

MODULE	HC: High-Level Controls
CHAPTER	HC-2: Approved Persons Loyalty

HC-2.2 Personal Accountability (continued)

HC-2.2.6A [This Paragraph was moved to Paragraph HC-5.4.39]

HC-2.2.6B [This Paragraph was moved to Paragraph HC-5.4.40]

HC-2.2.7 For purposes of Paragraph HC-2.2.6, an approved person should be considered to have a “personal interest” in a transaction with a company if:

- (a) He himself; or
- (b) A member of his family (i.e. spouse, father, mother, sons, daughters, brothers or sisters); or
- (c) Another company of which he is a director or controller,

is a party to the transaction or has a material financial interest in the transaction. (Transactions and interests which are de minimis in value should not be included.)

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HC-5.1 Principle

HC-5.1.1 The conventional bank licensee must remunerate approved persons and material risk-takers fairly and responsibly.

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HC-5.2 Role of the Board of Directors and Remuneration Committee

HC-5.2.1A The board of directors must actively oversee the remuneration system's design and operation for approved persons as well as for material risk-takers. The CEO and senior management must not primarily control the remuneration system.

HC-5.2.1 The Board must establish a remuneration committee of at least three directors which must:

- (a) Review the conventional bank licensee's remuneration policies for the approved persons and material risk-takers, which must be approved by the shareholders and be consistent with the corporate values and strategy of the bank;
- (b) Approve remuneration policies and amounts for approved persons and material risk-takers, as well as the total variable remuneration to be distributed, taking account of total remuneration including salaries, expenses, bonuses and other employee benefits;
- (c) Approve, monitor and review the remuneration system to ensure the system operates as intended; and
- (d) Recommend Board member remuneration based on their attendance and performance and in compliance with Article 188 of the Company Law.

HC-5.2.1A In reviewing the remuneration system (see Subparagraph HC-5.2.1(c)), the remuneration committee should ensure that the system includes effective controls, including back testing and stress testing of the remuneration policy. The practical operation of the system should be regularly reviewed for compliance with regulations, internal policies and bank procedures. In addition, remuneration outcomes, risk measurements, and risk outcomes should be regularly reviewed by the Board for consistency with Board's approved risk appetite.

HC-5.2.1B Stress testing or stressed measures might be used by banks to help ex-ante risk adjustments take into account severe but plausible scenarios, based on possible expected loss on loans, as an example. Due to the uncertainty of payoffs, there will always be a need for ex-post adjustments so as to back-test actual performance against risk assumptions.

HC-5.2.1C As part of the duties noted under Paragraph HC-5.2.1, the remuneration committee must carefully evaluate practices by which remuneration is paid for potential future revenues whose timing and likelihood remain uncertain. It must demonstrate that its decisions are consistent with an assessment of the bank's financial condition and future prospects.

HC-5.2.2 The committee may be merged with the nominating committee.

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HC-5.3 Remuneration Committee Charter

HC-5.3.1 The committee must adopt a written charter which must, at a minimum, state the duties in Paragraph HC-5.2.1 and other matters in Appendix C of this Module.

HC-5.3.1A Members of the remuneration committee must have independence of any risk taking function or committees.

HC-5.3.2 The committee should include only independent directors or, alternatively, only non-executive directors of whom a majority are independent directors and the chairman is an independent director. This is consistent with international best practice and it recognises that the remuneration committee must exercise judgment free from personal career conflicts of interest.

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HC-5.4 Standard for all Remuneration

HC-5.4.1 **Remuneration of approved persons and material risk-takers must be sufficient enough to attract, retain and motivate persons of the quality needed to run the conventional bank licensee successfully, but the conventional bank licensee must avoid paying more than is necessary for that purpose.**

HC-5.4.2 **This Section applies for the remuneration of all approved persons and material risk-takers whose total annual remuneration (including all benefits) is in excess of BD100,000.**

HC-5.4.3 **All policies for performance-based incentives should be approved by the shareholders, but the approval should be only of the plan itself and not of the grant to specific individuals of benefits under the plan.**

Application to Overseas Conventional Banks

HC-5.4.4 **Banks operating as overseas conventional banks licensees in Bahrain must apply the most stringent set of remuneration rules to which they may be subject to. Such rules are:**

- (a)** **The requirements imposed in Bahrain with respect to remuneration as outlined in Volume 1 CBB Rulebook; and**
- (b)** **The requirements imposed by their home supervisor and head office.**

Application to Foreign Subsidiaries and Branches of Bahraini Conventional Banks

HC-5.4.5 **Head offices of Bahraini conventional bank licensees must ensure that their foreign subsidiaries and branches take steps so that the remuneration practices are compliant with the policy defined at the group level. Such steps must include ensuring compliance with local rules that apply to the remuneration schemes of their subsidiaries and branches.**

HC-5.4.6 **As noted in Sections AU-3.6 and BR-4A.3, the external auditor must undertake an annual review of the bank's compliance with the remuneration Rules outlined in this Chapter. The results of this review are to be submitted to the CBB within 3 months from the financial year end.**

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HC-5.4 Standard for all Remuneration (continued)

Approved Persons in Risk Management, Internal Audit, Operations, Financial Controls, AML and Compliance Functions

HC-5.4.7 The bank's approved persons engaged in risk management, internal audit, operations, financial controls, AML and compliance functions must be independent, have appropriate authority, and be remunerated in a manner that is independent of the business areas they oversee and commensurate with their key role in the bank. Effective independence and appropriate authority of such staff are necessary to preserve the integrity of financial risk and management's influence on incentive remuneration.

HC-5.4.8 The performance measures of approved persons referred to in Paragraph HC-5.4.7 must be based principally on the achievement of the objectives and targets of their functions.

HC-5.4.9 The mix of fixed and variable remuneration for risk management, internal audit, operations, financial controls, AML and compliance functions personnel must be weighted in favour of fixed remuneration.

Effective Alignment of Remuneration with Prudent Risk-Taking

HC-5.4.10 Remuneration must be adjusted for all types of risks.

HC-5.4.11 In relation to Paragraph HC-5.4.10, two employees who generate the same short-run profit but take different amounts of risk on behalf of their bank should not be treated the same by the remuneration system.

HC-5.4.12 Both quantitative measures and human judgement must play a role in determining risk adjustments.

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HC-5.4 Standard for all Remuneration (continued)

HC-5.4.13 Risk adjustments must account for all types of risk, including intangible and other risks such as reputation risk, liquidity risk and the cost of capital.

HC-5.4.14 Banks' remuneration policies and practices must be designed to reduce employees' incentives to take excessive and undue risk.

HC-5.4.15 Remuneration outcomes must be symmetric with risk outcomes.

HC-5.4.16 The mix of cash, equity and other forms of remuneration must be consistent with risk alignment. The mix will vary depending on the employee's position and role and the bank must be able to explain the rationale for its mix to the CBB.

HC-5.4.17 Existing contractual payments related to a termination of employment must be re-examined, and kept in place only if there is a clear basis for concluding that they are aligned with long-term value creation and prudent risk-taking. Prospectively, any such payments must be related to performance achieved over time and designed in a way that does not reward failure.

HC-5.4.18 Banks must ensure that their employees commit themselves not to use personal hedging strategies or remuneration- and liability-related insurance to undermine the risk alignment effects embedded in their remuneration arrangements. Banks must ensure that appropriate compliance mechanisms are in place to monitor their employees commitment in this regard such as signed adherence by staff to the bank's code of ethics which should include the conditions outlined in this Paragraph.

Variable Remuneration

HC-5.4.19 Remuneration systems must link the size of the bonus pool to the overall performance of the bank.

HC-5.4.20 Employees' incentive payments must be linked to the contribution of the individual and business to such performance.

HC-5.4.21 As profits and losses of different activities of a bank are realised over different periods of time, remuneration payout schedules must be sensitive to the time horizon of risks and variable remuneration must therefore be deferred accordingly. Variable remuneration must not be finalised over short periods where risks are realised over long periods.

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HC-5.4 Standard for all Remuneration (continued)

HC-5.4.22 Senior management of the bank must question payouts for income that cannot be realised or whose likelihood of realisation remains uncertain at the time of payout.

HC-5.4.23 Banks must ensure that total variable remuneration does not limit their ability to strengthen their capital base. The extent to which capital needs to be built up must be a function of a bank's current capital position and its ICAAP.

HC-5.4.24 The size of the variable remuneration pool and its allocation within the bank must take into account the full range of current and potential risks, including:

- (a)** The cost and quantity of capital required to support the risks taken;
- (b)** The cost and quantity of the liquidity risk assumed in the conduct of business; and
- (c)** Consistency of the liquidity risk assumed in the conduct of business.

HC-5.4.25 Paragraph HC-5.4.24 focuses on the overall size of the variable remuneration, at the overall bank level, in order to ensure that the recognition and accrual of variable remuneration will not compromise the financial soundness of the bank.

HC-5.4.26 Bonuses must diminish or be deferred in the event of poor bank, divisional or business unit performance.

HC-5.4.27 Subdued or negative financial performance of the bank should generally lead to a considerable contraction of the bank's total variable remuneration, taking into account both current remuneration and reductions in payouts of amounts previously earned, including through malus and clawback arrangements. Recognition of staff who have achieved their targets or better, may take place by way of deferred compensation, which may be paid once the bank's performance improves.

HC-5.4.28 In the event of negative contributions of the bank and/or relevant line of business in any year during the vesting period, any unvested portions are to be clawed back, subject to the realised performance of the bank and the business line.

HC-5.4.29 Accrual and deferral of variable remuneration does not oblige the bank to pay the variable remuneration, particularly when the anticipated outcome has not materialised or the bank's financial position does not support such payments.

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HC-5.4 Standard for all Remuneration (continued)

HC-5.4.30 For approved persons and material risk-takers as their actions have a material impact on the risk exposure of the bank:

- (a) A substantial proportion of remuneration must be variable and paid on the basis of individual, business-unit and bank-wide measures that adequately measure performance; and
- (b) The variable proportion of remuneration must increase significantly along with the level of seniority and/or responsibility.

HC-5.4.31 For purposes of Paragraph HC-5.4.30:

- (a) At least 40% of the variable remuneration must be payable under deferral arrangements over a period of at least 3 years; and
- (b) For the CEO, his deputies and the other 5 most highly paid business line employees, at least 60% of the variable remuneration must be deferred for at least 3 years.

HC-5.4.32 The deferral period referred to under Subparagraph HC-5.4.31(a) must be aligned with the nature of the business, its risks and the activities of the employee in question. Remuneration payable under deferral arrangements should generally vest no faster than on a pro rata basis.

HC-5.4.33 As a minimum, 50% of variable remuneration (including both the deferred and undeferred portions of the variable remuneration) must be awarded in shares or share-linked instruments or where appropriate, other non-cash instruments.

HC-5.4.34 The remaining portion (other than that mentioned under Paragraph HC-5.4.33) of the deferred remuneration can be paid as cash remuneration vested over a minimum 3-year period.

HC-5.4.35 Banks must not provide any form of guaranteed variable remuneration as part of the overall remuneration package.

Remuneration in the Form of Shares or Share-Linked Instruments

HC-5.4.36 Awards in shares or share-linked instruments must be subject to a minimum share retention policy of 3 years from the time the shares are awarded.

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HC-5.4 Standard for all Remuneration (continued)

HC-5.4.37 Where fixed or variable remuneration include common shares, banks must limit the shares awarded to an annual aggregate limit of 10% of the total issued shares outstanding of the bank, at all times.

HC-5.4.38 All share incentive plans must be approved by the shareholders.

Remuneration from Projects and Investments

HC-5.4.39 In reference to Paragraph HC-2.2.6, for greater certainty, approved persons are not allowed to take any benefits from any projects or investments which are managed by the conventional bank licensee or promoted to its customers or potential customers except for board related remuneration (declared as per Paragraph HC-2.4.1) linked to their fiduciary duties to the investors of the project/investment. This Rule applies to all approved persons including those appointed as members of the board of special purpose vehicles or other operating companies set up by the conventional bank licensee for projects or investments.

HC-5.4.40 The reference to benefits in Paragraph HC-5.4.39 includes commission, fees, shares, consideration in kind, or other remuneration or incentives in respect of the performance of the project or investment

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HC-5.5 Board of Directors' Remuneration

HC-5.5.1 Remuneration of non-executive directors must not include performance-related elements such as grants of shares, share options or other deferred stock-related incentive schemes, bonuses, or pension benefits.

HC-5.5.2 The Board of Directors' remuneration must be fixed so that total remuneration (excluding sitting fees) must not exceed 5% of the bank's net profit, after all the required deductions outlined in Article 188 of the Company Law, in any financial year.

HC-5.5.3 If a senior manager is also a director, his remuneration as a senior manager must take into account compensation received in his capacity as a director.

HC-5.5.4 In the years where the bank has not generated any profits it must comply with the approval requirements of Article 188 of the Company Law.

HC-5.5.5 In addition to the requirements of Article 188 of the Company Law, the articles of association regarding remuneration of the board of directors must be in line with the Rules outlined in this Chapter.

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HC-5.6 [This Section was deleted and is replaced with requirements contained under Section HC-5.4]