

Employment: CBR Control Over Remuneration Systems at Russian Banks

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On January 1, 2015, the Central Bank of Russia (CBR) Instruction No.154-I of 17 June 2014 "On assessing remuneration systems in banks and eliminating non-compliance" (further, the CBR Instruction) came into force. This CBR Instruction is having a significant effect on remuneration systems in Russian banks and, in particular, is aimed at the introduction of risk-adjusted remuneration.

Enforcement of the CBR Instruction is a part of contingent development of the Russian banking system in the context of the Basel Committee's requirements. The CBR Instruction requires that employees who assume risk when performing their activities (risk-takers) are identified, along with the employees responsible for risk management and control (risk-controllers). Remuneration of these employees should be based on specific KPIs developed by the bank which link to the employees' areas of responsibility. The bonus received by a risk-taker or risk-controller should depend on their performance, as measured by the KPIs.

Though the CBR Instruction was meant to be based on Basel requirements, certain clauses directly contradicted the provisions in Basel II / III. For example, under the CBR Instruction, the bonus part of remuneration payable to risk-takers should be no less than 40 percent of their total remuneration, despite the respective provisions of Basel II / III stipulating that the bonus part of total remuneration should not exceed 40 percent. Additionally, the CBR Instruction stated that the bonus payable to risk-takers should be partially deferred for at least three years (generally, not less than 16 percent of the total remuneration) unless certain criteria are met.

Another significant difficulty for Russian banks was to comply with the required proportion of fixed / variable / deferred parts of remuneration for risk-takers, where the portion of the variable and its deferred parts should be no less than 24 percent and 16 percent respectively based on the CBR Instruction. Without doubt, risk-takers have been delighted to receive

bigger bonuses, but for some banks this could have resulted in a dramatic increase in the size of the remuneration pool, which from an economic point of view was not possible, nor was it probably the intention of the CBR.

Unlike those for risk-takers, changes in the remuneration requirements for risk-controllers have not been particularly significant. The CBR Instruction states that the fixed salary of risk-controllers should form more than 50 percent of their total remuneration. The amount of bonus paid to risk-controllers should be independent and decoupled from the financial results of the decisions taken by the risk-takers. For risk-controllers, bonuses should be linked to their completion of qualitative KPIs. This approach was consistent with the approach that many banks had already adopted, and thus, the CBR Instruction did not significantly affect the existing remuneration received by risk-controllers. However, there were some difficulties identifying who the risk-controllers were. In some banks the same employee was performing both risk-taking and risk-controlling functions within their daily responsibilities.

Implementation of remuneration systems that comply with the CBR Instruction has been a complex process involving experts from all of the different departments within banks, such as finance, risk management, legal, HR, and – for global banks — approval from their headquarters. In many cases, this challenging process was too much to perform by simply relying on internal sources, causing banks to bring in multidisciplinary teams of consultants for full-scope assistance or for assistance with certain aspects of the project (e.g. developing KPIs), or for an independent review of their internally-developed remuneration systems.

The CBR is authorized to begin reviewing the compliance of the remuneration systems in banks starting in October 2015. Some Russian banks have already received short requests from the CBR in connection with this, though to date there are no publicly available results from a formal audit conducted by the CBR.

Summarizing the above, the CBR Instruction is still relatively new and, to date, there is no much practice of its application. We are waiting for such practice and are looking forward to continuous cooperation with the CBR in developing balanced approaches to designing remuneration systems for Russian banks.

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