Remuneration policies for bank executive: international and European tendencies

Nedelchev, Miroslav

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REMUNERATION POLICIES FOR BANK EXECUTIVE: INTERNATIONAL AND EUROPEAN TENDENCIES*

Assoc. prof. Miroslav Nedelchev PhD

International Business School

Summary: *The paper considers bank executive remuneration from corporate governance point of view. Used perspective is the dynamics of remuneration policies in both the world and EU for reducing the impacts of global crises on banks and strengthening of corporate governance. The executive remuneration is core subject for scientific and practical researches in past decade.*

Keywords: *corporate governance, banks*

The remuneration of managers is one of the main issues in economics. The dynamics of theories of remuneration is determined by the type of ownership such as key moments can be attributed to national measures to deal with another crisis.

The classical economics considered remuneration in the family business. Remuneration is defined as the value of managerial work in the management and control. It agreed on a market basis between the person who administered their work, and the owner of capital.

With the expansion of the family business and to achieve the scale effect, management is separated from ownership. A. Berle and G. Means [1, 342] determine the remuneration as a requirement for increasing profits for shareholders. With the transfer of management to managers last receive the power to reward themselves with income and prestige. New reasons define the striving for the creation of

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conglomerates through mergers and acquisitions. The remuneration of the managers began to determine by the size of the company.

The modern economic thought considers the remuneration by the theory of "optimal contract". The contract is concluded between the principal and the agent of the competitive labor market. The main function of the optimal contract is aligning the actions of managers with the interests of shareholders. Additional function of the optimal contract is to minimize the agency costs between principal and agent. Despite the advantages of the theory of optimal contract, the practice reported abuse of the right to determine the remuneration where managers vote yourself, friends or relatives higher salaries, personal expenses, gratuities and pensions at the expense of shareholders [2, 444].

At the beginning of XXI century policies of some supervisors prevented certain banks to remain out of control. This error led in turn to the reasons for the creation of complex organizational structures and offering new financial services difficult to assess and control. The trends determine the remuneration of bank managers depending on the reported results, which in most cases are short-term and do not reflect the risks taken.

Traditional tools to protect the interests of shareholders and reduce information asymmetry did not give the expected result. Instead, the practice noted another result - coincidence of the interests of shareholders and managers reporting scores, which are associated with an increase in share price. The consequences of non-compliance with best corporate governance practices were transferred to stakeholders: guarantee funds deposits, government budget, taxpayers. The problem of microeconomic (genesis of the crisis) is transformed into a macro (economic growth to drop) and international (contagion).

The inadequate remuneration policies have been the basis of current crisis [3]. The motives of managers identified actions for excessive and imprudent risk-taking in the banking sector which led to systemic problems in individual countries and globally. In response to economic challenges, most countries responded with introduction of restrictions on remuneration of bank managers as part of the rescue plans, sponsored by government [4, 1].

Started in the USA, the economic crisis gradually gained global. To deal with the consequences pledged international organizations trends in remuneration.

To correct remuneration policies were introduced global principles on pay and compensation in financial institutions. The aim of the principles is to ensure that compensation structures to reward support sustainable growth and avoid excessive risk-taking.

G20

Modern remuneration policies are based on principles proposed by the G20 [5]. The aim of the principles is strengthening the financial system and prevents future crises.

Applying the principles will cease reasons for taking excess risk by:

- greater disclosure and transparency on the level and structure of remuneration for activities that have a material impact in taking risk;

- global standards on pay structure where it is legally established between fixed and variable remuneration in order remuneration practices are aligned with long-term value creation and financial stability;

- reforms on corporate governance in order to establish itself as the responsibility of the board of directors/Management Board to monitor the remuneration of managers and taken risks, including greater independence and accountability of the remuneration committees.

Financial Stability Board

The Financial Stability Board performs coordination at international level between national supervisory authorities. The principles of the FSB aimed at implementing sound remuneration practices [6].

In the development and implementation of remuneration policies, including both managers and officials which take a risk. Banks comply with the following principles in a way and to an extent that is appropriate to their size, internal organization, nature, scope and complexity of their activities:

- implementation of the remuneration policy is annually to central and independent internal review for compliance with policies and procedures for remuneration adopted by the management body in its supervisory function;

- assessment of the performance is a period of several years to ensure that the assessment of long-term performance and that the actual payment of performance-based components of remuneration is spread over a period reflecting the business cycle of the credit institution and its business risks.

Basel Committee on Banking Supervision

The Basel Committee published principles for the promotion of best practices in corporate governance for banking organizations [7]. They include a requirement for the board of directors/management board to oversee the establishment and operation of the remuneration system that equalizes wages undertaken with reasonable risk.

The principles of the Basel Committee include:

- the use of "ex ante" risk adjustment, which adjusts remuneration in time accumulation in the statement of future events;

- the use of "ex post" adjustment risk as late payment and restoration commitments paid bonuses that apply to remuneration;

- each governing body acting in a supervisory role should include non-executive members, who collectively have significant knowledge about policies and structures of remuneration;

- remuneration policy should be approved by shareholders and must be reviewed at least annually by the authority with supervisory function.

European Union

Directive 2010/76/EU introduced the requirement that the remuneration policies of managers of financial institutions be subject to supervisory review [8]. The Directive requires credit institutions and investment firms to develop and implement remuneration policies consistent with a healthy and effective risk management, which does not encourage risk taking over. The competent supervisory authority is obliged to carry out regular checks on risk management.

Directive 2010/76/EU is based on a completely new approach – considers the structure of remuneration rather than his size. The aim of the Directive is to achieve a combined impact of new capital requirements and the reasonable analysis of remuneration policies, which limit the excessive variable remunerations.

Part of the principles of the Directive includes:

- payments related to the early termination of a contract reflect performance achieved over time and are designed in a way that does not reward the failure;

- guaranteed variable remuneration is exceptional and only in the context of hiring new staff and is limited to the first year of employment;

- at least 50% of variable remuneration should be paid in shares or in appropriate non-cash instruments, which are subject to an appropriate retention policy;

- the ratio between fixed and variable remuneration is limited to 1:1 or greater than 1:2, which requires the approval of 66% of shareholders;

- at least 25% of variable remuneration in excess of 100% of fixed remuneration is deferred for five years.

Bulgarian National Bank

Directive 2010/76 / EU is reflected in the Guidelines and the Ordinance №4 of Bulgarian National Bank. The basis of supervisory policy is enshrined the principle of proportionality to align policies and practices for remuneration and risk profile; risk appetite and business strategy of the bank.

Regulation № 4 for the requirements to remuneration in banks [9] determines the basic principle that banks should ensure that their policies and remuneration practices promote sound and effective risk management. The provisions on remuneration are divided into three groups: management, risk reporting and transparency.

Guidelines on the requirements for remuneration in banks [10, 2] aim to facilitate the practical application of risk-based approach. They apply both to the basic principles for remuneration policies, and everyday practices used and procedures related to the implementation of these policies.

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The structure of the remuneration of managers should encourage long-term sustainability of the bank and to ensure that remuneration is based on performance [11]. Consequently, the variable components of remuneration should be linked to predetermined and measurable criteria for performance, including criteria of a non-financial nature.

Regardless of the time and the source of policies modern trends in remuneration of bank managers have these similar goals:

- to support sustainable growth;

- to avoid excessive risk taking;

- to strengthen the financial system;

- to prevent future crises;

- to promote long-term sustainability of the bank.

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