

BEST PRACTICE GUIDELINE

From the Banking Regulation and Supervision Agency:

GUIDELINE ON BEST COMPENSATION PRACTICES OF BANKS

FIRST PART

Objective, Scope and Definitions

Objective and Scope

1. The objective of this guideline is to set the best practices expected from banks in order to establish and manage the remuneration policies, process and implementations in banks within a sound and effective risk management approach framework.
2. The Guideline hereby consists of general principles regarding the remuneration of bank staff as well as the principles regarding the remuneration of only the identified staff.
3. The Guideline hereby is based on Article 93 of the Banking Law Nr. 5411 dated October 19,2005 and Article 7/A titled "Best Practice Guidelines" of the Regulation on Principles and Procedures Concerning the Audit to be performed by the Banking Regulation and Supervision Agency published in the Official Gazette dated July 22, 2006 Nr. 26236.

Definitions

4. Following terms used in this guideline shall have the meanings expressly designated to them below:

Agency: Banking Regulation and Supervision Agency.

Remuneration: All forms of cash or non-cash payments made by the bank in exchange of professional services rendered by staff. Remunerations are separated into two as fixed or variable remuneration.

Cash Payments: Benefits which can be represented by money such as payments in cash as well as share, cancellation of debts given to staff in case of dismissal and insurance contribution.

Non-cash Payments: Benefits such as health insurance, car, discount, cell-phone. The mentioned payments should be turned to monetary value by taking as basis their cost to the bank.

Fixed Remuneration: Cash or non-cash payments which do not depend on any performance criteria and basically reflect the responsibility to be taken as required by the professional experience and contract or business definition. For a remuneration to be deemed as fixed, it must be given in exchange of a certain duty and during the duty, conditions and amount should

be pre-determined, an obligatory payment for the bank, not be able to be cancelled, not to encourage the staff to take excessive risk and be transparent for the staff.

Variable Remuneration: Additional cash or non-cash payments which depend on performance under names of bonus , premium etc.

Malus: ‘Malus’ is an arrangement that permits the bank to prevent the vesting of all or part of deferred variable remuneration based on ex-post risk adjustments

Clawback: ‘Clawback’ is an arrangement under which the staff member has to return ownership of an amount of variable remuneration paid in the past in case the staff is in violation with banking legislation, practices and ethical rules and thus make a transaction that has material impact on the bank or has responsibility for such a transaction.

Earning Variable Remuneration: Independent from whether or not variable remuneration is paid to staff, determination of amount that is deemed to be paid to staff due to their performance during a certain performance assessment period.

Deferred Variable Remuneration: In order to assess the risks stemming from the transaction and to see its results, variable remuneration to be paid to staff, according to the contract, in a future period than it is earned.

Voluntary Retirement Benefits: Excluding obligatory contribution foreseen for bank staff, within the scope of variable remuneration earned in the related period, voluntary additional contribution by the bank to pension fund of the staff.

Bank Staff / The employee: Board of directors, senior management and all other employees of the bank.

Identified Staff: Identified staff are the staff whose professional activities have a material impact on the bank's risk profile.

Non-executive board members: Non-executive board members defined in Article 3 of Regulation on Internal Systems and Internal Capital Adequacy Assessment Process of Banks dated 11/07/2014 and number 29057.

Senior Management: Senior management defined in Article 3 of Regulation on Internal Systems and Internal Capital Adequacy Assessment Process of Banks.

Internal Systems: Internal systems defined in Article 3 of Regulation on Internal Systems and Internal Capital Adequacy Assessment Process of Banks.

Systemically Important Bank: Systemically important banks determined by the Board of Banking Regulation and Supervision Agency.

SECOND PART

Remuneration and Principles

The Proportionality Principle

5. The proportionality principle is the basis for the implementation of this guideline. The proportionality principle aims to match remuneration policies and practices consistently with the complexity of activities, individual risk profile, risk appetite and strategy of a bank. According to this principle, not all banks are obliged to comply with the remuneration requirements in the same scale and way. Systemically important banks should develop more detailed policies, processes and practices compared to other banks. Accordingly, while self-assessing and controlling its exposures, it is the responsibility of the bank to set remuneration policies and practices to ensure sufficient motivation to its staff. On the other hand, while the following practices should be adopted by systemically important banks and banks other than systemically important banks should implement these practices according to proportionality principle considering their own risk structure and strategies.
 - (a) at least 40% of variable remuneration should be deferred,
 - (b) the minimum deferral period is three years,
 - (c) at least 50% of variable remuneration should be paid with non-cash financial instruments,
 - (d) non-cash financial instruments should be retained for a certain period,
 - (e) Malus and clawback provisions should be in place.

Principles on determination of the Identified Staff

6. It is the responsibility of banks to determine the identified staff considering the principles provided in this guideline. Banks should keep record of the identification process as well as related documents and proofs and should be able to demonstrate to the Agency.
7. Members of board of directors, senior management and other bank staff whose functions have a material impact on the bank's risk profile as well as bank staff whose total annual remuneration earned is not less than total remuneration level of the mentioned persons are under the category of identified personnel.

Remuneration Policies

8. It is the responsibility of board of directors of the bank to approve, periodically review and oversee the implementation of the remuneration policy.
9. The bank should set its remuneration policy taking into account the following principles:
 - (a) the remuneration policy should contribute to maintain a sound and effective risk management, not be associated with excessive short-term profit-making goal of the bank exclusively and does not incentivize risk-taking that is beyond tolerated risk the level of the institution.

(b) the remuneration policy should be in line with the scope and size of the operations, risk management structure, business strategy, long-term financial soundness and capital adequacy level of the institution, and incorporates measures to avoid conflicts of interest.

10. The remuneration policy and practices and the procedures to determine them should be clear,¹ well-documented and transparent.
11. The bank should consider the impact of remuneration policies on soundness indicators such as capital and liquidity and in case of a threat against capital adequacy or when needed, a more conservative policy should be followed on all remuneration issues, mainly the variable remuneration.

Remuneration Committee

12. A remuneration committee should be established in banks to carry out monitoring of remuneration policies, processes and implementations on behalf of board of directors in order to provide an independent and effective remuneration system. Remuneration committee is comprised of at least two non-executive members of board of directors who have sufficient information and experience regarding remuneration policies and internal systems as a whole.
13. Preparation of decisions on remuneration submitted for approval to the board of directors , mainly the ones on remuneration of identified staff, regular monitoring on efficiency and conformity of remuneration policies with the risk appetite and targets of the bank, providing opinion and support to board of directors on establishment and functioning of remuneration system as well as monitoring of remuneration of top-level management of units under internal systems are the responsibility of remuneration committee. The committee, while fulfilling its duty, should take care of the interests of legal personality of the bank together with the interests of bank shareholders, investors and public.
14. The committee, concerning its duty, should be able to obtain support from all related units, mainly units responsible for internal systems and expert institutions; and be in cooperation with the audit committee, risk committee, if any, and other related committees.

Review of Remuneration Policies, Processes and Implementations

15. Independent review of remuneration policies, processes and implementations by internal audit unit at least once a year as well as ensuring the actions to be taken concerning the results of the mentioned review are essentially the responsibilities of the board of directors. Board of directors, without prejudice to its responsibility, may fulfill this duty via remuneration committee.

¹ For example, sufficient documentation should be provided by the bank on processes for taking decisions on determination of identified staff, measures taken against conflict of interest, performance measurement criteria, separation of fixed and variable remuneration, ratio of cash and non-cash instruments used in variable remuneration, deferral of remuneration, ratio of fixed and variable remuneration as well as remuneration.

16. Review process mentioned above, at least, should incorporate whether or not remuneration policies, processes and implementations are in conformity with the bank's risk appetite, strategy and long-term targets and whether or not they contradict with the provisions of this guideline.
17. In review of remuneration policies; human resources as well as other related units should cooperate and work together.

Remuneration of Members of Board of Directors

18. Remuneration of executive members of board of directors should be consistent with their powers, functions, experiences and responsibilities.
19. In order to prevent conflicts of interest, only fixed remuneration should be made to non-executive members of board of directors and remuneration committee members.

Remuneration of Staff Working in Units Responsible for Internal Systems

20. Total remuneration level of the staff working in units responsible for internal systems should enable the bank to recruit qualified and experienced employees. Substantial portion of the total remuneration given to these staff should be fixed payments.
21. In the determination of variable remuneration of staff working in units responsible for internal systems, targets specific to their own functions should be taken into consideration rather than the performance of business area they audited. Remuneration of the staff in units responsible for internal systems should not endanger their independence and not lead to conflicts of interest during performing their advisory service to board of directors and remuneration committee.

Variable Remuneration and Its Principles

22. Total variable remuneration should not restrict capital strengthening capacity of the bank. In resource allocation for variable compound of remuneration, the bank should take into consideration all current and potential risks.
23. In order to prevent activities causing excessive risk, variable remuneration amount provided to identified staff should be determined as the combination of individual performance of identified staff as well as performance of the unit under which he/she is working and the bank's final performance and by considering negative and positive impacts of the risk taken. While determining the performance of identified staff, financial and non-financial criteria² should be considered.
24. Performance assessment used in calculation of variable compound of remuneration should consider all related risk types, funding cost and liquidity position of the bank. Furthermore,

² As example to non-financial criteria, reaching at strategic targets, ensuring customer satisfaction, compliance to risk management policy, leadership, management, having features such as team work and motivation, working in coordination with other units and audit units can be given.

data concerning financial criteria used in performance assessment should be long-term as to reflect the risk level posed by identified staff and the bank.

- 25.** Pre-guaranteed variable remuneration should not take place in remuneration planning since it is not in accordance with an effective risk management approach. Guaranteed variable remuneration, can be applied for a newly employed staff under the names of welcome bonus, sign-on awards etc. only for the first year of the staff provided that the bank has a sound capital structure,
- 26.** In payments to be made to the staff in case the contract between the bank and staff is terminated before its term, related staff's contribution to the bank's long-term performance should be taken into consideration and payments should not be made so as to award the failure.
- 27.** The portion of fixed and variable compounds in total remuneration paid to identified staff should be balanced, share of fixed compound in total remuneration should be high enough to include the flexibility of not paying the variable compound, if necessary.
- 28.** The portion of at least 40% of variable remuneration of identified staff should be paid in periods so as to be in compliance with the nature and risks of the business and the activity of the identified staff provided that deferral period is not to less than three years.³
- 29.** Portion of cash, share and/or other non-cash instruments in total remuneration should consider the position and role of the identified staff in the bank and be consistent with the bank's risk profile. At least 50%⁴ of the variable compound of remuneration of identified staff should be paid by the following non-cash instruments, at least:
 - (a) Financial instruments based on shares or similar non-cash instruments, primarily shares issued by the bank,
 - (b) Debt instruments within the scope of Article 7(2) of the Regulation on Own Funds of Banks,
 - (c) Debt instruments within the scope of Article 8(2) of the Regulation on Own Funds of Banks on condition whose days to maturity is equal or more than the total of deferral period applied to variable remuneration and obligatory holding period,
 - (d) Other non-cash instruments including the contracts made between the bank and staff, on condition to have the following conditions and reflecting the deterioration in credit quality of the bank in any way.
 - (i) Its days to maturity should be equal to or more than total of deferral period applied to variable remuneration and obligatory holding period.
 - (ii) In case the bank's core capital adequacy ratio falls under 5,125%, it should consist conditions leading to decrease in its principal value or turn into share.
 - (iii) Excluding the bank's bankruptcy and liquidation process, counterparty should not have the right to demand for acceleration of redemption plan.

³ In the assumption of deferral period is determined by the bank as 3 years, whole of deferred portion can be paid both at the end of third year or a certain amount can be paid each year by 3-year installments.

⁴For example, in a case deferral ratio is adopted as 60% by the bank, of variable remuneration amounting to TL 100, TL 40 should be paid and TL 60 should be deferred. In such as case, at least TL 20 of cash paid amount and at least TL 30 of deferred amount should be made by non-cash instruments.

- (iv) During and at the end of deferral period, payments such as interest and dividend related to mentioned financial instruments accrued during deferral period should not be paid to the identified staff.
- 30.** The bank, in order to ensure that the incentive it provides to identified staff be consistent with long-term interest of the bank, should determine a proper obligatory holding period for not disposal of mentioned instruments by staff and ensure these instruments to be held during that period.
- 31.** Including those related to deferred remuneration, payment of variable remuneration earned by identified staff to identified staff should only be vested if the bank's financial status is suitable in the payment period.
- 32.** Variable remuneration of identified staff should be subject to malus and clawback provisions. Banks should determine the period for malus and clawback implementations and set clear criteria for such implementations in contract and policy documents. Mentioned criteria should include the following, at least:
- (a) The cases where relevant identified staff has made a transaction which lead to a significant loss for the bank or responsible for the realization of such a transaction,
 - (b) The cases where relevant identified staff is in violation with the banking legislation, practices and ethical rules, risk management and intra-bank regulations.
- 33.** Voluntary pension benefits which is a part of variable remuneration should be paid to identified staff via share or share-linked instruments or other instruments regulated in this guideline. In case the identified staff gets retired, voluntary pension benefits provided to identified staff should be provided to be held necessarily by retired staff for three years. In case identified staff quits the job in the bank before retirement, voluntary pension benefits should not be paid before three years.
- 34.** Identified staff should not use individual hedging strategies incompatible with risk mitigating principles given in remuneration policies and not have any insurance contract mitigating their liabilities arising from remuneration policies.

THIRD PART

Disclosure

- 35.** Banks should disclose the following issues, at least, on remuneration policies and implementations on annual basis. Remuneration disclosures laid out by this guideline should be provided as a part of Pillar 3 disclosures required by Communiqué on Disclosures About Risk Management to be Announced to Public by Banks in accordance with the general principles and procedures set out in that Communiqué excluding the provisions regarding independent review. Banks other than systemically important banks should implement mentioned requirements proportionately in line with their applications, risk structures and strategies:

A. Qualitative Disclosure on remuneration Policies

1. Disclosure on remuneration committee should include the following, at least:
 - (a) Information such as the structure, power and mandate of the Remuneration Committee and number of meetings it held,
 - (b) Detailed information on outsourced advisory service (by whom, how, on which specific subject etc),
 - (c) Implementation area of bank's remuneration policies as to include its applicability level to foreign partnerships and branches (split into region and activity branch),
 - (d) Information on who are the staff classified as identified staff and how they are determined as well as the number of identified staff.

2. Information on design and structure of remuneration process should include the following, at least:
 - (a) Process of determining the remuneration policy, policy targets and risk management in remuneration, information on the most important features of remuneration system,
 - (b) Whether or not the remuneration committee made an assessment in the previous year on the bank's remuneration policies, if made, general information on the changes made,
 - (c) Assessment on whether or not remuneration of the staff working under units responsible for internal systems are made independently from the performance of units of the staff.

3. Assessment on methods of bank's remuneration process for handling current and future risks should include the following, at least:
 - (a) Main risks considered by the bank in implementing remuneration process,
 - (b) Structure and types of methods used in considering main risks,
 - (c) Assessment on how the methods used are affecting remuneration,
 - (d) Whether or not the methods used changed within the last one year, if changed, the reason thereof and change impact.

4. The assessment on the bank's methods of associating the variable remuneration with performance should include the following, at least:
 - (a) General information main performance criteria on bank, important business lines and staff basis,
 - (b) Assessment on the extent of consideration of bank's general performance and individual performance of identified staff in the variable remuneration of identified staff,
 - (c) In the case that bank's performance criteria is negative, assessment on how they arrange the remuneration in general,.

5. Assessment on bank's methods for arranging remuneration according to long-term performance should include the following, at least:
 - (a) Assessment on the bank's policy on deferral and payment of variable remuneration,

- (b) In case deferral ratio of variable remuneration differs on identified staff or units basis, assessment on reasons of the difference,
 - (c) Assessment on the bank's policy on implementation of malus and clawback provisions.
6. Assessment on instruments used by the bank in variable remuneration and using purposes of such instruments should include the following, at least:
- (a) A general assessment on different instruments (cash, share, other share-linked instruments etc) used by the bank in variable remuneration,
 - (b) In case the shares of instruments used in variable remuneration in variable remuneration differs on identified staff or units basis, related explanatory information.

B. Quantitative Disclosure on Remuneration Policies

Table 1: Distribution of Fixed and Variable Remuneration Earned in the Related Period

	Current Year			Previous Year		
	Board of Directors and Top-Level Management	Other Identified Staff	Total Identified Staff	Board of Directors and Top-Level Management	Other Identified Staff	Total Identified Staff
Fixed remuneration						
Total Fixed Remuneration Amount Earned in the Related Year						
Number of Beneficiaries						
Variable Remuneration						
Total (Deferred and Non-deferred) Variable Remuneration Amount Earned in the Related Year						
Number of Beneficiaries						
Deferred Variable Remuneration Amount Although Earned in the Related Year						
<i>Cash</i>						
<i>Share</i>						
<i>Other</i>						

Non-deferred amount of Variable Remuneration Earned in the Related Year						
<i>Cash</i>						
<i>Share</i>						
<i>Other</i>						

Table 2: Distribution of Deferred variable Remuneration

	Current Year			Previous Year		
	Board of Directors and Top-Level Management	Other Identified Staff	Total Identified Staff	Board of Directors and Top-Level Management	Other Identified Staff	Total Identified Staff
Total Accrued Deferred variable Remuneration Amount as of Year-end						
Amount of Deferred Variable remuneration Earned in the Related Year						
Amount of Deferred variable Remuneration paid During the Year						
Amount of Variable Remuneration Decreased by Malus or Clawback in the Related Year						

Table 3: Guaranteed Variable Remuneration, Sign-on Awards and Leaving Compensation

	Current Year			Previous Year		
	Board of Directors and Top-Level Management	Other Identified Staff	Total Identified Staff	Board of Directors and Top-Level Management	Other Identified Staff	Total Identified Staff
Guaranteed Variable Remuneration						

Total amount Earned During the Year						
Number of Beneficiaries						
Sign-on Awards						
Total Amount Paid During the Year						
Number of Beneficiaries						
Severance Compensation						
Total Amount Paid During the Year						
Number of Beneficiaries						