

## LT in Focus

# Changes in compensation systems of non-credit financial organizations: recommendations of the Bank of Russia

The Bank of Russia (CBR) has released the recommendations on compensation systems and compensation information disclosure in some non-credit financial organizations aiming to prevent the organizations from taking excessive risks and ensuring financial sustainability. The recommendations apply to non-state pension funds, management companies, professional participants of securities market and insurance companies.

In continuation of the effort aimed at regulating executive and risk taker compensation practices in the credit organizations (Bank of Russia Instruction No. 154-I of June 17, 2014), the CBR issued recommendations for streamlining compensation systems in non-credit financial organizations (Bank of Russia Information Letter No. IN-06-54/53 of 14 July 2016).

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### Organizations to which the recommendations apply

- Non-state pension funds; management companies of mutual funds, joint-stock investment funds and non-state investment funds with **assets under management exceeding RUB 10 billion**
- Listed professional participants of securities market
- Insurance companies

### Key recommendations

#### Risk takers

- Sole executive body
- Members of collective executive body
- Other employees involved in the decision-making on taking risks which may affect the discharge of the entity's obligations

It is recommended for such organizations to identify the list of risk takers.

#### Efficiency and risk evaluation system

It is recommended that the compensation system be structured to discourage excessive risk taking which may weaken the entity's financial sustainability.

It is advisable to take into account both the outcome (the income earned by the entity or by the entity's division, or other KPIs) and the scale of all risks taken by the entity in order to achieve such outcome (including credit risk, market risk, liquidity risk, legal and reputation risks), as well as compliance of the transactions with the entity's approved strategy.

#### Risk taker remuneration structure

Employee's total remuneration should comprise:

- Fixed part of remuneration (base salary)
- Variable part of remuneration tied to the entity's performance
- Compensatory, incentive and social payments not related to the entity's performance.

The variable part of remuneration should account for 40-60 percent of the total remuneration.

It is recommended that the variable remuneration is accrued and paid gradually and evenly during the period in which the risks were taken, provided that the risk scale is in line with the entity's risk management and remuneration policies, and no such risks had occurred.

It is also recommended that the variable part of remuneration (not yet accrued or paid) be reduced or canceled if the entity has incurred a loss as a result of the risks taken previously by respective persons, or if

the latter took risks non-compliant with the entity's risk management policy.

According to the recommendations, the variable part of remuneration should be accrued and paid during the period of at least three years except for cases when risks are taken for shorter periods.

It is not recommended to accrue and pay the variable part of remuneration in full and as a lump sum in the event of termination of the employment contract (the employee's transfer to another division within the entity).

### **Risk manager remuneration structure**

It is recommended that a significant part of the total employee remuneration (40-60 percent) for those engaged in internal controls, risk management,

reporting and ALM, be fixed in order to discourage them from taking excessive risks.

### **Other forms of remuneration**

It is recommended that the decisions relating to employee compensation system take into account payments that are not compensation-related, are non-standard, or the amount of which is not adjusted to

reflect the risks taken by the entity (e.g., accommodation expenses, employee insurance, pension payments, or similar payments including those made by affiliated legal organizations).

### **Liability for non-compliance with the recommendations**

Contrary to the requirements for compensation systems of credit organizations, set in law, the liability for non-compliance with the recommendations is not clearly defined yet. However, the CBR has the ability to influence the access of such non-credit financial

organizations to management of pension savings, as well as regulate issuance of some investment licenses, based on which we assume that the organizations in question are likely to take these recommendations into consideration and comply with them.

### **Next steps**

In order to comply with the CBR's recommendations it is advisable for non-credit financial organizations to perform the following steps:

- Evaluate current compensation systems from a standpoint of compliance with the CBR's recommendations
- Identify risk takers
- Develop and/or adjust risk assessment rules and procedures within existing risk management frameworks
- Develop KPI-based remuneration policies and systems taking risks into account
- Ensure a mechanism is in place for calculating, paying adjusting and/or canceling variable remuneration
- Analyze current long-term employee incentive plans and/or develop long-term incentive plans with the aim of complying with the recommendations. Take into account significant amendments to current legislation (Article 136 of the Russian Labour Code), as well as the existing approaches to bonus-related payments and tax accounting practices
- Ensure the recommended level of information disclosure with respect to compensation systems

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We hope that you find the information in this edition interesting and informative. Should you have any questions on this subject, please do not hesitate to contact us.

Best regards,

**Deloitte CIS partners**

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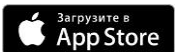


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## TaxSmart App



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