

**OFFICIAL INFORMATION
OF THE CZECH NATIONAL BANK**
of 22 December 2010

regarding the pursuit of business in the financial market by banks, credit unions
and investment firms

Remuneration

I. Scope and Purpose

1. This Official Information¹ contains information on the requirements for the remuneration of employees of banks, savings and credit unions and investment firms (hereinafter the “liable entity”).
2. The Czech National Bank aims to provide substantive explications and other information regarding more detailed definition of some of the requirements for remuneration contained in Annex 1a to Decree No. 123/2007 Coll., stipulating the prudential rules for banks, savings and credit unions and investment firms, as amended (hereinafter the “Decree”).

II. Assumptions, Objectives, Principles

3. The Czech National Bank's regulation is based on the applicable legal regulations and the relevant documents of both European and international organisations², particularly the recommendations on remuneration issued by the Committee of European Banking Supervisors (CEBS)³.
4. The regulation in the field of remuneration aims to ensure compliance of remuneration procedures with efficient risk management. For this purpose, the liable entity shall introduce a remuneration system that does not motivate employees to take excessive risks, is in accordance with the long-term interests of the liable entity, prevents conflicts of interests and guarantees that remunerations do not limit the ability of the liable entity to strengthen its capital base. Remuneration principles form part of the requirements for a governance system.
5. In addition to the employees whose professional activities have a material impact on the risk profile of the liable entity, the basic remuneration principles shall be applied to all other employees of the liable entity, too.
6. While supervising compliance with the applicable provisions, the Czech National Bank acts individually, taking into account the specific conditions of the focus and arrangement of the conduct of business by the liable entity. With respect to liable entities, the principle

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

² Consultative document: Range of Methodologies for Risk and Performance Alignment of Remuneration, Basel Committee on Banking Supervision (BCBS), 2010; FSB Principles for Sound Compensation Practices, Financial Stability Board (FSB), including the implementing methodologies, 2009; Compensation Principles and Standards Assessment Methodology, BCBS, 2010; Commission Recommendations 2004/913/EC, 2005/162/EC and 2009/385/EC; High-level Principles for Remuneration Policies, CEBS, 2009.

³ Guidelines on Remuneration Policies and Practices, CEBS, 2010.

of proportionality is applied (i.e., principles are applied in various manners and to various extents, taking into account the size, organisational arrangement, nature, scope and complexity of business of the liable entity).

7. Should the remuneration principles or specific remuneration procedures of the liable entity not be in accordance with the regulation in the field of remuneration, the Czech National Bank may impose qualitative and quantitative remedial measures on the liable entity. Priority shall be given to qualitative remedial measures, including, in particular, a possibility to demand a reduction in the amount of risks arising from the activities, products and systems of the liable entity, an implementation of changes to the remuneration structures or a possibility to demand the liable entity to limit the variable remuneration components to a specific percentage of its overall net profit. Quantitative remedial measures shall mean, in particular, additional capital requirements based on the evaluation of the fact whether the arrangements, strategies, procedures and mechanisms introduced by the liable entity and the capital of the liable entity ensure a secure and reliable conduct of business by the liable entity.

III. Final Provisions

8. Explication of more detailed definition of the requirements for remuneration is contained in the Annex to this Official Information.
9. This Official Information shall be followed from 1 January 2011.

Vice-Governor:

prof. PhDr. Ing. Vladimír Tomšík, Ph.D., signed

Annex:

Explication of more detailed definition of the requirements for remuneration

Financial Market Regulation and Analysis Department

Responsible:

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1. Scope

(quotation of the text of paragraph 1 of Annex. 1a to the Decree)

1. Remuneration principles and procedures shall be applied:
- a) to an employee's salary, reward and other analogous forms of income that may be regarded as remuneration (hereinafter "remuneration");
 - b) to selected groups of employees whose activities have a material impact on the risk profile of the liable entity, particularly including
 1. members of the bodies (executive and non-executive directors);
 2. senior management employees;
 3. employees responsible for independent control functions, particularly the employees responsible for risk management, compliance or internal audit;
 4. employees or groups of employees whose activities are associated with the risk taking of the liable entity (hereinafter "risk takers"); and
 5. other employees whose remuneration is analogous to that of the employees referred to under items 2 and 4 above;
 - c) in the manner and to the extent that takes into account the size, internal organisation, nature, scope and complexity of business of the liable entity.

1.1. The remuneration system of the liable entity shall be in accordance with Annex 1a to the Decree **both on an individual and a consolidated basis**. The remuneration principles of a group shall be applied to all entities within the regulated consolidated group. Group-wide remuneration principles shall also reflect the different obligations of the entities within the regulated consolidated group resulting from their particular location and nature of business.

1.2. Pursuant to Article 2(6) of the Decree, the reference to an **employee shall be understood** as a reference to a person being in the labour-law relation or another analogous relation to the liable entity, or to a person who is a member of a body of the liable entity. In accordance with paragraph 16 of Annex 1a to the Decree, the reference to an employee shall also be understood as a reference to any other person who has actually been performing activities for the liable entity on a long-term basis, irrespective of the formal legal relations, if this should circumvent the purpose of the regulation.⁴

1.3. The reference to **remuneration shall be understood** as a salary (under an employment contract), reward (under a contract of mandate) and other analogous forms of direct or indirect income of an employee in relation to his/her professional activities performed for the liable entity. The remuneration shall be divided into a fixed component and a variable component, the amount of which typically depends on an employee's fulfilment of certain criteria. Remuneration can take various forms, some of which may be excluded from the application of the rules for remuneration, if they are provided in compliance with general all-company principles and do not motivate employees to take risks⁵.

1.4. The understanding of the terms "employee" and "remuneration" is closely connected with paragraph 16 of Annex 1a to the Decree, which emphasises that the variable remuneration component shall not be paid out in instruments or in any form allowing for a circumvention of the requirements of the Decree. The interpretation of circumvention would include, for instance, special-purpose utilization of off-shore centres⁶ or, as the

⁴ Thus, an employee subject to regulation in the field of remuneration is, for instance, also an employee of the parent company who performs activities for the liable entity. Special attention shall also be paid to the outsourcing of such professional activities that may expose the liable entity to considerable risk.

⁵ Directive 2010/76/EC of the European Parliament and of the Council of 24 November 2010 amending Directives 2006/48/EC and 2006/49/EC as regards capital requirements for the trading book and for re-recruitments and the supervisory review of remuneration policies (CRD III) explicitly demonstrates this rule in relation to contractual pension benefits, which shall be understood as increased pension benefits granted to an employee at the discretion of the liable entity as part of the employee's variable remuneration. Such benefits do not include any amounts guaranteed to an employee pursuant to the pension schemes of the liable entity.

⁶ These are countries (also referred to as so-called "tax havens") where the income tax is collected in the form of a flat amount, irrespective of the current earnings/revenues of a company. Further, the publicly accessible

case may be, formal employing of employees of the liable entity in a non-regulated institution, including those situated in off-shore centres, some of the instances of the utilization of outsourcing mechanisms, or transformation of variable remuneration components into non-monetary benefits not falling under the definition of the term “remuneration”.

- 1.5. The **remuneration rules** pursuant to Annex 1a to the Decree fully **apply** to a specific group of employees whose activities have a material impact on the risk profile of the liable entity. The liable entity shall itself determine suitable criteria to assess the significance of particular employees’ impact on its risk profile and identify all employees concerned. In accordance with Article 13(4) of the Decree, the principles for the specific group of employees shall be approved and evaluated by the supervisory body.
- 1.6. Some of the basic principles (the principles referred to in paragraphs 2 to 5, 16 and 18 to 20 of Annex 1a to the Decree) shall be applied by the liable entity to all other employees, too. This requirement follows from Article 15(3) of the Decree, where an obligation is imposed on the board of directors to stipulate detailed principles for the management of human resources, including the principles for the selection, remuneration, evaluation and motivation of employees in accordance with the remuneration system approved by the supervisory body.
- 1.7. Paragraph 1(c) of Annex 1a to the Decree emphasises the **principle of proportionality**⁷. In justified cases, the principles referred to in paragraphs 6, 10 and 11 of Annex 1a to the Decree do not have to be applied at all. However, the decision not to apply these principles shall be properly justified by the liable entity (the “comply or explain” principle).
- 1.8. Proportionality can apply **at the level of institutions**, taking into account the size (e.g. value of assets and liabilities, risk exposure, number of employees, number of branches, share in the financial system of a Member State and of the European Union), organisational arrangements (e.g. legal form, listing), nature, scope and complexity of business of the liable entity (e.g. type of activities performed, customer base, share of risky activities in overall activities, international operations, stability, measurability and predictability of the riskiness of activities, time horizon and importance of risks, utilization of internal models to calculate capital requirements, comprehensiveness of products offered).
- 1.9. Proportionality also applies **at the level of employees** where, in addition to the aforesaid criteria, the position of an employee within the organisational structure of the liable entity, size of obligation that an employee is allowed to undertake on behalf of the institution, number of other employees with a material impact on the risk profile within the group, business model, total amount of an employee’s remuneration, etc. are taken into account, too. Thus, the liable entity may prescribe entirely different rules for some groups of employees.
- 1.10. Proportionality also works **at the level of individual principles**. Strict implementation of some principles may justify a more moderate or less sophisticated application of other principles⁸. Thus, the remuneration principles cannot be viewed separately, but the entire

registers usually do not contain any information about the owners of a company. For more details visit <http://www.imf.org/external/np/ofca/ofca.asp>.

⁷ The general principle of proportionality is expressed in Article 8 of the Decree (“the liable entity shall comply with the requirements for a management and control system with regard to its size, manner of management, number of employees, nature, scope and complexity of the business it conducts or intends to conduct, while taking into account the development of the environment in which the given person conducts business, including the development in the field of proper corporate governance”).

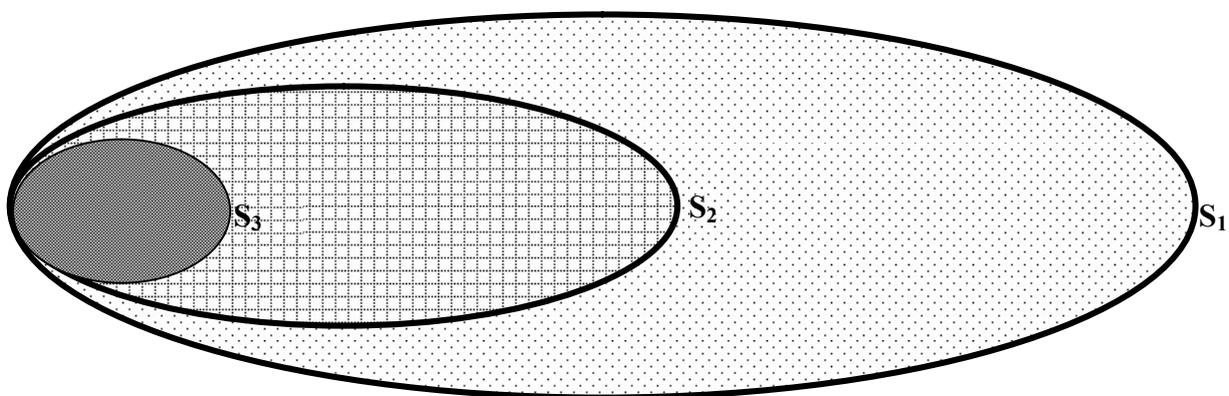
⁸ The liable entity who, for instance, consistently applies the principles referred to in paragraph 7 (c) and (d) of Annex 1a to the Decree (i.e., *ex ante* risk adjustment) no longer has to be so careful in applying the rule referred to in paragraph 10 of Annex 1a to the Decree (i.e., deferral of remuneration). Another example of this type of

context must be assessed, taking into account the comprehensive functioning of the whole system.

1.11. The aforementioned description of the scope of remuneration principles implies that the principles can be divided into:

- **basic principles** (Group I) – shall be applied by all liable entities to all employees (see S₁ in Fig. 1);
- **specific principles which**
 - **must be applied** (Group II) – shall be applied by all liable entities to all employees with a material impact on the risk profile of the liable entity (see S₂ in Fig. 1); and
 - **do not have to be applied** (Group III) – shall be applied only by some liable entities and only to some of the employees with a material impact on the risk profile of the liable entity (see S₃ in Fig. 1).

Fig. 1 – Application of remuneration principles to employees of the liable entity



GROUP I – Basic remuneration principles

All liable entities shall comply with the basic principles in respect of all employees.

It is typical of these remuneration principles that they determine the fundamental objectives of regulation in the field of remuneration and provide the liable entity with room to assess its situation itself and to implement the principles in an appropriate and proportionate manner.

2. General remuneration principles

(quotation of the text of paragraph 2 of Annex 1a to the Decree)

2. Remuneration principles and procedures shall:

- a) be consistent with and promote sound and effective risk management;
- b) not encourage risk-taking that exceeds the degree of risk accepted by the liable entity;
- c) be in line with the business strategy, objectives, values and long-term interests of the liable entity;
- d) include measures to avoid conflicts of interests in relation to remuneration; and
- e) ensure that the total variable remuneration does not limit the ability of the liable entity to strengthen its capital base.

2.1. The aforementioned remuneration principles represent the main objectives of regulation. Thus, with respect to no employee shall the liable entity select a remuneration scheme contradicting these objectives.

proportionality is shown by the relationship between the length of the evaluated period and the length of the deferral period, where a shorter evaluated period implies a longer deferral period, and vice versa.

- 2.2. The norm contained in paragraph 2 (e) of Annex 1a to the Decree is of key importance as it is aimed to support the long-term stability of liable entities. The liable entity should make sure that the determination, granting or payment of remunerations does not reduce its ability to strengthen the capital base.

3. Selected prerequisites for and the arrangement of a remuneration system

(quotation of the text of paragraph 5 (first sentence) of Annex 1a to the Decree)

5. (first sentence) Staff engaged in control functions are independent from the business units they oversee, have appropriate authority, and are remunerated in accordance with the achievement of the objectives linked to their functions, independent of the performance of the business areas they control;

3.1. The liable entity should remunerate members of the supervisory body solely by means of a fixed remuneration component (i.e., free of any motivating mechanisms). Only exceptionally may the liable entity also use a variable remuneration component in relation to supervisory tasks. If the liable entity also remunerates members of the supervisory body by means of non-monetary instruments, such instruments should be retained (see paragraph 11 of Annex 1a to the Decree) till the end of their mandates⁹.

3.2. Employees discharging internal control functions (risk management, compliance and internal audit, in particular) shall be remunerated by the liable entity mainly by means of a fixed remuneration component. Potential variable remuneration components shall be related to control tasks and independent of the performance of the departments controlled.

4. Prevention of potential circumvention of the purpose of regulation in the field of remuneration

(quotation of the text of paragraphs 16 to 19 of Annex 1a to the Decree)

16. The variable remuneration is not paid through vehicles or methods that facilitate avoidance of the requirements of this Decree or of other legal regulations. 18. Guaranteed variable remuneration is exceptional and occurs only in the context of hiring new staff and is limited to the first year. 19. Payments related to the early termination of a contract reflect performance achieved over time and are designed in a way that does not reward failure.

4.1. The liable entity shall not pay out remuneration in such instruments or in any form allowing for **circumvention of the requirements for remuneration** (see paragraph 1.4 of this Annex).

4.2. The reference to a **guaranteed variable remuneration component** shall be understood as a reference to any guaranteed remunerations, commencing remunerations, guaranteed minimum amounts of the variable remuneration component, etc. An exception to the general ban on guaranteed remunerations is formed by remunerations for new employees for a period of one year¹⁰, contractual severance payments and remunerations aimed to motivate employees in exceptional situations (e.g. an approaching merger) to continue the performance of their activities for the liable entity. Contractual severance payments (so-called “golden parachutes”) are contractual stipulations relating to the length of the notice period, non-competition clause or termination of an employment relation by the liable entity (e.g. an altered strategy of the liable entity, merger, takeover, etc.). The liable entity should stipulate the procedure and criteria for the determination and approval of severance payments.

5. Special provisions on remuneration in the case of public support

(quotation of the text of paragraph 20 of Annex 1a to the Decree)

20. In the case of a liable entity that benefits from exceptional government intervention: a) variable remuneration is strictly limited as a percentage of net revenues when it is inconsistent with the maintenance of a sound capital base and timely exit from government support;
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⁹ Providing that the liable entity complies with these principles, it no longer has to apply the specific remuneration principles (see the principles of Group II and Group III) to members of the supervisory body.

¹⁰ However, an employee who has changed his/her position within the same liable entity shall not be regarded as a new employee.

- b) the relevant competent authorities shall require the liable entity to restructure compensation in a manner aligned with sound risk management and long-term growth, including, where appropriate, establishing limits to the remuneration of directors; and
- c) no variable remuneration should be paid to the directors of that liable entity unless this is justified.

5.1. An example of a variable remuneration component justified granting is represented, for instance, by the hiring of new employees for the purpose of leading the liable entity out of problems.

GROUP II – Specific remuneration principles which must be applied at least to selected employees

All liable entities shall apply the specific remuneration principles at least to a specific group of employees [pursuant to paragraph 1 (b) of Annex 1a to the Decree] whose activities have a material impact on the risk profile of the liable entity¹¹. This requirement is considered to be the basic precondition for the applicability of the specific principles, while the list of persons in paragraph 1 (b) of Annex 1a to the Decree is regarded as demonstrative only¹². **The liable entity shall determine suitable criteria to assess the significance of an employee's impact on its risk profile, and shall identify the employees concerned.** Proportionality makes it possible for a less significant liable entity to indicate a smaller group of specific employees and to apply the principles to such employees in a proportionate (e.g. less sophisticated) manner.

6. Selected prerequisites for and arrangement of a remuneration system

(quotation of the text of paragraphs 3, 4 and 5 (second sentence) of Annex 1a to the Decree)

3. The supervisory body adopts and periodically reviews the general principles of the remuneration policy and is responsible for its implementation;
4. The implementation of the remuneration policy is, at least annually, subject to central and independent internal review for compliance with the policies and procedures for remuneration adopted by the supervisory body;
5. *(second sentence)* The remuneration of senior officers in risk management and compliance functions is directly overseen by the remuneration committee, if established (paragraph 6 below), or by the supervisory body.

6.1. The **supervisory body** should:

- determine and review the remuneration principles of the institution (cooperate with other functional units of the institution, particularly with internal control functions);
- determine and review the individual remunerations of members of the board of directors (unless the statutes or law reserve such decisions for a general meeting¹³);
- oversee the individual remunerations of the senior management, employees with the highest salaries and of key employees discharging internal control functions, and provide the board of directors with recommendations on their amounts and structure;
- oversee the individual remunerations of key employees discharging internal control

¹¹ An exception can be made solely in the case of asset managers, in respect of whom the liable entity does not have to apply the principle referred to in paragraph 8 of Annex 1a to the Decree at all and, while implementing paragraph 7 (c) of Annex 1a to the Decree, the liable entity may take into account the particularities of their activities.

¹² Thus, if an employee mentioned in any of the items of paragraph 1 (b) of Annex 1a to the Decree does not have a material impact on the overall risk profile, the liable entity shall not include him/her in the system of specific rules. For instance, if the general requirements for control functions pursuant to paragraph 5 of Annex 1a to the Decree are complied with in respect of members of the supervisory body and in respect of ordinary employees discharging control functions, the liable entity shall not be expected to include them in the specific remuneration system.

¹³ For instance, in the case of liable entities which are joint-stock companies, decisions about the remuneration of members of the board of directors are reserved for a general meeting directly by law [Article 187 (g) of the Commercial Code].

functions and provide the board of directors with recommendations on their remuneration, unless a remuneration committee is established (see Group III).

- 6.2. The functioning of remuneration principles (particularly compliance with the approved principles and plans), adequacy of remunerations with regard to the risk profile and the long-term objectives of the institution and compliance with national and international regulations and standards shall be subject to independent internal control. Smaller institutions may use outsourcing to perform such control, whereas more significant institutions shall ensure these activities by means of internal control functions, with potential support of external consultants. However, the adoption of remedial measures and the correct functioning of the system shall always be the responsibility of the supervisory body.

7. Measuring of performance in relation to remuneration

(quotation of the text of paragraph 7 of Annex 1a to the Decree)

7. Where remuneration is performance-related:
- a) the total amount of remuneration is 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 liable entity;
 - b) both financial as well as non-financial criteria are taken into account;
 - c) the assessment of performance is 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 performance-based components of remuneration is spread over a period which takes account of the underlying business cycle of the liable entity and its business risks; and
 - d) the measurement of performance used to calculate variable remuneration components or pools of variable remuneration components includes an adjustment for all types of current and future risks and takes into account the cost of the capital and the liquidity required.

- 7.1. In order to prevent excessive taking of risks, it is important for the variable remuneration component to be **adjusted for all related risks and costs** (i.e., current and future risks, balance and off-balance risks, risks taken by an employee, department or by the liable entity)¹⁴. If possible, the identification and qualification of risks at the level of the institution and organisational departments shall be based on an internal process for risk and capital adequacy assessment performed by the liable entity within the framework of an internal capital adequacy assessment system (hereinafter the “SVSK“, sometimes also “ICAAP”) and within the framework of an internal liquidity adequacy assessment system of the liable entity.

- 7.2. In order to **evaluate performance**, the liable entity should, in the first place, define the relevant objectives for the whole, for individual departments and individual employees or groups of employees, which shall be derived from the business strategy and the accepted degree of risk. Based on these objectives, the liable entity shall infer criteria for the evaluation of employee performance, which shall take long-term results into account and which the particular unit or employee shall have a chance to influence. The liable entity should always select some **financial (quantitative) criteria**, which shall include all of the risks, economic efficiency and take into account the relationship between revenues and the necessary capital (including the costs of the equity capital), and some **non-financial (qualitative) criteria** (e.g. achievement of strategic objectives, managerial capabilities, extent of cooperation with other departments and control functions, etc.). While evaluating performance, poor qualitative performance of a department or employee (particularly their unethical or objectionable behaviour) should outweigh even excellent quantitative performance, as a result of which the variable remuneration component should be reduced to a considerable extent. Performance shall be evaluated within an accrual period, which should cover at least one year’s time and take into account the

¹⁴ While performing risk adjustments, an appropriate combination of financial (quantitative) and non-financial (qualitative) criteria shall be applied. Even though the calculation of quantitative indicators may be transparent, it is often necessary to make a judgement-based adjustment to the result, or such adjustments need to be made already on entering the input data. The liable entity should plan in advance how to assess individual risks and how to subsequently keep records of the calculations and judgements used.

business cycle of the liable entity.

- 7.3. After the expiration of an accrual period, the resulting assessment of employees' performance shall be used to **determine remunerations**. In the first place, the liable entity should determine the total volume (pool) of funds reserved for remunerations and identify the risks at the level of the institution, departments and employees in order to ensure that the total volume of remunerations duly reflects the seriousness and length of the liable entity's exposure to all the risks. The total volume of remunerations should subsequently be allocated to particular employees on the basis of predetermined criteria covering all types of risks and costs¹⁵. Incorporation of risks into the determination of the variable remuneration component represents an *ex ante* risk adjustment.

8. Form and structure of remunerations

(quotation of the text of paragraphs 8 and 9 of Annex 1a to the Decree)

8. The fixed and variable components of the total remuneration are appropriately balanced; the fixed component represents a sufficiently high proportion of the total remuneration to allow the operation of a fully flexible policy on variable remuneration components, including the possibility to pay no variable remuneration component. Liable entities should set appropriate ratios between the fixed and the variable component of the total remuneration.
9. The allocation of the variable remuneration components within the liable entity shall also take into account all types of current and potential risks.

- 8.1. The aforesaid **fully flexible approach to the variable remuneration component** means that the liable entity may reduce the variable remuneration component, or decide not to grant it at all. This principle also implies that the fixed remuneration component should be sufficiently large in order to allow the liable entity not to grant the variable remuneration component at all in justified cases. The determination of the amount of the fixed remuneration components shall be subject to individual negotiation of the liable entity with the individual employee. However, the liable entity shall respect general remuneration principles (i.e., remuneration shall be tied to risks, remuneration shall form part of capital and liquidity planning, and be aimed to maintain the capital).
- 8.2. The **appropriate ratio of the fixed component to the variable component** differs for individual groups of employees. However, the fixed remuneration component and the variable remuneration component should always be clearly separated from each other. A consequence of a too small variable remuneration component may be that the liable entity will not be able to adequately reduce the overall amount of remuneration in an unfavourable financial situation. However, a too large variable remuneration component might also have a negative impact, should an excessive fulfilment of the performance criteria accelerate the risk taking. Therefore, in respect of certain groups of employees with a material impact on the risk profile of the liable entity, the liable entity should specify maximum ratios¹⁶ of the variable remuneration to the fixed remuneration.

9. Prevention of potential circumvention of the purpose of regulation in the field of remuneration

(quotation of the text of paragraph 17 of Annex 1a to the Decree)

17. The liable entity shall require employees to refrain from purchasing insurance policies or entering into hedging strategies related to their remuneration or responsibilities, as such steps might undermine the risk alignment effects embedded in their remuneration arrangements.

- 9.1. A specific example of circumvention of the purpose of regulation in the field of remuneration is given by **hedging strategies associated with remuneration**. The liable entity should therefore insist that its employees refrain from using such strategies (e.g. by

¹⁵ The calculation of the profitability of departments shall be based on the net result, which takes into account all direct and indirect costs of a department (e.g. costs of information technology, overhead costs, etc.). Since the liable entity's profits adjusted for risks should take into account all the costs and the required amount of capital (including the costs of the equity capital), all the costs of the liable entity shall be allocated to the appropriate departments.

¹⁶ This ratio should not correspond to the expected result, but rather to outstanding performance.

means of their prohibition in the ethical code or in some other internal regulation). However, the general rule prohibiting the application of insurance associated with remuneration does not prohibit insurance of private payments such as, for instance, mortgage instalments. The liable entity shall assess such cases on an individual basis.

10. Special pension benefits

(quotation of the text of paragraph 15 of Annex 1a to the Decree)

15. The pension policy is in line with the business strategy, objectives, values and long-term interests of the liable entity. Any contributions within the framework of employee pension insurance, supplementary pension insurance, pension insurance or contributions of an analogous nature and usual for employees of the liable entity shall not be regarded as special pension benefits. If the employee:
- a) leaves the liable entity before retirement, discretionary pension benefits should be held by the liable entity for a period of five years in the form of instruments as defined in paragraph 11 above;
 - b) reaches retirement, discretionary pension benefits should be paid to the employee in the form of instruments defined in paragraph 11 above, subject to a five year retention period.

10.1. Regulation in the field of remuneration deals with some specific situations separately. Like the other forms of remuneration, special pension benefits should be interrelated with the long-term interests of the liable entity (i.e., they should be granted and released to a leaving employee only with regard to the financial situation of the liable entity and to the risks taken by the employee while discharging his/her function). Thus, if the liable entity grants special pension benefits to employees with a material impact on the risk profile, it should do so in a form of non-monetary instruments pursuant to paragraph 11 of Annex 1a to the Decree, which shall be either deferred or retained for a certain period of time (see Group III).

GROUP III – Specific remuneration principles which do not have to be applied

These specific remuneration principles must be applied only by some liable entities and only to some of their employees whose activities have a material impact on the risk profile of the liable entity [paragraph 1 (b) of Annex 1a to the Decree].

Liable entities may decide not to apply some or all of the following principles. **However, doing so must be justified by every liable entity, with the exception of an investment firm pursuant to Articles 38 and 39 of the Decree** (the “comply or explain” principle).

After the liable entity determines whether to implement any of the following principles, it shall also define the appropriate group of employees to whom it shall apply the individual principles. The principle of proportionality makes it possible for less significant liable entities to identify a smaller group of such employees (i.e., to apply these principles, for instance, to members of the board of directors only).

Implementation of all of the following principles is regarded proportionate by the CNB for every liable entity with a significant market share, which is to be measured by the total balance sum for all liable entities. Any liable entity whose share exceeds 5 % shall always be regarded as a liable entity with a significant market share by the CNB.

11. Selected prerequisites for and arrangement of a remuneration system

(quotation of the text of paragraph 6 of Annex 1a to the Decree)

5. *(second sentence)* The remuneration of senior officers in the risk management and compliance functions is directly overseen by the remuneration committee, if established (paragraph 6 below), or by the supervisory body.
6. Liable entities that are significant in terms of their size, internal organisation and the nature, scope and complexity of their activities shall establish a remuneration committee. The remuneration committee shall be constituted in a way that makes it possible to exercise competent and independent judgment on remuneration policies and practices and the incentives created for managing risk, capital and liquidity.

The remuneration committee (if established) shall be responsible for the preparation of decisions regarding remuneration, including those which have implications for the risk and risk management of the liable entity concerned and which are to be taken by the supervisory body. When preparing such decisions, the remuneration committee shall take into account the long-term interests of shareholders, investors and other stakeholders in the liable entity.

- 11.1. Most of the remuneration committee members, including the chairman, should be independent of the liable entity¹⁷. At least one member of the remuneration committee should possess sufficient knowledge of and experience with the mechanism of how to interrelate remuneration with risk and capital management.
- 11.2. Within the framework of its activities, the remuneration committee should:
- a) support the supervisory body in the preparation of remuneration principles;
 - b) submit proposals regarding the remuneration of members of the board of directors to the supervisory body or to a general meeting;
 - c) oversee the individual remuneration of key employees discharging internal control functions and provide recommendations regarding their remuneration to the board of directors;
 - d) have access to the relevant information from the internal control functions and from the supervisory body;
 - e) cooperate with control functions, committees (e.g. the risk management committee, the audit committee) and other relevant departments (e.g. human resources, strategic planning);
 - f) have the option to use external advisors on remuneration;
 - g) give its opinion on the appointment of an external advisor on remuneration, if the supervisory body intends to use one;
 - h) oversee the remuneration principles and their application, particularly focusing on the mechanism for capturing all risks and liquidity and capital considerations and on the compliance of the remuneration system with the long-term prudent management of the liable entity; and
 - i) inform the supervisory body or, as the case may be, also a general meeting about its activities.

12. Form and structure of remuneration

(quotation of the text of paragraphs 10 and 11 of Annex 1a to the Decree)

10. A substantial portion, which is at least 40 % of the variable remuneration component, is deferred over a period which is not less than three to five years and is correctly aligned with the nature of the business, its risks and the activities of the member of staff in question. Remuneration payable under deferral arrangements shall vest no faster than on a pro-rata basis. In the case of a variable remuneration component of a particularly high amount, at least 60 % of the amount is deferred.
11. A substantial portion, which is at least 50 % of the deferred and non-deferred variable remuneration component, shall consist of an appropriately balanced mix of:
- a) shares or equivalent ownership interests or share-linked instruments of the liable entity, subject to the legal structure of the liable entity concerned, or share-linked instruments or equivalent non-cash instruments in the case of a non-listed liable entity, and,
 - b) where appropriate, instruments referred to in Article 63 (6) a) where these instruments adequately reflect the credit quality of the liable entity as a going concern.
- These financial instruments are subject to an appropriate retention policy designed by the liable entity to align employee incentives with its longer-term interests.

- 12.1. Pursuant to paragraph 10 of Annex 1a to the Decree, the **liable entity shall defer the granting of an entitlement** to at least 40 % of the variable remuneration component (60 % in the case of large amounts). The granting of the deferred part of the remuneration shall be distributed over a deferral period (vesting period) which begins with the granting of the non-deferred (upfront) part of the variable remuneration component and ends with the granting of the last part of the deferred remuneration. The deferral period shall take at least 3 years (sometimes at least 5 years), whereas for some employees (e.g. members of

¹⁷ Their independence shall be assessed in a manner analogous to the assessment of the independence of the audit committee members. See also Commission Recommendation 2005/162/EC of 15 February 2005.

the board of directors) it should take even longer. Important is the manner in which the deferred remuneration is distributed over the deferral period. The liable entity shall not grant the deferred part earlier than on a pro-rata basis (i.e., evenly over the length of the deferral period), and the parts of the deferred remuneration shall not be granted earlier than one year after the granting of the non-deferred part of the variable remuneration component or of the previous part of the deferred remuneration. Thus, if the deferral period is 3 years, the fastest way of granting shall be as follows: every year, 1/3 of the deferred remuneration shall be granted and paid out (1/3, 1/3, 1/3). However, it may also be granted more slowly, e.g. 0, 1/3, 2/3 or 0, 0, 3/3. The deferral pattern is thus defined (i) by the deferral period, (ii) by the deferred part of the variable remuneration component, (iii) by the pace and manner of the granting of the deferred part of the remuneration, (iv) by the interval between the granting of the non-deferred part of the variable remuneration component and the granting of the first part of the deferred remuneration, and (v) by the instruments in which the deferred remuneration is granted (see paragraph 11). The liable entity may set these elements of the system differently, so that a strict application of one part justifies a more moderate application of some other part.

12.2. Pursuant to paragraph 11 of Annex 1a to the Decree, the liable entity shall grant at least 50 % of the deferred remuneration and at least 50 % of the non-deferred part of the variable remuneration component in **non-monetary instruments** that properly reflect the credit quality of the liable entity¹⁸. A liable entity whose securities are admitted to trading in the public market (typically a regulated market) should select an appropriate combination of the group of instruments specified in sub-paragraph a) above, i.e., subscriber securities, analogous property values (shares, interim certificates, share warrants), other instruments the price of which shall be tied to the value of the share in the market (options and other derivatives) and, if appropriate, of the group of instruments specified in sub-paragraph b) above (i.e., hybrid capital instruments¹⁹). An liable entity whose securities are not admitted to trading in the public market may also use analogous non-monetary instruments such as, for instance, investment certificates or so-called “Phantom Plans”, where the price of such instruments shall be professionally assessed and determined by a third party. The liable entity should value the non-monetary instruments at the moment when it determines an appropriate quantity of non-monetary instruments to be provided to an employee for an accrual period. The evolution of the price of such non-monetary instruments in the market (in the course of the deferral period and retention period) shall then represent an implicit *ex post* risk adjustment²⁰.

12.3. Pursuant to paragraph 11 (last sentence) of Annex 1a to the Decree, the liable entity shall determine the principles for the retention of remunerations (retention policy) (i.e., the obligation to retain non-monetary instruments for a certain period of time under certain conditions) in respect of individual types of instruments and groups of employees. During this retention period, an employee is already the owner of such instruments (the entitlement has been granted to him/her already), but the employee’s right of disposal to such instruments is limited. The principles should stipulate the minimum length of the retention period in respect of the non-monetary instruments granted within the scope of the non-deferred part of the variable remuneration component (e.g. 1.5 years) and in respect of the instruments granted within the scope of the deferred remuneration (e.g. 1 year). The length of the retention period should take into account the other related elements of the remuneration system, particularly the length of the accrual period and of the deferral period. For instance, if performance is evaluated on a multiple-year basis, the

¹⁸ This condition implies, for instance, that the liable entity shall only remunerate its employees by means of instruments tied to the shares of the parent company, if its securities have not been admitted to trading in the public market and if using other below-described instruments would be inappropriate with regard to the size, organisational arrangement, nature, scope and complexity of its business.

¹⁹ Detailed Official Information of the Czech National Bank has been issued regarding hybrid capital instruments.

²⁰ This is the only instance where the variable remuneration component may be subsequently increased.

deferral period takes five or more years and the risks associated with an employee's activities are not of a longer-term nature, the liable entity may also select a shorter retention period. However, for members of the bodies, it is contrariwise recommended to ensure that the retention period is longer.

12.4. The aforementioned rules for the deferral and structure of remuneration are demonstrated in the following examples. Example 1 shows what options a liable entity can select while granting remuneration. The time line of granting and graphical representation of individual parts of remuneration is shown in Fig. 2. Example 2 shows the remuneration of an employee in several consecutive years.

13. Limitations on the variable remuneration component

(quotation of the text of paragraphs 12 to 14 of Annex 1a to the Decree)

12. The variable remuneration, including the deferred portion, is paid or vests only if it is sustainable according to the financial situation of the liable entity as a whole, and justified according to the performance of the liable entity, the business unit and the individual concerned. Otherwise, no entitlement shall be granted, or it shall be granted to a limited extent only (so-called “malus”).
13. The liable entity shall introduce measures allowing it to withdraw any already granted variable remuneration component, or any part thereof, and to demand repayment of any already paid out variable remuneration component (so-called “claw back”); this is without prejudice to the provisions of other legal regulations.
14. In the case of unfavourable financial performance or of its setback, the overall variable remuneration component shall be reduced to a considerable extent, including the application of measures pursuant to paragraphs 12 and 13 above, both in respect of the current remuneration and in respect of remunerations for previous periods.

13.1. In order to fully interrelate the remuneration with risks, it is necessary for the liable entity to re-evaluate (retrospectively test) the performance and the relevant determined remuneration after a certain period of time and to adjust it for any actually realized risks. For this purpose, the liable entity shall introduce *ex post* risk adjustment tools in order to supplement the previously carried out *ex ante* risk adjustment pursuant to paragraph 7 of Annex 1a to the Decree. The main forms of *ex post* risk adjustment are represented by the measures pursuant to paragraph 12 (so-called “malus”) and paragraph 13 (so-called “claw back”) of Annex 1a to the Decree, which may be applied to the variable remuneration component, irrespective of the fact in what form it has been or should be granted. The aim of such measures is to enable the liable entity in the case of unfavourable financial performance to minimize the cost of employee remuneration and to have a chance to strengthen the capital base.

13.2. The “**malus**” tool makes it possible for the liable entity to grant the variable remuneration component partially, or not to grant it at all. For instance, when the liable entity agrees with, or stipulates for, an employee certain criteria for the determination of the variable remuneration component (see paragraph 7 of Annex 1a to the Decree), the liable entity shall supplement these criteria with another precondition for the commencement of an employee's entitlement to thus determined amount of the variable remuneration component, namely favourable financial performance of the institution, department or some other specific circumstances²¹. Incorporation of such instances into the terms and conditions governing an employee's entitlement to the variable remuneration component will enable the liable entity (in cases selected by itself) not to grant the variable remuneration component to employees²².

13.3. The “**claw back**” tool provides the liable entity with further possibilities to reduce remunerations, as this tool can also be used to affect the variable remuneration that has already been granted. The provisions of paragraph 10 of Annex 1a to the Decree shall be implemented by the liable entity e.g. by means of supplementing the contracts with employees with certain legal clauses. The terms and conditions governing the realization

²¹ A liable entity may tie the application of the “malus” tool to a fault or serious misconduct of an employee, to the detection of errors in risk management, to the termination of its relationship with an employee, etc.

²² The CNB considers the “malus” tool appropriate for nearly all liable entities. Therefore, any non-application of this tool would have to be very strongly justified by the liable entity.

of such clauses may be defined by the liable entity at its discretion²³. This tool shall be applied by the liable entity solely in such cases where it does not contradict the mandatory provisions of another act. The principle of proportionality at the level of individual principles implies that, were it not possible to apply the “claw back” tool to any employee, the liable entity should more thoroughly apply the principles referred to in paragraphs 10 and 11 of Annex 1a to the Decree.

- 13.4. If the liable entity finds out that the results are better than expected (i.e., some of the risks included in *ex ante* or *ex post* risk adjustment were not realized), the variable remuneration component cannot be increased retrospectively.

²³ The preconditions for the application of the “claw back” tool may include, for instance, situations where the variable remuneration component has been determined on the basis of incorrect data, an employee has made a serious mistake or resorted to fraudulent behaviour or breached internal or external regulations, the value of the positions entered into by him/her has considerably decreased, etc.

Example 1

Let us assume that the liable entity in accordance with its remuneration principles and procedures:

- determines that the maximum ratio of the fixed component to the variable component for a certain group of employees shall be 1:1 (*pursuant to paragraph 8, it shall be an appropriately balanced ratio, which the liable entity shall determine itself*)
- agrees with employee XY that his/her fixed salary component shall amount to 1200 units (*the fixed remuneration component shall be sufficiently large in order to allow for the variable component not to be granted at all – paragraph 8*)
- based on criteria determines that the variable component for employee XY shall amount to 1000 units (*the criteria must be in accordance with paragraph 7*)
- defers the entitlement to 60 % of the variable remuneration component, since it is a large-volume variable component (*the minimum pursuant to paragraph 10*)
- determines a period of 3 years (vesting period) over which the granting of the entitlement to the deferred part of the variable component shall be distributed (*the minimum pursuant to paragraph 10*)
- grants 50 % of the non-deferred (upfront) part in money (*the maximum pursuant to paragraph 11*)
- grants 50 % of the deferred part in money (*the maximum pursuant to paragraph 11*)

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

For the aforementioned assignment, many different options can be found for the granting of the variable component, some of which are given below for illustration. A particular option shall be selected by the liable entity in accordance with the principles and procedures applied by the liable entity (the regulation does not prescribe any of the options).

A) The liable entity selects the manner of the granting of the variable component – evenly:

Some of the potential options:

(i) see Fig. 2

Year of evaluation	Remuneration components	Years when the remuneration is granted (values given in units)			
		2012	2013	2014	2015
2012	Fixed	1200			
	Variable cash upfront	200			
	Variable non-cash upfront	200			
	Variable cash deferred		100	100	100

	Variable non-cash deferred		100	100	100
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(ii)

Year of evaluation	Remuneration components	Years when the remuneration is granted (values given in units)			
		2012	2013	2014	2015
2012	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 manner of the granting of the variable component – gradually:

Some of the potential options:

(i)

Year of evaluation	Remuneration components	Years when the remuneration is granted (values given in units)			
		2012	2013	2014	2015
2012	Fixed	1200			
	Variable cash upfront	200			
	Variable non-cash upfront	200			
	Variable cash deferred		100	200	
	Variable non-cash deferred				300

(ii)

Year of evaluation	Remuneration components	Years when the remuneration is granted (values given in units)			
		2012	2013	2014	2015
2012	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 manner of the granting of the variable component – the whole amount comes in the last year:

There is one single option associated with this manner of granting:

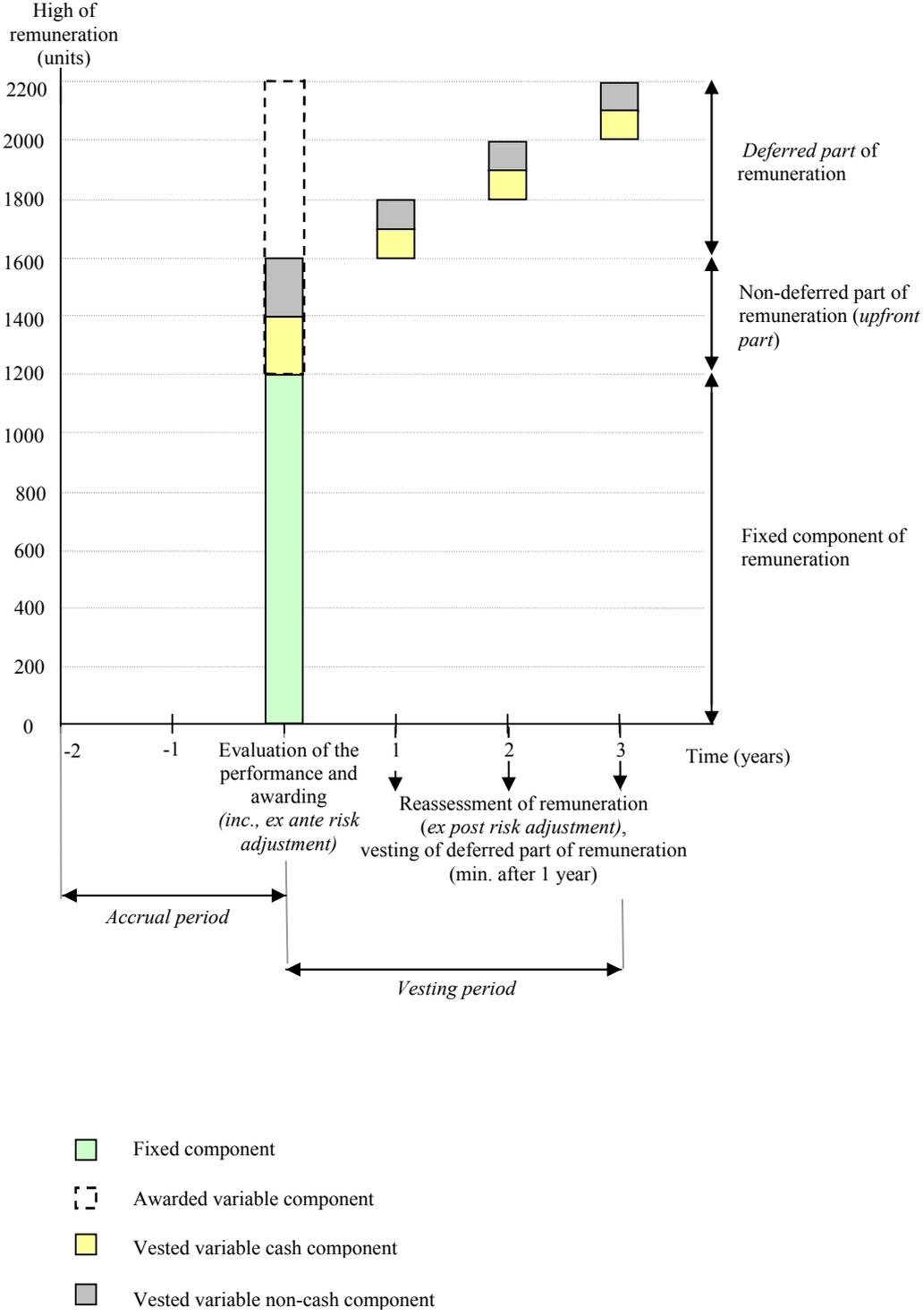
Year of evaluation	Remuneration components	Years when the remuneration is granted (values given in units)			
		2012	2013	2014	2015
2012	Fixed	1200			
	Variable cash upfront	200			
	Variable non-cash upfront	200			
	Variable cash deferred				300
	Variable non-cash deferred				300

Note:

- *Grey cells represent non-cash instruments; an employee should retain them (i.e. should not dispose of them) during the retention period, the length of which is not laid down by the regulation and its determination remains at the discretion of the liable entity.*

Fig. 2

A graphical illustration of the variable component granting process - see the assignment in Example 1, letter A, i.e. the granting of the variable component – evenly, option (i)



Example 2

One of possible remuneration schemes in the course of several consecutive years

Year of evaluation	Components	Years when the remuneration is granted (values given in units)							
		2012	2013	2014	2015	2016	2017	2018	2019
2012 Fixed =1000 u, Variable = 1000 u 60 % deferred Vesting - evenly	Fixed	1000							
	Variable cash upfront	200							
	Variable non-cash upfront	200							
	Variable cash deferred		200	100					
	Variable non-cash deferred			100	200				
2013 Fixed =1000 u, Variable = 250 u 40 % deferred Vesting - in the last year	Fixed		1000						
	Variable cash upfront		75						
	Variable non-cash upfront		75						
	Variable cash deferred								
	Variable non-cash deferred					100			
2014 Fixed =1000 u, Variable = 0 u Deferral - irrelevant Vesting - irrelevant	Fixed			1000					
	Variable cash upfront								
	Variable non-cash upfront								
	Variable cash deferred								
	Variable non-cash deferred								
2015 Fixed =1000 j, Variable = 2000 j 60 % deferred Vesting - gradually	Fixed				1000				
	Variable cash upfront				400				
	Variable non-cash upfront				400				
	Variable cash deferred					200	400		
	Variable non-cash deferred							600	
To be vested in cash		1200	1275	1100	1400	200	400	0	0
To be vested in non-cash		200	75	100	600	100	0	600	0

Note.: Grey cells illustrate non-cash instruments; an employee should retain them (i.e. should not dispose of them) during the retention period, the length of which is not laid down by the regulation and its determination remains at the discretion of the liable entity.