9040806933 **Saudi Arabian Monetary Agency**

Banking Supervision Dept.

المرفقات: ١٥

3 May, 2010

٣٦١٩٤ /BCS/ ١٢٥٨٠

From	:	Saudi Arabian Monetary Agency
To	:	All Banks
Attention	:	Managing Directors, Chief Executive Officers and General Managers
Subject	:	**Rules on Compensation Practices**

1) In terms of its Charter issued by the Royal degree No. 23 dated 23-5-1377 H (15 December 1957 G), the Saudi Arabian Monetary Agency(SAMA) is empowered to regulate the commercial banks. In exercise of these powers, SAMA has been setting regulatory requirements for banks from time to time. With regard to compensation practices, SAMA has recently issued Circular No. B.C.S 842 dated 26 August 2009 and Circular No. B.C.S/ 1984 dated 9 January 2010 to banks advising them to take into account the guidance provided in the FSB Principles and the Implementation Standards in establishing their compensation policies and practices.

2) SAMA has also advised banks to fix remuneration and attendance fee of their Board members in an Article and disclose all the amounts paid to them during a financial year in their Annual Report. Furthermore, the remuneration of Audit Committee members as determined by the Board of Directors should compare reasonably with the remuneration paid to other Board members. The remuneration of the chairmen and members of the Board of Directors of banks has also been fixed at a minimum of SR 240,000 and maximum of SR 360,000 per person per annum plus SR 3,000 for attending each meeting, which is subject to proper disclosure and provided that the total remuneration so paid shall not exceed 5% of the net profit. Banks should ensure compliance of

P. O. Box 2992 - Riyadh 11169, Saudi Arabia - Tel.: 01-463 3000 - Telex 404390 SJ - Fax 01-466 2119

these instructions and, if required, amend their Bye-laws/Articles to make them consistent therewith.

3) SAMA has now decided to issue the enclosed "Rules on Compensation Practices". These Rules set out the minimum requirements to be complied with by banks and shall come into force with immediate effect. The employment contracts already in force at the time of issuance of these Rules shall be regularized by 31 December 2010. In case a bank is unable to meet this timeline for regularization in respect of a particular contract due to some genuine reason, it can approach the Agency by 30 June 2010 along-with the reasons for the same.

4) Banks shall also ensure compliance of the Implementation Framework enclosed with the Rules as an Appendix and submit the Compliance Report to the Agency as prescribed there under. The Agency will reconsider the usefulness and periodicity of the Compliance Report after two years.

Al Hamidi

Dr. Muhammad Al-Jasser
Governor

Encl: As above

P. O. Box 2992 - Riyadh 11169, Saudi Arabia - Tel.: 01-463 3000 - Telex 404390 SJ - Fax 01-466 2119

1.2 Objective:

The objective of these Rules is to set the minimum requirements and provide supervisory guidance to banks in formulation of their policies, procedures and practices on compensation to ensure financial soundness and promote effective risk management. The Rules are aimed at dealing with the risks posed by the compensation practices, and not at determining the absolute amount of compensation which will continue to be determined by the banks in line with their compensation policies.

1.3 Scope of Application:

These Rules shall apply to all banks as under:

i. All locally incorporated banks licensed and operating in Saudi Arabia shall follow these Rules in letter and spirit;

ii. Where a locally incorporated bank has majority owned Subsidiary(ies) operating in the financial sector, it will either formulate group level compensation policy and practices consistent with these Rules for application across the group or will ensure that the subsidiary's compensation policy and practices are in line with these Rules;

iii. Where a locally incorporated bank has majority owned subsidiary(ies) licensed and operating outside Saudi Arabia and / or has branch operations in any foreign jurisdiction, it will ensure that the compensation policy and practices of such subsidiary or branch are in accordance with these Rules provided that there is no inconsistency with the legal and regulatory requirements of host country;

iv. The branches of foreign banks licensed and operating in Saudi Arabia shall also follow these Rules in designing their compensation policy and practices for Saudi operations. However, their policy can be approved by the Chief Executive or a duly authorized senior executive at Head Office instead of the Board of Directors.

1.4 Effective Date:

These Rules shall come into force with immediate effect and all banks shall take necessary measures to ensure compliance thereof. The banks will also ensure that all employment contracts negotiated or renegotiated after issuance of these

Rules are consistent with the Rules. The contracts already in force at the time of issuance of these Rules shall be brought in line with these Rules by 31 December 2010.

2. Governance of Compensation:

2.1 Role of Board of Directors:

i. The Board of Directors of a bank shall be responsible for the overall design and oversight of the compensation system and accordingly shall not delegate this responsibility to the management;
ii. Despite the establishment of a Board Compensation Committee, the Board shall be ultimately responsible for promoting effective governance and sound compensation practices;
iii. The Board of Directors of a bank shall review and, if satisfied, approve the Compensation Policy on the recommendation of the Compensation Committee, taking into account, inter-alia, the guidance provided in these Rules by 30 September 2010. A copy of the Policy duly approved by the Board shall be submitted to Banking Supervision Department of the Agency within 15 working days of its approval;
iv. The Board of Directors shall review and, if satisfied, approve the recommendations of the Compensation Committee on subsequent revision/updating of the Compensation Policy. A copy of the revised Policy shall be submitted to the Agency within 15 working days of its approval by the Board;
v. The Board shall review and, if satisfied, approve the recommendations of the Compensation Committee regarding the level and composition of remuneration of the key executives;
vi. The Board shall ensure that the management has put in place elaborate systems and procedures and an effective oversight mechanism to ensure compliance of these Rules and the FSB Principles and Standards.

2.2 Compensation Policy:

i. Every bank shall have a written Compensation Policy duly approved by its Board of Directors;
ii. The Compensation Policy should be designed to attract and retain quality staff with sufficient knowledge, skills and expertise to effectively conduct the business of the bank;

iii. The Compensation Policy should comprehensively cover all aspects of compensation so as to ensure that risks related to compensation have been prudently managed;

iv. The Compensation Policy should, inter-alia, cover the following areas:
   - The objectives of the compensation scheme(with focus on promoting effective risk management and achieving financial soundness and stability of the bank);
   - Scope of policy should cover all levels and categories of employees whether regular or contractual as well as outsourcing arrangements with third-party service providers;
   - Broad structure of the compensation system(including key determinants of compensation, alignment of compensation with risk taking, etc.)
   - Set a requirement for linking compensation with performance;
   - Determinants of the mix of remuneration components(including fixed and variable components; cash, equity and other non-cash benefits, etc.);
   - Description and details of major perquisites to be made part of the compensation package;

v. Banks shall ensure that the incentives provided by their compensation systems take into consideration risk, capital, liquidity and the likelihood and timeliness of earnings;

vi. The Compensation Policy should not be solely based on industry practices but should also take into account the business model, financial condition, operating performance and business prospects of the bank.

2.3 Compensation Committee:

i. Every bank shall have a Compensation Committee comprising of at-least three members. This Committee can also be called Nomination & Compensation Committee or Nomination & Remuneration Committee. All members of the Committee should be non-executive and preferably independent members of the Board of Directors of the bank. The Chairman of the Committee shall be an independent member of the Board. For the purpose of these Rules, the terms "non-executive director" and "independent member" shall have the following meanings:

Non-executive Director: A member of the Board of Directors appointed to provide opinion and professional advice to the board and who is not in any way involved in the bank's day to day management and/or does not receive monthly or yearly salary.

Independent Member: A member of the Board of Directors who enjoys complete independence. This means his being independent from the management and the bank. Independence is the ability to exercise sound judgment after fair consideration of all relevant information without undue influence from management or other vested interests. Independence cannot be fully attained if a board member:

a) Is currently having, or it has had in the past two years, executive position in the bank;
b) Is a first-degree relative of any board member of the bank or of any other company within that bank's group;
c) Is first-degree relative of any of senior executives of the bank or of any other company within that bank's group;
d) Has close family ties with any of the bank's directors or senior employees;
e) Is a member of the board of a company that has a relationship with the bank;
f) A partner or employee of the external auditor of the bank or an associated company within the last two years;
g) Is under any financial or moral obligation towards the bank that might reduce his freedom of action (e.g. availed loan or credit facility);
h) Has been a member of the board of directors for three consecutive terms (9 years).

ii. The terms of reference of the Compensation Committee should, inter-alia, include the following:
- Overseeing the compensation system's design and operation on behalf of the Board of Directors;
- Preparing the Compensation Policy and placing it before the Board for approval;
- Periodically reviewing the Compensation Policy on its own or when advised by the Board, and making recommendations to the Board for amending/updating the Policy;

- Periodically evaluating the adequacy and effectiveness of the Compensation Policy to ensure that its stated objectives are achieved;
- Evaluating practices by which compensation is paid for potential future revenues whose timing and likelihood remain uncertain;
- Making recommendations to the Board on the level and composition of remuneration of key executives of the bank. The key executives for this purpose will include all those executives whose appointment is subject to no objection by SAMA;
- Determination of bonus pool based on risk-adjusted profit of the bank for payment of performance bonus;
- Reviewing compliance of the Compensation Policy with these Rules and the FSB Principles and Standards;
- Performing any other related tasks to comply with the regulatory requirements.

iii. A copy of the terms of reference of the Compensation Committee shall be submitted to the Agency along-with the Compliance Report;

iv. The members of the Compensation Committee are expected to possess the required knowledge, skills and expertise to take independent and impartial decisions on compensation policies and practices and the incentives created for managing risk, capital and liquidity;

v. The Compensation Committee should work closely with the bank's Risk Management Committee and / or the Chief Risk Officer in the evaluation of the incentives created by the compensation system;

vi. The Compensation Committee shall review implementation of the Policy at-least on half-yearly basis to ensure achievement of its stated objectives. For this purpose the Committee shall require the Management to place before it the prescribed information on operation of the compensation system.

3. Performance Measurement:

i. Every bank shall have a performance measurement system in place to evaluate and measure the performance of its employees at various levels in an objective manner;

ii. Procedures and processes for performance appraisal and measurement should be clearly stated and documented. Such procedures and processes should provide for avoidance of undue influence and conflict of interest situations, and be transparent to the employees concerned;

iii. Adherence to risk management framework, implementation of internal controls and compliance with the regulatory requirements should be given due weightage in performance measurement;
iv. Gross revenue or profit earned should not be the sole factor for measuring performance. Other factors such as risks associated with the underlying transactions, quality of business transacted, customer satisfaction, risk adjusted return on capital ,etc. should also be taken into account, where-ever practicable, in measuring employee performance;
v. The performance measurement of senior level employees should be based on longer-term performance of the bank and accordingly the performance based component of their compensation should not be based solely on the current year's performance;
vi. The performance measurement procedures and processes should provide for measuring individual contribution, to the extent practicable, to the overall performance of the bank. The individual contributions so measured should, however, be supplemented with managerial judgment in determining the performance based compensation of an employee.

4. Alignment of Compensation with Risk Taking:

i. Every bank shall ensure that the mix and level of compensation of an employee reflect effective alignment of compensation with prudent risk taking;
ii. An employee's compensation should take into account all existing and potential risks including difficult-to-measure risks such as liquidity risk, reputation risk and cost of capital. Furthermore, the size of the variable compensation pool and its allocation within the firm should take into account the full range of risks;
iii. Compensation payments should be sensitive to the time horizon of risks and, if needed, the variable component of compensation should be deferred where risks are realized over long periods;
iv. Every bank shall employ an appropriate technique/criteria to adjust its accounting profits for the full range of identifiable risks keeping in view the size and complexity of its operations;
v. The review of Compensation Policy to assess its adequacy and effectiveness should be made an integral part of the bank's risk management framework.

5. Compensation Structure:

i. The compensation structures for various levels of employees should be designed to promote effective risk management and achieve compensation objectives;

ii. The mix of forms of compensation should vary depending on the employee's position and role, and may include cash, equity and other forms of compensation;

iii. The proportion of fixed and variable components of compensation for different business lines may be determined taking into account the nature and level of responsibilities of an employee, business area in which he is working, and the overall philosophy of Compensation Policy of the bank. Banks should, however, ensure that total variable compensation does not limit their ability to strengthen their capital base;

iv. The compensation structure of employees working in control functions such as risk management, compliance, internal control, financial control, internal audit etc. should be designed to ensure objectivity and independence of these functions. In this regard, it should be ensured that performance measurement and determination of compensation of such employees are not dealt with by any person working in/associated with the business areas monitored by them;

v. The determination of bonus pool should take into account the overall performance of the bank whereas its distribution to individual employees should be based on performance of the employee as well as that of the business unit or division in which he is working. There should, however, be no guaranteed minimum bonuses and similar other payments, other than an employee's salary, that are not based on performance ;

vi. Banks may, as a part of their Compensation Policy, provide for deferment of a reasonable proportion of performance bonus with a minimum vesting period of not less than three years. The proportion of bonus to be deferred and the vesting period should be determined based on the nature of the business, its risks and the activities of the concerned employee;

vii. Where the Compensation Policy provides for payment of a part of the compensation in shares, it should also lay down the criteria to be used for determining the value for allocation of shares. Furthermore, the payouts in shares should be subject to an appropriate share retention policy.

6. Disclosure Requirements:

i. Each bank shall disclose in the Annual Financial Statements the aggregate quantitative information on compensation paid to various categories of employees and their number with breakup of fixed and variable components and the forms of payment. The categorization of employees will include key executives whose appointment is subject to no objection by SAMA, employees engaged in control functions, outsourced, etc.;

ii. Each bank shall also disclose in its Annual Financial Statements the salient features of its Compensation Policy and its implications for the bank's risk profile as well as the composition and the mandate of the Compensation Committee. Such disclosure should also provide information on the overall design of compensation system and the manner of its implementation, description of the manner of risk adjustment, linkage of compensation with actual performance, deferral policy and vesting criteria, parameters for allocating cash versus other forms of compensation, and achievement of the stated policy objectives.

7. Supervisory Review:

i. Every bank is expected to use these Rules in identification and assessment of risks arising out of compensation policies and practices as part of its Internal Capital Adequacy Assessment Plan(ICAAP);

ii. SAMA will review the compensation policies and practices of banks during its on-site examination and while conducting the Supervisory Review Process in a bank;

iii. In case of material deficiencies noted during the on-site examination and/or the Supervisory Review Process, the Agency shall direct the concerned bank(s) for rectification of deficiencies and may also prescribe increased capital requirements for such bank(s).The Agency may also impose penalty in case of serious violations;

iv. If needed, SAMA may limit a bank's total variable compensation as a percentage of total net revenues when it is inconsistent with the maintenance of a sound capital base or with sound risk management practices.

Appendix (to the Rules on Compensation practices)

Implementation Framework

1. Implementation Guidelines:

While complying with the Rules on Compensation practices, all banks shall ensure, inter-alia, the following:

i. The Board of Directors through its Compensation Committee shall ensure that an annual compensation review (internally through Internal Audit or externally commissioned by a recognized firm) is conducted independently of management and submitted to SAMA. Such a review should assess the bank's compliance with the SAMA Rules on Compensation Practices and the FSB Principles and Standards. The Board should take into account the findings of such a review in deciding compensation related matters and may also, if deemed appropriate, disclose a summary of the same publicly in the bank's Annual Report.

ii. The Compensation Committee of the Board should require the management to submit to it for review, at-least on a half-yearly basis, a report on the actions taken and planned next steps for implementation of the SAMA Rules and the FSB Principles and Standards. Such a report should also cover all other related matters on compensation;

iii. As emphasized in Part 4 of the SAMA Rules, the bank should take into account the full range of risks in determining the size of the variable compensation pool and its allocation. In this regard, the bank should also ensure the following:

   a) The variable compensation of senior executives whose appoint is subject to no objection by SAMA as well as other employees whose actions have a material impact on the risk exposure of the bank should be determined in line with Standard # 6 of the FSB Implementation Standards;

   b) A subdued or negative financial performance of the bank for the period under consideration should generally lead to a considerable contraction of the total variable compensation, taking into account both current compensation and reductions in payouts of amounts previously earned, including through clawback arrangements.

2. Compliance Report:

In order to enable SAMA to monitor implementation of its Rules and the FSB Principles/Standards on Compensation practices, all banks are required to submit a compliance report to SAMA in the following manner:

i. The periodicity of the report will be on calendar half-yearly basis i.e. half-year ending 30th June / 31st December;
ii. The report will be submitted within two months of the end of every calendar half-year to the Deputy Governor for Technical Affairs of the Agency;
iii. The first such report for the half year ending 30th June 2010 shall be submitted by 31st August 2010.

3. Coverage of the Report:

The report should cover all actions taken by the bank to comply with the SAMA Rules and the FSB Principles/Standards on Compensation Practices. It should contain at a minimum the following information:

i. Composition of the Compensation Committee including the names, qualification and status (whether shareholder, independent, non-executive or executive member) of each member. Also attach the terms of reference of the Committee;
ii. Confirmation to the effect that all employment contracts negotiated or renegotiated after issuance of the SAMA Rules are compliant with the Rules. Also provide information regarding the number of contracts, if any, which were in force at the time of issuance of SAMA Rules but are still non-compliant with these Rules along-with the reasons thereof and the timeline for their regularization;
iii. Confirmation to the effect that the bank has formulated a Compensation Policy with the approval of its Board of Directors. A copy of the approved or updated (in case of subsequent updation) Policy should be annexed with the report;
iv. Details of the measures taken to ensure compliance to the SAMA Rules and the FSB Principles and Standards by the bank. Any documentary

evidence in support of these measures should be listed and, where-ever practical, annexed to the report;

v. Details of the measures taken to ensure compliance of the SAMA Rules and the FSB Principles and Standards by the local and foreign subsidiaries and foreign branches of the bank. Also provide the name(s) and location(s) of all such subsidiaries and branches to which the SAMA Rules have been applied to;

vi. Categories of employees and their number to which the measures taken to implement the SAMA Rules and the FSB Principles and Standards apply to. Such categories of employees should, inter-alia, include senior executives requiring SAMA no objection, employees engaged in risk taking activities, employees working in control functions, other employees of the bank and outsourced employees/service providers (engaged in material risk taking activities on behalf of the bank, if allowed under the SAMA's Rules on Outsourcing);

vii. Listing down the material changes to date in the compensation practices of the bank/subsidiaries since implementation of the SAMA Rules and the FSB Principles and Standards. Each of these changes should be elaborated with supporting information;

viii. Brief description of / reference to the disclosures made in the bank's Annual Report with regard to risk management framework, internal controls and compensation policy and practices;

ix. Confirmation to the effect that the bank has established appropriate compliance arrangements by seeking commitment from their employees not to use personal hedging strategies or compensation- and liability-related insurance to undermine the risk alignment effects embedded in their compensation arrangements;

x. Any unexpected issues that have been encountered to date in the implementation of the SAMA Rules and the FSB Principles and Standards should be enumerated;

xi. Detail of the steps planned for the next half-year for further refinement of the compensation practices.

4. Compensation Details:

The banks are advised to also submit, along-with the Compliance Report, the following:

i. Details of total compensation including break-up of fixed and variable compensation as per Annexure-I;

ii. Details of compensation of the top 12 highly compensated employees of the bank as per Annexure-II.

****

ANNEXURE-I

DETAILS OF COMPENSATION Paid
FOR THE HALF-YEAR/YEAR ENDED
30[TH] JUNE / 31[ST] DECEMBER ----------

Name of the Bank: ______________ **(SR in '000s)**

Categories of Employees	No. of Emp.	Fixed Compensation			Variable Compensation						Total Compensation
		Salaries and Wages	Other Benefits/ Allowances	Total	Performance Bonuses (in Cash)	Performance Bonuses (in Shares)	Other Performance Linked Incentives	Deferred Compensation paid during the period	Others	Total	
- Senior Executives (requiring SAMA no objection)											
-Employees engaged in risk taking activities(business areas)											
- Employees engaged in control functions											
- Other employees											
- Outsourced Empl. /Service providers (engaged in risk taking activities)											
TOTAL											

Note: Amounts of outstanding deferred compensation (split into vested and unvested), new sign-on and severance payments made during the period and number of beneficiaries of such payments should be given by way of footnote.

ANNEXURE-II

DETAILS OF COMPENSATION OF THE TOP 12 HIGHLY PAID EXECUTIVES FOR THE HALF-YEAR/YEAR ENDED 30TH JUNE / 31ST DECEMBER ---------

Name of the Bank: ______________

(SR in '000s)

Serial No.	Names of Employees	Fixed Compensation			Variable Compensation						Total Compensation
		Salaries	Other Benefits/ Allowances	Total	Performance Bonuses (in Cash)	Performance Bonuses (in Shares)	Other Performance Linked Incentives	Deferred Compensation paid during the period	Others	Total	
1.											
2.											
3.											
4.											
5.											
6.											
7.											
8.											
9.											
10.											
11.											
12.											
TOTAL											