

HKMA consultation paper 6 May 2019

The Hong Kong Monetary Authority (HKMA) issued a consultation on revisions to the SPM module CG-5 "Guideline on a Sound Remuneration System" to update the guideline issued in 2015.

The main objective of the guideline is to ensure that the remuneration systems of Authorised Institutions (AIs) are consistent with, and promote, effective risk management. It provides guidelines on inappropriate and excessive risk-taking which could threaten the safety, soundness and stability of AIs. The consultation paper aims to reiterate the responsibilities of the Board and risk functions on the effectiveness of the remuneration systems; emphasize the consideration of conduct risk in the remuneration system; and align the relevant disclosures with the Banking (Disclosure) Rules (BDR).

Elements of a sound remuneration system

Governance

- Remuneration policy should be in line with objectives, business strategies and the long-term goals of the AI
- The remuneration arrangement for employees whose activities could have a material impact on the AI's risk profile and financial soundness should support, but not undermine, the overall risk management approach.
- The Board of an AI is ultimately responsible for overseeing the formulation and implementation of the AI's remuneration policy.
- The Board of a licensed bank should establish a board remuneration committee to assist the Board to design and operation of the AI's remuneration system.
- Risk control personnel should have appropriate authority and involvement in the process of design and implementation of the AI's remuneration policy.

Structure of remuneration

- Balance of fixed and variable remuneration should be determined with regards to the seniority, role, responsibilities and activities of their employees and the need to promote behaviour amongst employees that supports the AI's risk management framework and long-term financial soundness.
- Variable remuneration should be paid in such a manner as to align an employee's incentive awards with long-term value creation and the time horizons of risk.
- Guaranteed minimum bonus to senior management or Key Personnel should be subject to the approval of the Board

Measurement of performance for variable remuneration

- The award of variable remuneration should depend on the fulfilment of certain pre-determined and assessable performance criteria which include both financial and non-financial factors
- Size and allocation of variable remuneration should take into account the current and potential risks associated with the activities of employees, as well as the performance.
- The rationale for the exercise of judgment and the final outcomes should be clearly recorded in writing.

Alignment of remuneration payouts to the time horizon of risks

- Deferment of variable remuneration is appropriate when the risks taken by the employee in question are harder to measure or will be realized over a longer timeframe.
- The award of deferred remuneration should be subject to a minimum vesting period and pre-defined vesting conditions in respect of the future performance
- AIs should seek undertakings from employees not to engage in personal hedging strategies or remuneration- and liability-related insurance to hedge their exposures in respect of the unvested portion of their deferred remuneration.

Remuneration Disclosure

- AIs should make remuneration disclosures at least annually.
- HKMA has set out both qualitative and quantitative information that an AI should include in its annual remuneration disclosure.

Key changes / additions in the consultation



Board's responsibilities

- HKMA has reiterated that the Board of an AI is ultimately responsible for overseeing the remuneration systems and control process, on top of the related policy.



Risk control function's responsibilities

- Risk control functions should access risk measures, risk judgements as well as the effectiveness of the incentives created by the remuneration systems (e.g. whether the remuneration arrangement incentivises individual staff to engage in inappropriate or excessive risk-taking).
- Where any risk control personnel assists in the design of the AI's remuneration policy, the roles and responsibilities of such personnel should be clearly documented in the remuneration policy.



Consideration of misconduct risk in the remuneration system

- An AI's remuneration policy should set out consequences of misconduct on remuneration such as a reduction in variable remuneration.
- Amount of remuneration to be adjusted should be proportionate with the misconduct outcome.
- AIs may extend the use of remuneration adjustment to staff beyond those directly responsible for misconduct (e.g. staff responsible for the relevant control framework weakness)
- AIs should regularly monitor and analyse the extent to which remuneration and related performance measurement mechanisms are used to prevent and remediate potential misconduct risk.



Pre-determined criteria for performance measurement

- While the award of variable remuneration should depend on the fulfilment of pre-determined performance criteria, additional non-financial factors may be considered for employees supervising other staff within the AI.



Deferral portion and period

- Proportion of variable remuneration subject to deferral arrangements for senior management and Key Personnel should be substantially higher
- The Board should review at least annually whether the deferral threshold set for variable remuneration is appropriate in aligning remuneration with prudent risk-taking.
- HKMA has specified in the consultation paper that the deferral period (at least for senior management and Key Personnel), in principle, should not be less than 3 years.



Remuneration disclosure

- Instead of listing out the information of remuneration disclosure, HKMA set out the method of disclosure:
 - Remuneration policy, the fixed and variable remuneration awarded during the financial year, details of any special payments made, and information on its total outstanding deferred and retained remuneration.
 - Both locally incorporated and overseas incorporated AIs should make disclosures in accordance with Division 9 under Part 2A of the BDR using the relevant standard templates and table specified by the MA pursuant to section 6(1)(ab) of the BDR. Overseas incorporated AIs can make such disclosures either by themselves or through head office.

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