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Bankers' pay

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Contents

Summary

Bankers' pay was rarely a specific political issue before the 2007/08 financial crisis. In 1992, the Cadbury Report recommended increasing transparency and objectivity in executive remuneration overall. This ultimately led to the publication of the Combined Code on Corporate Governance in 1998.

The financial crisis focused attention on the activities of banks - and the pay of bank executives. There was a widespread view amongst the public, media and politicians that bankers' remuneration was too high and that the way it was calculated encouraged executives to take excessive risks of the type that had contributed to the crisis. Criticism of bankers was particularly strong in the UK, given its role as a global banking and financial services hub.

Those concerns led to several reviews of pay in financial services, including those by the head of the UK regulator Lord Turner and banker Sir David Walker. Subsequent reform within the UK and the EU has both increased requirements for disclosure and limited the levels and structure of remuneration in financial services. The then-UK financial services regulator, the Financial Services Authority, introduced a legally binding Remuneration Code for UK financial services firms from 2010. Initially applicable to only 26 firms, it has since been developed and extended in scope.

The international Financial Stability Forum (now the Financial Stability Board, FSB) also published a set of principles to inform national regimes on the issue. An April 2021 review by the FSB concluded that the UK's remuneration rules for financial services firms were broadly consistent with these principles.

Today, figures for executive remuneration in large listed banks can be found in their Directors' Remuneration Report. Remuneration is complex because it includes several different factors, such as salary, pension, company benefits, bonuses, and other longer-term forms of payment. But listed companies are required to calculate and publish single aggregate figures for each director. For example, the 2020 annual report for HSBC shows that in 2020 its Chief Executive (Noel Quinn) received total pay of £4.154 million, of which £799,000 was a bonus.

1. Background

Pre-financial crisis

Banking executives' pay was rarely a focus of public attention before the financial crisis. There were broader concerns about executive pay in general from the 1990s, when a series of high-profile cases of corporate mismanagement exposed deficiencies in financial reporting and director accountability.

These included home furnishings group Coloroll[1] and FTSE-100 textiles company Polly Peck International[2], later followed in 1991 by BCCI bank[3] and media group Maxwell Communication Corporation.[4]

The Cadbury Report

Responding to public concern,[5] accounting regulator the Financial Reporting Council, the London Stock Exchange and the accountancy profession set up The Committee on the Financial Aspects of Corporate Governance. The Committee was chaired by Sir Adrian Cadbury, a former chairman of the chocolate-making family business.

The Cadbury Report was published in 1992 and has been described by the *Financial Times* as "pioneering" in the reform of corporate governance.[6] The report published a draft "Code of Best Practice" and suggested that the boards of all listed companies registered in the UK should have to make a statement about whether they comply with it. As many other companies as possible should also seek to meet the Code's requirements.

The Cadbury Report rejected proposals to give shareholders the opportunity to determine matters such as directors' pay at general meetings, viewing them as unworkable. However, it did recommend that:

- There should be full disclosure of directors' pay. Separate figures should be given for salary and performance-related elements and the basis on which performance is measured should be explained;
- Company boards should appoint remuneration committees, made up wholly or mainly of non-executive directors, to recommend to the board the levels of pay of executive directors. Executive directors should play no part in decisions on their own pay; and
- Directors' contracts should not exceed three years without shareholders' approval.[7]

1 See The Independent, Pension Scandal: Coloroll chief ordered to compensate ex-colleagues: Ombudsman rules former company chairman abused his position, 6 April 1994
2 See BBC, How Asil Nadir stole Polly Peck's millions, 22 August 2012
3 See The Guardian, Timeline: BCCI, 2 November 2005
4 See The New York Times, Maxwell's Empire: How It Grew, How It Fell -- A Special Report.; Charming the Big Bankers Out of Billions, 20 December 1991
5 See Financial Reporting Council, History of the UK Corporate Governance Code, 1992
6 See for example the Financial Times, Sir Adrian Cadbury, corporate governance pioneer, 1929-2015, 4 September 2015
7 See the Report of the Committee on the Financial Aspects of Corporate Governance, 1 December 1992, paras 3.1, 4.40-46, draft Code para 3

The London Stock Exchange required listed companies to comply with the Code or otherwise explain the reasons for non-compliance. This "comply or explain" approach has since become a cornerstone of UK corporate governance.[8]

The Greenbury Report

In January 1995, business trade body the Confederation of British Industry (CBI) set up The Study Group on Directors' Remuneration. This was in response to concerns from shareholders and the public about large pay increases for executives in the recently-privatised utility industries. Chaired by Sir Richard Greenbury, the then Chairman of Marks & Spencer, its specific terms of reference were to "identify good practice in determining Directors' remuneration and prepare a Code for such practice for use by UK PLCs".[9] Reporting in July 1995 and building on the work of the Cadbury Report, the Greenbury Report found that:

- Pay levels for UK directors lay within the range of European practice and well below American levels;
- There had been mistakes and misjudgements on executive pay; and
- A proper allocation of responsibilities would be preferable to statutory controls. Companies should make full disclosure of their approach to executive pay every year. Responsibility for determining pay should be delegated to a group of people with good knowledge of the company but with no financial interest in the decisions they are taking.

The Greenbury Report included its own Code of Best Practice which included Remuneration Committees formed of non-Executive directors, annual reports to shareholders and full disclosure of the details of executive pay (including by each individual director).[10] Its finding were implemented through amendments to the London Stock Exchange's Listing Rules.[11]

The Committee on Corporate Governance

The Committee on Corporate Governance was set up on the initiative of the Financial Reporting Council in November 1995 to review the implementation of the findings of the Cadbury and Greenbury reports.

Chaired by Ronnie Hempel, Chief Executive[12] of Imperial Chemical Industries, what became the Hempel report was published in January 1998, and endorsed "the overwhelming majority of the findings" of the Cadbury and Greenbury committees.[13]

The Cadbury, Greenbury and Hempel reports in turn led to the publication in June 1998 of the Combined Code, by the Committee on Corporate Governance.[14] The Combined Code was intended to be a

8 University of Cambridge Judge Business School website, The Cadbury Report
9 See Financial Reporting Council, Report of a Study Group chaired by Sir Richard Greenbury, 17 July 1995
10 Financial Reporting Council, Directors' Remuneration: Report of a Study Group chaired by Sir Richard Greenbury, 17 July 1995, especially paras 1.13 to 1.16
11 Committee on Corporate Governance, Final Report, January 1998, para 1.9
12 See The Independent, ICI turns in results at high end of forecasts, 28 July 1994
13 Committee on Corporate Governance, Final Report, January 1998, para 1.7
14 Committee on Corporate Governance, The Combined Code, June 1998

"consolidation of the work of the three committees, not as a new departure". Its three key principles on directors' remuneration were that:

> 1. Levels of remuneration should be sufficient to attract and retain the directors needed to run the company successfully, but companies should avoid paying more than is necessary for this purpose. A proportion of executive directors' remuneration should be structured so as to link rewards to corporate and individual performance.
>
> 2. Companies should establish a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors. No director should be involved in deciding his or her own remuneration
>
> 3. The company's annual report should contain a statement of remuneration policy and details of the remuneration of each director.

The principles of the Combined Code were adopted by the London Stock Exchange and made applicable to all listed companies incorporated in the UK, using the same original "comply or explain" concept used in the Cadbury Report.[15] Revisions to the Combined Code (which maintained the same core principles) were subsequently made in 2003, 2006, and 2008 before being rebranded the Corporate Governance Code in 2010.

Following a campaign by shareholder bodies and corporate governance activists, the Government also intervened directly. *The Director's Report Remuneration Regulations 2002 SI 2002/1986* required listed companies to publish a "remuneration report" detailing the pay of directors in their annual reports, and to put a resolution on this report to a (non-binding) vote of shareholders at each AGM. Failure to comply is a criminal offence, punishable by a fine.[16]

Trade and Industry Committee Report

On 26 September 2003 the Trade and Industry Select Committee had published a report titled "Rewards for Failure". The report followed a number of high-profile cases where directors who appeared to have presided over losses in the value of their companies subsequently left with very large redundancy packages. It also looked at the issue of executive remuneration more generally, finding that:

- Executive remuneration had increased dramatically over the previous ten years. Figures from Pensions Investment Research Consultants showed that the median base salary for the highest paid directors amongst FTSE 100 companies had increased from £301,000 in 1993 to £579,000 in 2002. This represented an increase of 92% over a period in which inflation has risen by 25% and average wages by only 44%;

15 Ibid
16 See Herbert Smith Freehills, UK: The Directors' Remuneration Report Regulations 2002, 7 August 2002. The Regulations inserted the relevant requirements into the Companies Act, and remain in force today

- The proportion of executive salaries payable as a bonus had also risen, with a trend of bonuses set as a larger proportion of considerably higher salaries;
- The recent increases in salaries and bonuses were not due to tougher performance targets or better company performance - "It would appear that executives have been rewarded not only for success but for failure as well."; and
- Executives in the UK were paid more than those in any country other than the USA.

The report however concluded that "we see no need at the moment for a legislative solution to the problem of rewards for failure", arguing instead that shareholder pressure might lead companies to embrace a culture of change.

2. Financial crisis: the focus turns to banks

By the 2007/08 financial crisis, many of the UK's largest banks were listed on the London Stock Exchange. These included Barclays (listed in 1953)[17], NatWest (listed in 1968)[18], Lloyds (listed in 1986)[19] Abbey National (now Santander, listed in 1989)[20], HSBC (listed in 1991)[21], Northern Rock (listed in 1997)[22], Alliance & Leicester (listed in 1997) and Bradford & Bingley (listed in 2000)[23]. As listed companies, these banks were required to disclose if and how they complied with the Combined Code, including its provisions on remuneration of executives.

Nonetheless, during this period, the pay of bank executives in particular emerged as a major political issue.

In October 2008, Prime Minister Gordon Brown announced a £400 billion rescue package to help struggling banks as the Bank of England promised to take "all actions necessary" to ensure liquidity in the banking system.[24]

These measures drew criticism from some sections of the public, who (according to the FT) complained that "Mr Brown has found huge sums of money to prop up failing banks, while they struggle to pay bills and see local post offices of hospitals closing". At the time, Labour MP Mark Lazarowicz said:

> I'm sure I'm not the only MP who has had phone calls and e-mails from a number of constituents who are angry that people made a massive amount of money and made massive bonuses and now expect the taxpayer to pick up the bill for their mistakes.

Responding to public pressure, Mr Brown told GMTV "I am angry at irresponsible behaviour...the days of big bonuses are over".[25] The Conservative Party also criticised high levels of pay awarded to bankers, with Shadow Chancellor George Osborne telling the Tory party conference in September 2008:

> I will not increase taxes on the family earning £20,000 to carry on paying the bonuses of the banker earning £2m. You helped cause this mess and you can help clean it up.[26]

Criticism of banker remuneration was such that Charles Bear QC, writing in the *Financial Times*, joked that "Calls for a cap on fat cat bonuses have become today's equivalent of standing for the national anthem – a patriotic gesture with little identifiable content."[27]

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[17] London Stock Exchange, BARCLAYS PLC
[18] London Stock Exchange, NATWEST GROUP PLC
[19] London Stock Exchange, LLOYDS BANKING GROUP PLC
[20] Thisismoney.co.uk, Last day for Abbey National shares, 13 November 2004
[21] London Stock Exchange, HSBC HOLDINGS PLC
[22] UK Asset Resolution, Our Business
[23] London Stock Exchange, BRADFORD & BINGLEY PLC
[24] Financial Times, UK banks thrown £400bn lifeline, 8 October 2008
[25] Financial Times, Brown cranks up rhetoric on City pay, 9 October 2008
[26] Financial Times, Osborne promises 'age of responsibility', 29 September 2008
[27] Financial Times, City bonuses: levelling the playing field, 16 October 2008

In late 2009 the then-Chancellor Alistair Darling announced a one-off "bank payroll tax" of 50% on bonuses of more than £25,000 awarded up to April 2010. This would be paid by the banks rather than employees. Mr Darling said:

> However, there are some banks who still believe their priority is to pay substantial bonuses to their already high-paid staff. So I am giving them a choice. They can use their profits to build up their capital base. But if they insist on paying substantial rewards, I am determined to claw money back for the taxpayer.[28]

FSA response

In October 2008, the UK financial services regulator, the Financial Services Authority (FSA), wrote to the CEOs of various firms, including around 20 banks, outlining the detail of its work on reforming pay in investment banking and trading. The letter stated that the FSA did not wish to become involved in setting pay, but wanted to ensure policies were aligned with sound risk management systems and controls.[29] On 26 February 2009, the FSA published a draft Code of Practice on Remuneration Policies for consultation. The draft Code consisted of one general and ten specific principles intended to apply to all FSA-regulated firms.[30] A revised Code was published for further consultation the next month (the same month as the publication of the Turner Review (see below) with a final version of the Code published in August 2009, to be effective from 1 January 2010.[31]

The final Code consisted of one "general requirement" underpinned by a series of principles and guidance. The general requirement was that:

> A firm must establish, implement and maintain remuneration policies, procedure and practices that are consistent with and promote effective risk management

The Code initially applied apply only to 26 large banks, building societies and broker dealers, rather than all regulated firms.[32] It was incorporated into the FSA Handbook to allow the FSA to enforce it directly.

The Turner Review

In October 2008 the then Chancellor of the Exchequer Alistair Darling asked the Chairman of the FSA, Lord Turner, to conduct a review into the causes of the financial crisis, and to make recommendations on creating a more robust banking system. Published in March 2009 the Turner Review recommended that:

> Remuneration policies should be designed to avoid incentives for undue risk taking; risk management considerations should be closely integrated into remuneration decisions. This should be achieved through the development and enforcement of UK and global codes.

28 BBC, Darling unveils super-tax plans for bankers' bonuses, 9 December 2009
29 Slaughter and May, PLC Financial Services and PLC Corporate, FSA letter on remuneration policies published, 29 October 2008
30 PLC Financial Services, FSA publishes draft code of practice on remuneration policies applicable to all regulated firms, 26 February 2009
31 FSA, Revising the Remuneration Code, July 2010. Para 1.8
32 The FSA's remuneration code (pinsentmasons.com)

Turner found that "while inappropriate remuneration structures played a role" in contributing to the financial crisis, "they were considerably less important than other factors..." He did however recognise that "past remuneration policies...have created incentives for some executives and traders to take excessive risks" and vowed that in future the FSA "will enforce a set of principles which will better align remuneration policies with appropriate risk management".

Treasury Committee Report

In May 2009 the Treasury Select Committee published a report titled "Banking Crisis: reforming corporate governance and pay in the City". The report expressed "concern that the Turner Review downplays the role that remuneration played in causing the banking crisis" and questioned "whether the Financial Services Authority has attached sufficient priority to tackling remuneration in the City." The report proposed several reforms, including enhanced disclosure requirements for firms about their remuneration structures and about remuneration below board level, reforms to remuneration committees to make them more open and transparent, and a Code of Ethics for remuneration consultants.[33]

Financial Stability Forum Principles

The Financial Stability Forum (FSF, replaced by the Financial Stability Board) was an intergovernmental forum of financial authorities, to promote information exchange and coordination. It was founded in 1999, initially by the finance ministries, central banks and leading regulators of the G7 member countries, together with representatives from several international organisations.[34]

After the financial crisis a sub-group of the FSF formed the FSF Compensation Workstream, noting that inappropriate compensation packages were "one factor among many that contributed to the financial crisis". The Workstream Group comprised officials from 14 countries and international organisations, including the UK, France and the United States.

In April 2009 the FSF published the nine FSF Principles for Sound Compensation Practices, as developed by the Workstream Group. Some of these nine principles were that (i) a firm's board of directors (rather than primarily the CEO and management team) must oversee the compensation system's design and operation; (ii) compensation must be adjusted for all types of risk; and (iii) that firms must disclose information about compensation to facilitate engagement by all stakeholders.[35] Guidance on compliance with the Principles was then provided in Implementation Standards published in September 2009.

33 Treasury Select Committee, Banking Crisis: reforming corporate governance and pay in the City, Summary, 15 May 2009

34 Financial Stability Board, Announcement of the First Meeting of the FSF, Washington, 6 April 1999

35 Financial Stability Board, FSF Principles for Sound Compensation Practices, 2 April 2009

The Walker Review

In February 2009 Prime Minister Gordon Brown appointed banker Sir David Walker to conduct a review into corporate governance in the UK banking industry. The Walker Review was published in November 2009.

On remuneration, the Review recommended:

> Recommendation 31
>
> For FTSE 100-listed banks and comparable unlisted entities such as the largest building societies, the remuneration committee report for the 2010 year of account and thereafter should disclose in bands the number of "high end" employees, including executive board members, whose total expected remuneration in respect of the reported year is in a range of £1 million to £2.5 million, in a range of £2.5 million to £5 million and in £5 million bands thereafter and, within each band, the main elements of salary, cash bonus, deferred shares, performance-related long-term awards and pension contribution. Such disclosures should be accompanied by an indication to the extent possible of the areas of business activity to which these higher bands of remuneration relate.
>
> Recommendation 33
>
> Deferral of incentive payments should provide the primary risk adjustment mechanism to align rewards with sustainable performance for executive board members and "high end" employees in a BOFI included within the scope of the FSA Remuneration Code. Incentives should be balanced so that at least one-half of variable remuneration offered in respect of a financial year is in the form of a long-term incentive scheme with vesting subject to a performance condition with half of the award vesting after not less than three years and of the remainder after five years. Short-term bonus awards should be paid over a three-year period with not more than one-third in the first year. Clawback should be used as the means to reclaim amounts in circumstances of misstatement and misconduct. This recommended structure should be incorporated in the FSA Remuneration Code review process next year and the remuneration committee report for 2010 and thereafter should indicate on a "comply or explain" basis the conformity of an entity's "high end" remuneration arrangements with this recommended structure.[36]

The Treasury subsequently announced that it "will move quickly to implement the reforms of bank pay and governance proposed by Sir David Walker."[37]

The FSA said it "reiterates its commitment to reviewing its remuneration code next year in order to take any international developments into account. This review will also consider whether, and how, to implement Sir David's wider recommendations on remuneration."[38]

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36 Final Report of Review team led by Sir David Walker: A Review of corporate governance in UK banks and other financial industry entities, *November 2009*

37 HM Treasury press release, 26 November 2009

38 FSA press release, 26 November 2009

Reaction to the proposals varied from comments that it did not go far enough to those who suggested it had gone too far. The *Financial Times* article below reflects a range of these views:[39]

> Back in the summer, when Sir David Walker published the draft version of his review of corporate governance at financial services companies, hard-nosed bankers laid into the bureaucracy and populism that they said underpinned his recommendations.
>
> With a few tweaks, those reforms are today being toughened into formal proposals - with a plan for some guidelines to be backed up with legislative powers. The "dead hand of bureaucracy" that one senior banker said he feared in July would be the result of the proposals may still be a danger, as Sir David beats no retreat on the principle that banks should have board-level risk and remuneration committees, which should probe all bankers' pay structures.
>
> But most senior figures yesterday applauded the proposals. "The quality and depth of knowledge on bank board's needs to be better than has been the case in the past. And the Walker recommendations are a significant step towards that," says Colin Grassie, chief executive of Deutsche Bank in the UK. "
>
> […]
>
> There was relief, too, that the report does not extend its recommendations on pay disclosure - particularly that banks will not be required to identify top earners by name, as is the case for US boards. Instead Sir David sticks with his view that banks should publish the numbers of staff earning above certain pay bands. "Naming and shaming was a big concern," says one US banker. "But disclosure in bands is fine."
>
> Jon Terry, head of remuneration practices at PwC, also supports Sir David's recommendation. "With named disclosure there could be unintended consequences such as the ratcheting up of pay. Banded disclosure will provide information to stakeholders that is useful. "However, one senior banker argues that even banding poses problems. "This is a political distraction. Our willingness to comply will depend on how far the principle is applied to other industries."
>
> As a measure of how controversial the pay requirements are likely to be, Sir David says he has asked the government to include the pay disclosures requirement in its legislative proposals to ensure that all UK banks and UK subsidiaries of global banks follow his strictures. However, branch offices of European institutions, such as BNP, Société Générale and Deutsche Bank, will not be covered.
>
> If banks were offered the ordinary option of being required to "comply or explain" why they were not following the rules, "they would all want to explain that the recommendation is too broad and makes them uncompetitive," Sir David says, adding that he expects the rules to "cause howls of outrage" from bankers.
>
> Industry groups and practitioners largely praise the plan to elevate risk to board level. "I think it might have helped boards avoid mistakes," says Mark Wippell, senior corporate partner at Allen & Overy. But William Lawes, partner at Freshfields, warns that a separate risk committee could change the focus of board members. "While managing risk is what banks do, and some have

[39] *Some bankers still fear the imposition of the 'dead hand of bureaucracy',* Financial Times 26 November 2009

> to do it better, Walker has to be careful his risk committee recommendations don't split boards," he says.

Implementing the Walker Review

The Walker Review informed the FRC's new Corporate Governance Code, the FSA Remuneration Code and legislation.

In June 2010, the Financial Reporting Council (FRC) produced a revised edition of the Combined Code – now rebranded as the UK Corporate Governance Code, applying to financial years from June 2010. The new Code provided for annual re-election of all FTSE-350 directors.[40] Provisions on remuneration were amended to clarify that the remuneration of non-executive directors should not include any performance-related elements, that payouts under incentive schemes should be subject to non-financial performance criteria where appropriate and compatible with the company's risk policies and systems, and that companies should consider provisions that enable them to reclaim variable components in cases of mis-statement or misconduct.[41]

The *Financial Services Act 2010* gained Royal Assent in April, shortly before the 2010 General Election. This Act granted to the Treasury a power to make regulations requiring the preparation of reports related to financial services firms authorised under the Financial Services and Markets Act 2000 (FSMA). While quoted (listed) companies already had to produce such reports, the power allowed the Treasury to expand the disclosure regime to non-listed companies and to employees who are not directors.[42] This provided a mechanism to implement the final recommendations of the Walker Review which extended disclosure to include banded disclosure of the remuneration of high-end non-board executives.[43]

Section 6 imposed a duty on the FSA to make rules authorised financial services to have and implement a remuneration policy. This provided a "clearer basis"[44] for the FCA's Remuneration Code. Such rules needed to be consistent with the effective management of risks and the FSF/Financial Stability Board's Principles for Sound Compensation Practices (discussed above).[45] Section 6 was eventually replaced by rule-making provisions in the *Financial Services Act 2012*.[46]

The FSA said it believed its Renumeration Code was "well-aligned" with the recommendations of the Walker Review, and only proposed to make changes in one area (relating to long term incentive plans).[47]

EU reforms

A draft of the *Third Capital Requirements Directive* (CRD III) was approved by the European Council and Parliament in July 2010. CRD III

40 FRC, The UK Corporate Governance Code, June 2010
41 FRC, Revisions to the UK Corporate Governance Code, May 2010, p12
42 Financial Services Act 2010, Explanatory Notes, Section 4
43 Dechert LLP, An Overview of the Financial Services Act 2010, 25 May 2010
44 Ibid
45 Financial Services Act 2010, Explanatory Notes, Section 4
46 See Schedule 19 and Section 24
47 FSA, Revisiting the Remuneration Code, July 2010, para 2.19

was adopted on 24 November 2010 and included remuneration disclosure requirements for banks, building societies and investment firms. The Committee of European Banking Supervisors (CEBS)[48] published its draft guidelines on remuneration on 8 October 2010.[49] Explaining its position, CEBS said:

> Under the revised CRD III, as agreed upon by the European institutions, CEBS is required to elaborate and issue guidelines on sound remuneration policies in the financial sector in order to facilitate the compliance of the remuneration principles included in the amended Annex V of the CRD.
>
> Article 22 of the revised CRD lays down the fundamental principle whereby institutions are required to ensure that their remuneration policies and practices are consistent with their organisational structure and promote sound and effective risk management.[50]

The document acknowledges the balance to be struck between, for example, fixed and variable pay structures:

> Having a fully-flexible policy on variable remuneration implies not only that variable remuneration should decrease as a result of negative performance but also, that it can go down to zero in some cases. For its practical implementation, it also implies that the fixed remuneration should be sufficiently high to remunerate the professional services rendered, in line with the level of education, the degree of seniority, the level of expertise and skills required, the constraints and job experience, the relevant business sector and region.
>
> […].
>
> Individual levels of fixed remuneration are, however, indirectly impacted by the basic principle on risk alignment, and more specifically by the requirement that remuneration should be included in the capital and liquidity planning of the institution and should contribute to maintaining a sound capital base.[51]

It continues, explaining why fixed ratios between pay and bonuses are not part of its recommendations:

> Because situations vary enormously, it is not possible to decree one optimal relationship between the fixed and variable components of remuneration. To determine the actual institution specific ratio(s), the starting point is that a high ratio of variable to fixed components implies less discretion for the institution to make choices about how to comply with the other specific requirements on risk alignment.
>
> […]
>
> Institutions should be able to explain retained ratios of variable to fixed components through their remuneration policy. Institutions

48 CEBS was composed of high level representatives of bank regulators and central banks throughout the EU. It was subsumed into the European Banking Authority in 2010.

49 CEBS website 8 October 2010, at http://www.c-ebs.org/News--Communications/Latest-news/CEBS-has-published-today-for-consultation-its-draf.aspx

50 Ibid

51 CEBS, Consultation Paper on Guidelines on Remuneration Policies and Practices (CP42), 2010 p44

> should also be able to explain how the ratio will evolve when the institution is faced with a serious loss.[52]

At a late stage in its process, the follow-up to CRDIII, the *Fourth Capital Requirements Directive*, also included provisions on remuneration. A European Parliament amendment to fix the ratio of bonus to salary in law was put forward in March 2013 and approved shortly after. CRD IV introduced requirements for variable remuneration (e.g. bonuses) to be deferred for at least three years. It fixed the ratio for firms at 1:1 or at 2:1 if shareholders approve and came into force in January 2014 (the so-called "bonus cap"). The UK Treasury, led by the Chancellor, George Osborne, initially launched a legal challenge against the bonus cap, arguing it would hurt financial stability by creating perverse incentives to raise fixed pay, although the legal challenge was withdrawn when it became clear that it was unlikely to succeed.[53]

The Fifth Capital Requirements Directive needed to be transposed by 28 December 2020, and so was one of the last pieces of EU law the UK adopted before leaving the single market. It introduced fresh reforms including (i) expanding the definition of "Material Risk Taker" and so the number of individuals subject to the remuneration rules; (ii) removing discretion to apply the remuneration code proportionately (and so extending "bonus cap" and clawback provisions to all firms within its scope); and (iii) extending the minimum deferral period for variable remuneration from three to four years.[54] These changes were implemented through amendments to the FCA's Remuneration Codes.[55]

Project Merlin

Project Merlin is the outcome of negotiations between the Coalition Government and four main banks (Barclays, Lloyds, RBS and HSBC) on issues relating to lending, pay and bonuses.

After a long period of negotiation agreement was reached on 9 February 2011. Part of the agreement related to bonus payments. It included the following:

> Pay and Disclosure
>
> The aggregate 2010 bonus pool of the four banks UK-based staff will be lower than in 2009 and will reflect the explicit consideration and reflection the banks have given to the public mood and their engagement with the FSA, the Government (including through these discussions) and representatives of their leading shareholders on the subject of pay throughout the year, and reflects their duty to manage pay policy to protect and enhance the long-term interests of their shareholders. The Remuneration Committee Chair of each bank, responsible for pay and bonuses, will write to the FSA to confirm that their firm's

52 Ibid p46

53 *Financial Times*, Osborne gives up on challenge to bank bonus cap, 20 November 2014

54 BLP, Remuneration Code changes now in force - What do you need to know? 21 January 2021

55 See FCA, PS20/16: Updating the Dual-regulated firms Remuneration Code to reflect CRD V, published 17 December 2020

> 2010 pay settlements are consistent with the statement by the banks.
>
> The Remuneration Committee of each bank will review and sign-off the remuneration of the 10 highest paid staff in each business area, where they do not already do so.
>
> The pay of the 5 highest paid 'senior executive officers' will be published annually on an unnamed basis, in addition to the pay of the Executive Directors already published on a named basis in annual accounts. This means that the salary details of at least 7 executives (5 + the minimum of 2 Executive Directors salaries based on current board representation) will be published for each of the banks involved in these discussions, compared to the maximum of five individuals required in the USA.
>
> The banks will voluntarily publish this information in 2011, covering pay in 2010.
>
> The Government will consult with a view to introducing similar disclosures on a mandatory basis for all large banks from 2012 onwards, but go further and consult on the basis that the pay of the 8 highest paid 'senior executive officers' – in addition to those Executive Directors' salaries already disclosed - ought to be published annually.[56]

Parliamentary Commission on Banking Standards

Following the financial crisis and revelations of rigging of the London Interbank Offered Rate (LIBOR), a joint committee of Parliament was established in July 2012, with 10 members. Chaired by Andrew Tyrie (now Lord Tyrie, then a Conservative MP and chair of the Treasury Select Committee), its other members included the Archbishop of Canterbury, former Chancellor of the Exchequer Lord Lawson, and Labour MP Pat McFadden. Known as the Parliamentary Commission on Banking Standards (the Commission), its remit was to:

- consider the "standards and culture of the UK banking sector";
- assess the lessons learned for corporate governance and Government policy; and
- make recommendations for legislative and other regulatory action.

In total, the Commission published five reports between December 2012 and June 2013.

Its fifth and final report, titled *Changing Banking for Good*, made over 100 recommendations. On pay, it recommended "a radical re-shaping of remuneration" for bankers, arguing for:

- much more remuneration to be deferred and, in many cases, for much longer periods of up to 10 years;
- more of that deferred remuneration to be in forms which favour the long-term performance and soundness of the firm, such as bail-in bonds;
- the avoidance of reliance on narrow measures of bank profitability in calculating remuneration, with particular scepticism reserved for return on equity;

56 HM Treasury press release 9 February 2011

- individual claims on outstanding deferred remuneration to be subject to cancellation in the light of individual or wider misconduct or a downturn in the performance of the bank or a business area; and
- powers to enable deferred remuneration to Senior Persons and licensed individuals, as well as any unvested pension rights and entitlements associated with loss of office, to be cancelled in any case in which a bank requires direct taxpayer support.[57]

The Government responded that it "supports the conclusions of the Commission on remuneration and broadly accepts its specific recommendations" but said the "remuneration proposals which the Commission has put forward can be accommodated under the existing framework or existing rule-making powers".[58] The FCA expressed "support [for] the Commission's wider recommendations on remuneration" but, for example, rejected the Commission recommendation for its Remuneration Code to be extended a greater number of individuals, arguing that "Applying the Code to other individuals would go well beyond the international standards on remuneration."[59]

Further regulatory reform

In June 2015 the FCA and the PRA announced joint changes to the Remuneration Code. They would "further align risk and individual reward in the banking sector, to discourage irresponsible risk-taking and short-termism". The main changes were:

- Extending deferral (the period during which variable remuneration is withheld following the end of the accrual period) to seven years for Senior Managers, five years for risk managers with senior, managerial or supervisory roles at PRA-regulated firms and three to five years for all other staff whose actions could have a material impact on a firm (material risk takers).
- Clawback rules (where staff return part or all of variable remuneration that has already been paid) for periods of seven years from award of variable remuneration for all material risk takers, which were already applied by the PRA. Both the PRA and the FCA clawback rules were strengthened by a requirement for a possible three additional years for Senior Managers (10 years in total) at the end of the seven year period where a firm or regulatory authorities have commenced inquiries into potential material failures.
- Prohibition on variable pay for Non-Executive Directors.
- No variable pay including all discretionary payments should be paid to the management of a firm in receipt of taxpayer support.
- Strengthening the PRA requirements on dual-regulated firms to apply more effective risk adjustment to variable remuneration.

57 Parliamentary Commission on Banking Standards, Changing Banking for Good, June 2013, p9

58 HM Treasury and Department for Business Innovation & Skills, The Government's response to the Parliamentary Commission on Banking Standards, July 2013, para 2.22 onwards

59 FCA, The FCA's response to the Parliamentary Commission on Banking Standards, October 2013, paras 13 to 15

The full policy statement[60] builds on a consultation document published in 2014.[61]

60 FCA PS15/16: *Strengthening the alignment of risk and reward*; June 2015
61 FCA CP14/14: *Strengthening the alignment of risk and reward*; July 2014

3. The Current FCA Code

Details of the FCA codes can be found on its website. There are in fact five separate codes applied to different types of financial services firm.

In total, the remuneration requirements apply to over 7,000 firms, including banks, building societies and various types of investment funds.[62]

The aims of these codes are to:

- ensure greater alignment between risk and individual reward
- discourage excessive risk taking and short-termism
- encourage more effective risk management
- support positive behaviours and a strong and appropriate conduct culture within firms

The main requirements include the following:

- Deferring a certain proportion of relevant bonuses over a number of years – including greater proportions and longer periods for the most senior and highly paid staff.
- Awarding a certain proportion of a bonus in shares, share-linked instruments or other equivalent non-cash instruments...These shares or instruments should be subject to an appropriate retention period.
- Ensure guarantees are only given in exceptional circumstances to new hires for the first year of service.
- Ensure senior management adopts and periodically reviews the general principles of the firm's remuneration policy and ensure its implementation as well as disclosure of details of their firm's remuneration policies at least annually.
- [Ensure] Variable remuneration is risk-adjusted and ensures performance is assessed with respect to financial and non-financial factors and is based on the overall performance of the firm, relevant business unit and the individual concerned.
- Ensure that any variable remuneration, including a deferred portion, is paid or vests only if it is sustainable according to the financial situation of the firm as a whole, and justified on the basis of the overall performance of the firm, the relevant business unit and the individual concerned.

The actual Codes are part of the firm's Rulebook.

- SYSC 19A – IFPRU Remuneration Code
- SYSC 19B – AIFM Remuneration Code
- SYSC 19C – BIPRU Remuneration Code
- SYSC 19D – Dual-regulated firms Remuneration Code
- SYSC 19E – UCITS Remuneration Code

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62 FCA website, Remuneration, published 9 May 2015

Financial Stability Board peer review

Following the publication of the FSB principles in April 2009 (on which see above), in April 2021 the Financial Stability Board completed a peer review to "examine the steps taken by the authorities to implement the FSB Principles and Implementation Standards (P&S) and assess the effectiveness of financial sector compensation reforms in the UK". The review concluded that UK regulators "have implemented financial sector compensation reforms in the UK that are consistent with the P&S [principles and standards]" However, four recommendations for improvement were made on which the FCA and PRA agreed to "continue to work together to take these forward":

- Reviewing the interaction between the UK's remuneration regimes and the Senior Managers and Certification Regime;
- Improving the efficiency of data collection;
- Considering other supervisory approaches for assessing the effectiveness of the regime; and
- Providing additional guidance to the insurance sector.[63]

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63 Bank of England, Joint PRA and FCA Statement on the FSB Peer Review on remuneration, 14 April 2021

4. Components of executive remuneration packages

Because of the complexity of most directors' remuneration packages the figures quoted in the debate over remuneration vary widely. This complexity is demonstrated by the size of the typical quoted company's remuneration report. The 2020 remuneration report for Barclays Bank, to take a typical example, is over 30 pages long.[64]

A typical remuneration package consists of several different elements. These key ones are fixed pay, the annual performance incentive (bonus), and long-term incentive awards.

Fixed pay

This is the most straightforward part of the package to deal with. It is not dependent on other variables and is not subject to interpretation.

It includes fixed pay (salary), pension and other taxable benefits such as private medical insurance, and can be paid in some combination of cash and shares.

Bonus

Except for legally-binding restrictions (such as the FCA's Remuneration Code) companies can set their own bonus criteria. Barclays PLC's 2020 Remuneration Report states that:

> The maximum annual bonus opportunity is 93% of Fixed Pay (cash and shares) for the CEO and 90% of Fixed Pay (cash and shares) for the GFD [Group Finance Director]. Individual bonuses are entirely discretionary (any amount may be awarded from zero to the maximum value) and decisions are based on the Committee's judgement of Executive Directors' performance in the year, measured against Group and personal objectives.[65]

Long-term incentive awards

These awards are designed to align the directors' goals with the long-term success of the company. Barclays report states that the aim of the payment is that "long term incentive awards reward execution against the Group strategy and the creation of sustained growth in shareholder value"

Barclays' report states that these exist:

> To incentivise execution of Barclays' strategy over a multi-year period. Long-term performance measurement, deferral and holding periods encourage a long-term view and align Executive Directors' interests with those of shareholders.[66]

Amounts payable are typically spread over several years and can be reduced from the sums originally indicated as they are subject to clawback provisions.

64 See Barclays Bank PLC, Annual Report, p108-142
65 Barclays Bank PLC, Annual Report, p115
66 Barclays Bank PLC, Annual Report, p116

Content of remuneration reports

Requirements for the content of remuneration reports are largely derived from the Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013, addressed the issue of the complexity of directors' payments (see below). The Regulations, for example, require there to be:

> a single total figure table of remuneration in respect of each person who was a director during the relevant financial year;
>
> the percentage change in the remuneration of the chief executive officer, the relative importance of spend on pay; and
>
> a statement of how the directors' remuneration policy of the company will be implemented in the financial year following the relevant financial year.[67]

[67] Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013, Explanatory Notes, Schedule 8

5. Remuneration packages of UK banking executives

Remuneration reports can usually be found in the publicly available annual reports for listed financial services firms.

For example, the 2020 Annual Report for HSBC, the UK's largest bank,[68] shows that in 2020 its Chief Executive (Noel Quinn) received total pay of £4.154 million, of which £799,000 was a bonus.[69] In 2005, HSBC's Chief Executive (Stephen Green) received total pay of £2.529m, of which £1.75 million was a bonus.[70]

These figures are a simplified headline figure, and not adjusted for inflation.

EU sources

Some historic figures on pay can be obtained from EU sources. Under CRD IV, the European Banking Authority is required to benchmark remuneration trends in financial services at EU level and to publish data.[71] Before the UK left the EU single market at the end of 2020, this data included the UK.

Data is available by Member State and collectively in its 'High Earners Report'. For example, 2018 data (the latest available) for the UK shows that there were 1,433 investment bankers earning between €1 and €2 million and two individuals who earned between €15 and €16 million. The UK had by far the largest number of high earners of any EU country.[72]

68 As determined by total assets in 2019. Source: Statista
69 HSBC, All Reporting page, 2020 report p239
70 Ibid, 2005 report p227
71 EBA Report, Benchmarking of Remuneration Practices at the European Union Level (2017 and 2018 data) and data on high earners (2018 data), p6
72 Ibid, pp7, 75-78

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