point 9 of Annex 1 of the Decree)

9. If performance-related remuneration is stipulated,
- a) the total remuneration shall be based on a combination of the assessment of the performance of the individual and of the section concerned, and of the overall results of the liable entity,
 - b) when assessing individual performance, both financial and non-financial criteria shall be taken into account;
 - c) the assessment of the performance shall be set in a multi-year framework in order to ensure that the remuneration process is based on longer-term results and that the actual payment of portions of the variable component of performance-based remuneration is spread over a period whose length takes into account the underlying business cycle of the liable entity and the related risks; and
 - d) the procedure used to measure the performance for the purposes of calculating the variable remuneration component, or variable remuneration components as a whole, shall include adjustments that will take into account all types of existing and future risks as well as the costs of ensuring the capital and liquidity required.

3.3.1. In order to prevent excessive risk-taking, it is important that the variable remuneration is **purged of all related risks and costs**, i.e., present and future risks, balance-sheet risks and off-balance-sheet risks, and risks assigned by an employee, section or the liable entity¹³. The identification and qualification of risks at the level of institutions and organizational units are based, where possible, on the internal risk assessment and capital adequacy process, conducted by the liable entity within the framework of the Internal Capital Adequacy Assessment Process (ICAAP) and the internal assessment of the adequacy of the liquidity of the liable entity.

3.3.2. For **performance evaluation** the liable entity should first set objectives for the whole, for individual sections and individual employees or groups of employees that are derived from the business strategy and the degree of risk accepted. From these

¹² For example, in respect of liable entities that are joint-stock companies, decisions on the remuneration of members of the board of directors are only made by the general meeting by law [Article 59(2) of the Act on Business Corporations].

¹³ When taking account of risks, an appropriate combination of financial (quantitative) and non-financial (qualitative) criteria is applied. Although the calculation of quantitative indicators is transparent, the result often has to be modified upon deliberation, or requires adjustment on the basis of deliberation during the actual entry of the input data. A liable entity should plan out in advance how it will assess individual risks and record calculations and evaluations.

objectives it will derive criteria for evaluating the performance of employees, which take into account the long-term results and can be influenced by the unit or employee. The liable entity should always choose **financial (quantitative) criteria** that include all risks, economic efficiency, and take into account the relationship between revenues and required capital (including the cost of equity), and **non-financial (qualitative) criteria** (e.g., the achievement of strategic objectives, management skills, the level of cooperation with other sections and control functions etc.) During the evaluation, poor quality performance by a section or employee, especially unethical or inappropriate behavior, should override even excellent quantitative performance, and the variable component of the remuneration should be substantially reduced. Performance is evaluated in the context of the evaluation period (*accrual period*), which should be at least one year and should take into account the business cycle of the liable entity.

3.3.3. At the end of the accrual period, the resulting assessment of the employees' performance is used for **calculating remuneration**. The liable entity should first determine the total amount of funds designated for remuneration (the *pool*) and identify risks at the level of the institution, sections and employees, to ensure that the total volume of remuneration properly reflects the severity and length of exposure of the liable entity to all risks. The total volume of remuneration should then be allocated among employees based on predetermined criteria that include all kinds of risks and costs¹⁴. The inclusion of risks in the assessment of variable remuneration represents ex ante risk adjustment.

3.4. Form and structure of remuneration

(quoted from the text of points 10 - 12 of Annex 1 of the Decree)

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| <p>10. The fixed and variable components of the total remuneration of the selected employee shall be appropriately balanced; the fixed remuneration component shall represent a sufficiently large proportion of the total remuneration so as to allow the application of a fully flexible approach to the variable remuneration component, including the option of paying out no variable remuneration component. The liable entity shall stipulate an appropriate ratio between the fixed and the variable remuneration component for the individual persons or groups of persons, on the understanding that:</p> <ul style="list-style-type: none"> a) the variable component of any individual shall not exceed 100% of the fixed component of his/her total remuneration, unless the stakeholders or members of the liable entity approve a higher maximum level for the ratio between the fixed and variable remuneration components, provided that the overall level of variable remuneration is capped at 200% of the fixed component of their total remuneration, and b) for the purposes of calculating the amount of the variable remuneration component, a liable entity may apply a discount rate of up to 25% of the total amount of the variable remuneration component in respect of any individual, on the understanding that it is paid out by means of instruments that are deferred over a period of at least 5 years. <p>11. A higher ratio between the fixed and variable components of total remuneration in accordance with point 10 a) is approved through the following procedure:</p> <ul style="list-style-type: none"> a) the stakeholders or members of the liable entity act on the basis of detailed recommendations drawn up by the liable entity containing the reasons for the required approval and its scope, including the number of selected employees to which it will apply, their functions, and the expected impact on the requirement to maintain sound capital, b) the stakeholders or members of the liable entity act through at least a 66% majority, provided that at least 50% of the shares or equivalent ownership interests are represented, or in the case of non-compliance with this condition, act through a 75% majority of the represented shares or ownership interests, c) the liable entity informs all stakeholders or members of the liable entity a sufficient time in advance that will ask for approval of the proposal under point 10 letter a), |
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¹⁴ The calculation of the profitability of sections is based on net income, which takes into account all the direct and indirect costs of the section (e.g., including information technology costs, overhead costs, etc.) As the risk-adjusted profits of a liable entity should take into account all the costs and the volume of required capital (including the cost of equity), all the costs of the liable entity are allocated to the relevant sections.

- d) the liable entity will promptly inform the Czech National Bank of its recommendation to the stakeholders or members as well as the proposed higher maximum ratio of the fixed and variable components of total remuneration and its justification, and is able to demonstrate to the Czech National Bank that the proposed higher ratio is not in conflict with the obligations of the liable entity under this Decree or the Regulation, especially with regard to capital requirements,
- e) the liable entity shall promptly inform the Czech National Bank of the decisions taken by its stakeholders or members, including all higher maximum ratios under point 10 a) that have been approved,
- f) the selected workers directly affected by the higher maximum level of variable remuneration under point 10 a) may not directly or indirectly exercise any voting rights during the related negotiations that they may have as stakeholders or members of the liable entity; for such cases the liable entity shall provide in its Articles of Association rules for the assessment of the ability of the general meeting or meeting of members to be quorate.
12. The allocation of the variable remuneration components of the selected employees shall take into account all types of existing and future risks.

3.4.1. **The appropriate ratio between fixed and variable components** may differ for individual groups of employees, however, the fixed and variable remuneration components should always be clearly separated. If the variable remuneration component is too small, the liable entity will not be able to adequately reduce total remuneration in the event of an unfavorable financial situation. An excessive variable component of remuneration could also have a negative impact if the excessive fulfillment of the performance criteria leads to increased assumption of risk. The variable remuneration component for any individual thus must not exceed 100% of the fixed component of their total remuneration, unless a higher rate was approved under point 11 of Annex 1 of the Decree meaning that the variable component for an employee may be up to 200% of the fixed component of the total remuneration. The liable entity may use, for the purposes of calculating the amount of the variable remuneration component, a discount rate of up to 25% of the total amount of the variable remuneration component [under point 10 b) of Annex 1 of the Decree], while this part of the remuneration is paid in the form of instruments deferred over a period of at least 5 years. The method of calculating the discount rate is stipulated through the guidelines of the European Banking Authority (EBA)¹⁵.

3.5. Prevention of potential circumvention of the purpose of regulation in respect of remuneration

(quoted from the text of point 23 of Annex 1 of the Decree)

23. A liable entity shall contractually oblige the selected employees not to use insurance or other hedging strategies in respect of their remuneration or liability, which might undermine or limit the effects of the risk-focused elements embedded in the remuneration policies.

3.5.1. **Hedging strategies related to remuneration** are a specific case of circumvention of the purpose of regulating remuneration. The liable entity should therefore contractually oblige or otherwise commit employees (e.g., through a prohibition in the code of ethics or other internal regulation) not to use a hedging strategy in relation to their remuneration. The general rule on a ban on insurance related to remuneration however does not prohibit arranging insurance for private payments such as mortgage payments. The liable entity will assess the cases on an individual basis.

3.6. Special pension benefits

(quoted from the text of point 21 of Annex 1 of the Decree)

21. The policies governing the provision of any discretionary pension benefits, provided to the selected employees over and above any blanket scheme of a liable entity for employees, including any supplementary employee insurance, shall be in line with the strategy, objectives, values and long-term

¹⁵General EBA guidelines on the applicable notional discount rate for variable remuneration (EBA), 2014.

interests of the liable entity. No contributions within the framework of employee pension insurance, supplementary pension insurance with state contribution, supplementary pension savings, retirement insurance or contributions of a similar nature and customary for the employees of a liable entity, shall be regarded as discretionary pension benefits. Discretionary pension benefits shall form part of the variable remuneration component. If the selected employee

- a) leaves a liable entity before the entitlement to a retirement pension arises, discretionary pension benefits shall be deferred by the liable entity over a period of five years, in the form of the instruments pursuant to paragraph 14 above; or
- b) reaches the entitlement to a retirement pension, discretionary pension benefits shall be granted to him/her in the form of the instruments pursuant to paragraph 14 above, and the liable entity shall be obliged to retain the same over a period of five years.

3.6.1. The regulation of remuneration is also applied to some specific situations. Special pension benefits should, like other forms of remuneration, be linked to the long-term interests of the liable entity, i.e., they should only be awarded and released to outgoing employees with regard to the financial situation of the liable entity and the risk that the employee was exposed to during his tenure. Thus, if a liable entity awards special pension benefits to employees with a significant impact on the overall risk profile, it should choose a form of non-cash instruments referred to in point 14 of Annex 1 of the Decree that are either deferred or retained for some time (see group III).

4. GROUP III - Special remuneration principles that may be disapplied

4.1. Introduction

4.1.1. **A liable entity need not apply the special remuneration principles indicated in group III to selected employees. With the exception of an investment firm, any liable entity must, however, justify use of this possibility pursuant to Article 4 of the Decree (comply or explain).**

4.1.2. After a liable entity determines whether it will apply any of the following principles, it will also define the appropriate group of employees to whom it will apply the individual principles.

4.1.3. **Less significant liable entities** may reasonably apply some of the principles set out below on a small number of selected employees. It must justify this approach. Some principles, however, should apply at least to members of the management body in its managerial function.

4.1.4. **Liable entities with a significant position on the given market** [letter c) of point 1 of Annex 1 of the Decree] will reasonably apply all the following principles to all selected employees. The liable entity must apply the principle of proportionality for each employee or provide due justification, while this justification must be related to the specific activities of such employee at the liable entity and the risks arising from its activities for the liable entity.

4.2. Selected prerequisites for and the arrangement of the remuneration system*(quoted from the text of point 8 of Annex 1 and points 3 and 4 of Annex 2 of the Decree)*

8. The remuneration of managers in risk management, internal audit and compliance shall be directly overseen by the remuneration committee or by the management body in its supervisory function.
3. The liable entity shall ensure that the members of the remuneration committee have adequate professional qualifications and experience, in particular in order to ensure a qualified and independent assessment of the remuneration policies and procedures and of proposals for motivational incentives in respect of risk, capital and liquidity management.
4. The remuneration committee prepares proposals for decisions regarding remuneration, including those that impact on risks and risk management of the liable entity adopted by the management body in its supervisory function of the liable entity. In the preparation of such decisions, the remuneration committee shall take into account the long-term interests of the liable entity's stakeholders or members, investors and other interested parties, and the public interest.

4.2.1. The majority of the members of the remuneration committee, including its chairperson, should be independent of the liable entity¹⁶. At least one member of the committee should have sufficient knowledge and experience with the mechanism linking remuneration to risk and capital management.

4.2.2. As part of its activities, the remuneration committee should:

- a) support the management body in its supervisory function in preparing the remuneration principles,
- b) submit to the management body in its supervisory function or the general meeting proposals relating to the remuneration of members of the management body in its managerial function,
- c) oversee the individual remuneration of key employees in internal control functions and give recommendations to the management body in its managerial function regarding their remuneration,
- d) have access to relevant information from internal audit functions and from the management body in its supervisory function,
- e) cooperate with the control functions, committees (e.g., the risk management committee, the audit committee) and other relevant sections (e.g., the personnel department, strategic planning),
- f) have the possibility to use an external consultant for remuneration,
- g) comment on the appointment of an external consultant for remuneration if the management body in its supervisory function intends to use one,
- h) oversee the remuneration principles and their application, in particular should focus on the mechanism for taking into account all risks, liquidity and capital, and the consistency between the remuneration system and the long-term prudent management of the liable entity,
- i) inform the management body in its supervisory function and possibly also the general meeting of its activities.

4.3. Form and structure of remuneration*(quoted from the text of points 13 - 16 of Annex 1 of the Decree)*

13. The entitlement to a substantial portion (and in any event at least 40%) of the variable remuneration component shall be deferred over a period of at least the following three to five years; the length of the period shall be appropriately stipulated in consideration of the nature of the liable entity's business, the risks thereof and the activities of the selected employee concerned. The entitlement to a deferred portion of the variable remuneration component may not be granted earlier than on a pro-rata basis with respect to the total length of the period over which the granting of the entitlement to a substantial portion of the variable remuneration component has been deferred. If a portion of the variable remuneration component reaches an

¹⁶ Independence will be judged similarly to that of the members of the audit committee. See also Commission Recommendation 2005/162/EC of 15 February 2005.

extraordinarily large amount, the granting of the entitlement to not less than 60 % of the amount shall be deferred.

14. A substantial portion (and in any event at least 50% of a deferred portion and 50% of a non-deferred portion) of the variable remuneration component of the selected employee shall consist of an appropriate mix of
 - a) capital instruments or other assets depending on the liable entity's legal form, capital instrument-related instruments or, if the liable entity has issued no capital instruments admitted to trading on the regulated market, other non-cash instruments; and
 - b) where appropriate, instruments pursuant to Article 52 or Article 63 of the Regulation, or other instruments that can be fully converted to Common Equity Tier 1 capital instruments or written down, and that always adequately reflect the liable entity's credit quality, while taking into account the going concern principle of the liable entity on the financial market in conformity with its line and plan of business, and that are adequately usable for the purposes of the variable remuneration component.
15. The instruments pursuant to paragraph 14 above shall be deferred over an appropriate period pursuant to a liable entity's policy, so as to ensure that the motivation of the selected employees is aligned with the liable entity's long-term interests.
16. The instruments pursuant to paragraph 14 above issued by a liable entity, or by a person with close links, shall not be automatically regarded as instruments adequately reflecting the liable entity's credit quality, while taking into account the going concern principle of the liable entity on the financial market in conformity with its line and plan of business, unless the liable entity is able to demonstrate otherwise.

4.3.1. **The liable entity will defer entitlement** to at least 40% of variable remuneration (60% in case of extremely high amounts) under point 13 of Annex 1 of the Decree. The award of the deferred part is spread over the deferral/vesting period, which begins with the award of the non-deferred part of the variable remuneration (upfront part) and ends with the award of the last part of the deferred remuneration. The deferral/vesting period will be at least 3 years, sometimes at least 5 years, while for some employees (e.g., members of the management body in its managerial function) it should be even longer. The way the deferred remuneration is spread over the deferral/vesting period is important. The liable entity will not award the deferred part faster than on a pro-rata basis, i.e., evenly throughout the deferral/vesting period, and will not award part of the deferred remuneration earlier than one year from the award of the upfront part of the variable remuneration component or the previous part of the deferred remuneration. Thus, if the deferral/vesting period is 3 years, then the fastest possible method is that 1/3 of the deferred remuneration is awarded and paid each year (1/3, 1/3, 1/3). It is also possible to award it in a slower manner, e.g., 0, 1/3, 2/3 or 0, 0, 3/3. The deferral scheme is thus defined through (i) the deferral/vesting period, (ii) the part of the variable remuneration component that is deferred, (iii) the speed and manner in which the deferred part of the remuneration is awarded, (iv) the time span between the award of the upfront part of the variable remuneration component and the award of the first part of the deferred remuneration (v) instruments through which the deferred remuneration is awarded (see point 14 of Annex 1 of the Decree). The liable entity may configure these elements of the system differently so that the strict application of one of the parts justifies the more lenient application of another.

4.3.2. Under point 14 of Annex 1 of the Decree, a liable entity reports at least 50% of deferred remuneration and at least 50% of the upfront part of the variable component of the remuneration in **non-cash instruments that appropriately reflect the credit quality of the liable entity**. A liable entity whose equity instruments are admitted for trading on a public market (typically a regulated market) should choose a suitable combination of the group of instruments referred to in point 14 a) of Annex 1 of the Decree, i.e., equity instruments, other assets (shares, interim certificates, vouchers for shares), other instruments whose price is connected to the value of shares on the market (options and other derivatives) and, if appropriate, group b), i.e., other instruments

issued under the Commission Regulation ¹⁷ [i.e., instruments under 14 b) of Annex 1 of the Decree]. **A liable entity whose equity instruments not are admitted for trading on a public market** may also use similar non-cash instruments, for example investment certificates or so-called *phantom plans*, where the price of the instruments is stipulated through expert assessment by a third party. A liable entity should evaluate the non-cash instruments at the moment it stipulates the appropriate amount of non-cash instruments for an employee for the evaluation period. The development of the price of non-cash instruments on the market (during the deferral/vesting period and the retention period) is then understood to be implicit *ex post* risk adjustment¹⁸.

4.3.3. A liable entity will stipulate, according to the last sentence of point 15 of Annex 1 of the Decree - for the different types of instruments and groups of employees - the principles for the retention policy, i.e., the obligation to retain non-cash instruments for a certain time under certain conditions. In this retention period the employee is already the owner of the instruments (his claim has already been recognized), but his disposal right to the instruments is limited. The principles should set a minimum length for the retention period in the event of non-cash instruments granted in the upfront part of the variable remuneration component (e.g., 1.5 years) and the instruments granted within the framework of the deferral/vesting period (e.g., 1 year). The retention period should take into account other related elements of the remuneration system, particularly the length of the evaluation period and the deferral/vesting period. For example, if performance is evaluated on a multi-annual basis, the deferral/vesting period is five years or more and the risks from the employee's activities are not longer-term, the liable entity may also choose a shorter retention period. It is however recommended that the retention period is longer for members of bodies.

4.3.4. The rules indicated above for the deferral/vesting period and the structure of remuneration are demonstrated in examples in the conclusion to this Annex. Example 1 outlines which options a liable entity can choose when awarding remuneration. The time line for awarding and a graphical representation of each part of the remuneration is illustrated in Fig. 1. Example 2 shows the remuneration of an employee over several consecutive years.

4.4. *Limitations on the variable remuneration component*

(quoted from the text of points 17 - 20 of Annex 1 of the Decree)

17. The entitlement to the variable remuneration component, or to any portion thereof, shall only be granted, if it is sustainable with regard to the overall financial situation of the liable entity and justified by the performance of the section concerned and of the selected employee concerned. Otherwise, no entitlement shall be granted, or it shall be granted to a limited extent only.
18. A liable entity shall implement measures that will allow it to withdraw the already granted variable remuneration component, or any portion thereof, and to demand a refund of the already paid out variable remuneration component; the foregoing shall be without prejudice to the provisions of other legal regulations.
19. In the event of unfavourable financial performance or of its setback, the total variable remuneration component shall be considerably reduced, including the application of the measures pursuant to paragraphs 17 and 18 above, both in respect of the current remuneration and in respect of the remuneration for previous periods.

¹⁷ Commission Delegated Regulation (EU) No 527/2014 of 12 March 2014 supplementing Directive (EU) No 2013/36/EU of the European Parliament and of the Council with regard to regulatory technical standards specifying the classes of instruments that adequately reflect the credit quality of an institution as a going concern and are appropriate to be used for the purposes of variable remuneration.

¹⁸ This is the only case that can result in a subsequent increase in the variable component of remuneration.

20. A liable entity shall stipulate specific criteria for the application of a system of not granting the entitlement to remuneration in part or in its entirety, and of demanding a refund of the already paid out remuneration. In particular, such criteria shall apply to situations where the selected employee
- a) was involved in or accountable for an act that has resulted in significant losses for the liable entity; and
 - b) failed to meet adequate standards in terms of trustworthiness, professional qualifications and experience.

4.4.1. To ensure that the remuneration fully reflects the risks, it is necessary that the liable entity reassesses the performance of the employee and the relevant determined remuneration after a certain period of time (back-testing) to take into account the evolution of risks. For this purpose, the liable entity will introduce *ex post* risk adjustment tools, which will complement the previously conducted *ex ante* risk adjustment in accordance with point 9 of Annex 1 of the Decree. The main forms of *ex post* risk adjustment are measures in accordance with point 17 (*malus*) and 18 (*claw back*) of Annex 1 of the Decree, which can be used for the variable remuneration component irrespective of in what form it was or should be granted. The aim of these measures is to ensure that the liable entity may minimize costs for the remuneration of employees and have the opportunity to strengthen capital if its financial performance and credit quality are unfavorable.

4.4.2. The **malus institute** allows the variable remuneration component to be granted partially, or not to be granted at all. If, for example, the liable entity arranges with the employee or stipulates the criteria for the assessment of the variable remuneration component (see point 9 of Annex 1 of the Decree), it will add positive financial performance by the institution, section or other specific circumstances¹⁹ as an additional condition for entitlement to the variable remuneration amount thus assessed. The incorporation of these cases into the conditions for the variable remuneration component will allow the liable entity (in cases selected by itself) to not grant the variable remuneration component to employees²⁰.

4.4.3. The **claw back institute** provides the liable entity with another option to reduce remuneration, because this tool can also affect the variable remuneration component that has already been granted. The liable entity will implement the provisions of point 13 of Annex 1 of the Decree through for example the supplementation of legal clauses into contracts with employees. The liable entity may select the conditions for the implementation of these clauses at its discretion²¹. The liable entity will apply this tool only in cases where it is not inconsistent with the mandatory provisions of another law. Proportionality at the level of the individual principles indicates that if it is not possible to apply the *claw back* tool for any employee, the liable entity should more thoroughly apply the principles under points 13 and 14 of Annex 1 of the Decree.

4.4.4. If the liable entity finds that the results are better than expected, i.e., certain risks included in the *ex ante* or *ex post* risk adjustment do not appear, it cannot increase the variable component of the remuneration retrospectively.

¹⁹ A liable entity may link *malus* to an error or serious misconduct by an employee, the discovery of errors in risk management, the termination of the relationship with the employee and so on.

²⁰ The CNB considers the *malus* tool to be adequate for almost all Obligated Entities. A liable entity would therefore have to very carefully justify any eventual non-application of this tool.

²¹ The conditions for the application of the *claw back* tool can be e.g., the assessment of the variable part of the remuneration on the basis of incorrect information, an employee has committed a serious error, fraud, or breached internal or external regulations, there was a significant fall in the value of the closed positions, etc.

Example 1

Let us assume that the liable entity, according to its principles and procedures for remuneration:

- stipulates for a certain group of employees a maximum ratio between the fixed and variable components of 1:1 (*according to point 10 this should be a properly balanced ratio, the liable entity itself stipulates it within specified limits*)
- arranges with employee XY a fixed salary component of 1200 units (*the fixed remuneration component must be high enough to allow for the variable component not being granted at all - point 10*)
- on the basis of the criteria it assess for employee XY a variable component of 1000 units (*the criteria must be in accordance with point 9*)
- it defers the entitlement to 60% of the variable remuneration component, since it is a high volume variable component (*minimum according to point 13*)
- it sets a 3-year period (*vesting period*) over which the granting of the entitlement to the deferred portion of the variable component is spread (*minimum according to point 13*)
- of the part that is not deferred (*upfront*), it grants 50% in cash (*maximum according to point 14*)
it grants 50% of the deferred component in cash (*maximum according to point 14*)

Fixed remuneration component	1200 units	
Variable remuneration component	1000 units	
<i>of which:</i>		
40% granted immediately (<i>upfront</i>)	400 units	
<i>of which:</i>		
50% in cash		200 units
50% in non-cash instruments		200 units
deferred	600 units	
<i>of which:</i>		
50% in cash		300 units
50% in non-cash instruments		300 units

For the above tasks it is possible to find many options for granting the variable component, while some of them are listed below as examples. The selection of the specific option is made by the liable entity, in accordance with the principles and procedures that the liable entity applies (the regulation does not prescribe any of the options).

A) the liable entity selects the method of granting the variable component - evenly

Some of the possible options:

(i) see fig. 1

The year in which the assessment is performed	Remuneration components	The years in which the remuneration is granted (values in units)			
		2014	2015	2016	2017
2014	Fixed	1200			
	Variable cash upfront	200			
	Variable non-cash upfront	200			
	Variable cash deferred		100	100	100
	Variable non-cash deferred		100	100	100

(ii)

The year in which the assessment is performed	Remuneration components	The years in which the remuneration is granted (values in units)			
		2014	2015	2016	2017
2014	Fixed	1200			
	Variable cash upfront	200			
	Variable non-cash upfront	200			
	Variable cash deferred		200	100	
	Variable non-cash deferred			100	200

B) the liable entity selects the method of granting the variable component - gradually*Some of the possible options:*

(i)

The year in which the assessment is performed	Remuneration components	The years in which the remuneration is granted (values in units)			
		2014	2015	2016	2017
2014	Fixed	1200			
	Variable cash upfront	200			
	Variable non-cash upfront	200			
	Variable cash deferred		100	200	
	Variable non-cash deferred				300

(ii)

The year in which the assessment is performed	Remuneration components	The years in which the remuneration is granted (values in units)			
		2014	2015	2016	2017
2014	Fixed	1200			
	Variable cash upfront	200			
	Variable non-cash upfront	200			
	Variable cash deferred		50	100	150
	Variable non-cash deferred		50	100	150

C) the liable entity selects the method of granting the variable component - everything in the last year

In this method for granting, there is only one option

The year in which the assessment is performed	Remuneration components	The years in which the remuneration is granted (values in units)			
		2014	2015	2016	2017
2014	Fixed	1200			
	Variable cash upfront	200			
	Variable non-cash upfront	200			
	Variable cash deferred				300
	Variable non-cash deferred				300

note:

- *the fields marked in gray represent non-cash instruments; the employee would have to hold them for a certain period, respectively not dispose of them (the retention period is not stipulated through regulation and depends on the choice of the liable entity).*

Fig. 1
 Graphical representation of the system for granting remuneration - see example 1 letter A, i.e., uniform granting of deferred remuneration, option (i)



