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Banking executives' remuneration in the UK

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Summary

The level of 'boardroom pay'; the way it is set; and its complexity have become significant issues ever since the financial crisis in 2007. The way in which executives had been rewarded was seen as a contributing factor to this crisis.

Rather than just being a private sector concern, the remuneration of banking executives became an important political issue ever since the government invested public money in the Royal Bank of Scotland and the Lloyds Banking Group. These major shareholdings justified close scrutiny of the remuneration of these companies' directors.

General concern about 'corporate governance' and the widening gap between 'top pay' and that of 'ordinary workers' has meant that there is a wider interest in the determination of executive pay beyond the banking sector.

No single body or organisation has sole responsibility for regulating or reforming executive remuneration. As a consequence various streams of reform from different sources have affected the issue. This Paper summarises these.

This Briefing Paper briefly describes the main elements of the directors' remuneration packages and provides information on the amount of these packages for the Chief Executives, Chairmen and highest paid directors of the United Kingdom's five largest retail banks. It also includes details of the remuneration of the five highest paid non board member executives of these banks.

1. Introduction

1.1 Background

The issue of bank executive and trader remuneration became one of the more 'populist' issues of the financial crisis. At a public/media level, criticism tended to focus upon the absolute level of salaries and bonuses paid to bank management at a time when the whole sector (directly or indirectly) was in receipt of substantial sums of 'taxpayers money'. The issue was characterised by the phrase 'rewards for failure'.

From the standpoint of the regulators, the focus has been the structure of bonuses – what they were paid for? The policy issue was to what extent had pay structures contributed to excessive risk taking by banks.

Box 1: Been here before?

This is not the first time that the issue of "rewards for failure" has been raised. Following the large severance packages afforded to executives at GlaxoSmithKlein and Marconi in 2001 and 2002, the then Department for Trade and Industry published a Green Paper entitled *"Rewards for Failure" Directors' Remuneration – Contracts, Performance and Severance* in June 2003.[1]

This report proposed reducing contract and notice period length, capping severance at six month's pay and phased payments in order to reduce large severance payments without reducing the competitiveness of British companies in the market for high-quality executives. The Trade and Industry Committee subsequently produced a report that concluded that legislation, likely to reduce desirable contract flexibility, should only be pursued where the "comply or explain" code of conduct fails. Ultimately, the committee determined that a change of culture was required, and that this could be initiated by the companies themselves, under pressure from shareholders.

The *Companies Act 2006, Part 15 Chapter 5* requires publicly quoted companies to provide details of the remuneration of their directors. In tandem with *The Director's Report Remuneration Regulations 2002 SI 2002/1986*, companies are legally obliged to publish details of the remuneration of executive and non-executive directors in their annual report.

This Paper focuses on the UK's largest retail banks and restrict its interest to executive directors who, unlike non-executive board members, bear direct responsibility for the management of the company and are eligible for performance-related bonuses. Part of the *Financial Services Act 2010* provides for the *Companies Act* legislation to be extended to executives of large and medium sized companies.

1.2 Reform streams

No single body has had sole responsibility for regulating pay and bonuses and this has contributed greatly to the complexity of the narrative of the reform process.

Since 2008 there have been various streams of reform from different sources concentrating on different aspects of the issue. Because the financial crisis was the stimulus for much comment, many of the initiatives are directed solely towards the financial sector, rather than to companies more widely. The main bodies involved include:

[1] Department for Trade and Industry Green Paper, '"Rewards for Failure" Directors' Remuneration – Contracts, Performance and Severance', June 2003

- The FSA (FCA)
- The Financial Stability Board
- The Walker Review
- European directives
- Committee of European Banking Supervisors
- The G20
- The government through Companies Act proposals

Not surprisingly the issue has been the subject of much parliamentary activity. A House of Commons Treasury Committee report argued that:

> cash bonuses awarded on the immediate results of a transaction and paid out instantly meant individuals often paid little or no regard to the overall long-term consequences and future profitability of those transactions.[2]

Furthermore, the Committee's report noted that in

> too many cases the design of bonus schemes in the banking sector were flawed and not aligned with the interests of shareholders and the long-term sustainability of the banks.[3]

The Financial Stability Board (FSB) published its principles and implementation standards for sound compensation practices in 2009. These were subsequently endorsed at the Pittsburgh G20 Summit.

A number of prospective EU directives currently being developed at European level also contain sections on remuneration, including the third and fourth Capital Requirements Directives.

The totality of regulation is difficult to grasp at times since, for example, FSA/FCA rules must be aligned with EU Directives, and yet the Rules were produced first. But, FSA/FCA work and thinking has been informed by the findings of, for example, the Walker Report. With other recommendations, it is difficult to see how they have been implemented and by what, again, is it an FSA Rule or an EU directive. Parts of 'Walker' for example, can be found in FSA Rules and in new legislation introduced by the Coalition government which amended the *Companies Act*.

Part 2 of the Paper sets out action taken under the various work streams of the different bodies, largely now, for historical reporting reasons and reference.

[2] House of Commons Treasury Committee, Banking Crisis: reforming corporate governance and pay in the City, 14 May 2009, p12
[3] Ibid., p15

2. Reform

2.1 The Walker Report

In May 2010, the Financial Reporting Council (FRC) produced a revised edition of the Code which applies to financial years starting after June 2010. Section D of the Code applies to remuneration setting and management.[4] Informing this work was the Walker Review - A Review of corporate governance in UK banks and other financial industry entities, published in November 2009.

The Review was commissioned by the Treasury and the findings have informed the FRC new corporate governance code; the FSA Code and provisions in the *Financial Services Act 2012.*

In a Treasury consultation document: Reforming Financial Markets,[5] which had preceded Walker, the Labour Government said that the final Walker Report on governance and the FSA's Code of practice on pay would "form a framework for action for market participants". Its terms of reference were:

> the effectiveness of risk management at board level, including the incentives in remuneration policy to manage risk effectively;
>
> the balance of skills, experience and independence required on the boards of UK banking institutions;
>
> the effectiveness of board practices and the performance of audit, risk, remuneration and nomination committees;
>
> the role of institutional shareholders in engaging effectively with companies and monitoring of boards; and
>
> whether the UK approach is consistent with international practice and how national and international best practice can be promulgated.

The Walker Review team published a consultation document in July 2009 and the final Report[6] on 26 November 2009. With respect to 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.

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4 UK Corporate Governance Code, Financial Reporting Council. June 2010
5 HM Treasury July 2009 CM 7667, http://www.hm-treasury.gov.uk/reforming_financial_markets.htm
6 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*

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.

Reaction from the Treasury to the Review's findings was:

The Government announced on 26 November 2009 that it will move quickly to implement the reforms of bank pay and governance proposed by Sir David Walker. His final report suggests a series of reforms to strengthen the role of shareholders, improve the quality of bank boards, and to increase transparency of pay and bonus policies.[7]

The FSA said

The FSA 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.[8]

Reaction to the proposals has 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:[9]

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

7 HM Treasury press release 26 November 2009
8 FSA press release 26 November 2009
9 *Some bankers still fear the imposition of the 'dead hand of bureaucracy',* Financial Times 26 November 2009

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

2.2 FSA/FCA Code

With regard to the technical/regulatory concerns over the structure of bonus payment systems the FSA was the lead force. It had to ensure that its new Code was broadly in line with EU directives that would follow.

The FSA, in its original consultation paper, emphasised its focus upon the *structure* of remuneration, rather than its *level*:

> We are not concerned with the levels of remuneration, which we regard as a matter for firms' boards and shareholders. None of the principles in our Code will prevent firms providing large remuneration packages to employees if such packages can be

> justified by their contribution to the success of the firm, adjusted appropriately for risk.[10]

Box 2: Turner Review

The FSA paper appeared at the same time as the another review of financial regulation on 18 March 2009, commonly called the Turner Review (the Review) after its author Adair (now Lord) Turner, the Chairman of the FSA. This included sections on remuneration which, unsurprisingly, closely matched FSA proposals.

The central proposition of the Code, addressed risk management. It was intended for large banks and brokerages under the authority of the FSA. More specifically, this includes bank and building societies that have consolidated regulatory capital in the UK banking entities in excess of £1bn and/or are part of an international financial group whose regulatory capital is in excess of £20bn. FSA-authorised investment firms are included with £750m and £5bn in regulatory capital for UK banking entities and international financial groups respectively.

The general requirement stated that:

> A firm must establish, implement and maintain remuneration policies, procedures and practices that are consistent with and promote effective risk management.[11]

The code as it was first published contained 11 main Principles and a twelfth – divided into eight subsections – which consists of "a series of *rules*, *evidential provisions* and *guidance* relating to *remuneration* structures".

Expanded measures

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

[10] FSA, Reforming remuneration practices in financial services, Consultation Paper 09/10, 18 March 2009, p6

[11] FSA, Reforming remuneration practices in financial services, Consultation Paper 09/10, 18 March 2009, p28

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; and
- Strengthening the PRA requirements on dual-regulated firms to apply more effective risk adjustment to variable remuneration

The full policy statement can be found here.[12] It builds on a consultation document published in 2014 which can be found here.[13]

The current Code is shown in the FCA Code Section below.

2.3 EU

At the EU level it was agreed that a regulatory framework based simply on an EU Recommendation – which is not legally enforceable – would not be sufficiently rigorous. Hence, the Commission looked at how to translate requirements incorporating regulations on pay that might have been in a code, into amendments to a directive.[14] It used the new version of the Capital Requirements directive (CRD III) as the vehicle for change.

The draft Directive was approved By the Council and Parliament in July 2010. Proposals for amending the Directive as it applies to remuneration policies can be found on the Commission website.[15]

Comment on the impact of the new proposals focussed on the fact that the European proposals were stricter than the FSA equivalent (the EU rules apply to a wider spread of companies). The Committee of European Banking Supervisors (CEBS)[16] published its draft guidelines on remuneration on 8 October 2010.[17] 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.

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[12] FCA PS15/16: *Strengthening the alignment of risk and reward;* June 2015

[13] FCA CP14/14: *Strengthening the alignment of risk and reward;* July 2014

[14] EU Impact Assessment on amendments to the Capital Requirements Directive, [COM(2009) 362 final], p4

[15] http://ec.europa.eu/internal_market/bank/docs/regcapital/consultation-renumeration_en.pdf

[16] CEBS, was composed of high level representatives of bank regulators and central banks throughout the EU. It was subsumed within the European Banking Authority in 2010.

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

> 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.[18]

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.[19]

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 should also be able to explain how the ratio will evolve when the institution is faced with a serious loss.[20]

A significant part of the Report relates to issues over vesting of benefits - the delay between performance and vesting of benefits; the proportion that should be available for vesting and the nature of those benefits.[21]

At a very late stage in its process, the follow up to CRDIII, CRD IV, also included changes to 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. It fixed the ratio normally to 1:1 or at 2:1 if shareholders approve and came into force in January 2014. Details of the proposal can be found here.

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18 Ibid

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

20 Ibid p46

21 Ibid pp 60-61

2.4 Companies legislation

The main requirement on **all companies subject to the *Companies Act 2006*** is that they must produce a company directors' remuneration report. These provisions were given force by, first, The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008, SI 2008/410 and, second, by The Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013, SI 20131981. These Regulations were derived from the *Financial Services Act 2010.* This was introduced to address some of the regulatory reform issues not previously addressed in the other post crisis legislation (e.g. in the Banking Act 2009). In the event, proceedings on it were truncated by the announcement of the General Election in 2010. Of the provisions that survived, sections 4 & 5 of the 2010 Act gave the Treasury power to amend the reporting requirements of the *Companies Act 2006*.

Section 4(1) of the Act states:

> 4. Executives' remuneration reports
>
> (1)The Treasury may make provision by regulations about the preparation, approval and disclosure of executives' remuneration reports.

The next key part is Section 5 (1&2):

> 5. Executives' remuneration reports: supplementary
>
> (1)Regulations under section 4 may, in particular, make provision as to—
>
> (a) the information that must be contained in an executives' remuneration report,
>
> (b) how information is to be set out in the report, and
>
> (c) what is to be the auditable part of the report.
>
> (2)The information that may be required to be contained in an executives' remuneration report includes—
>
> (a) information corresponding to information that could be required by regulations under **section 421 of the Companies Act 2006** to be contained in a directors' remuneration report, and
>
> (b) information comparing the remuneration of relevant executives of an authorised person with the remuneration of employees of the authorised person who fall within a prescribed description

The key distinction made by the regulations is between quoted and unquoted companies and that the remuneration provisions apply to *directors* not to employees. Both must produce annual directors' remuneration reports which show:

- The total remuneration of the company's directors.
- The total gains made by the company's directors exercising their share options.
- The total amount paid to the directors in that financial year under any long term incentive scheme.
- The total company contribution to the directors' pension scheme/s.

- How many directors are accruing retirement benefits under either 1) money purchase schemes or 2) defined benefit schemes.

For **unquoted companies**, if a director's total remuneration in the financial year exceeds £200,000 the remuneration report must state:

- How much the highest paid director was paid.
- The value of the company's contribution to this director's pension. If this pension is a defined benefits pension the report must show the amount of the accrued pension and the value of any lump sum at the end of the financial year.
- Whether the highest paid director exercised any share options in that financial year.
- Whether any shares were received by the highest paid director in respect of a long term incentive scheme.
- Additional information has to be provided on any compensation paid to directors for loss of office, excess retirement benefits and payments made to third parties in respect of the directors' services. Most of this material can be presented as total amounts for all the directors without identifying an individual.

For **quoted companies** the Directors' remuneration report must:

- Show each director's individual remuneration for the current and previous financial year as a single figure.
- Show whether each director was granted or exercised any share options in that financial year.
- State if any share options are unexpired at the end of the financial year and show how many options are outstanding, the exercise price and the date on which the options expire for each director.
- Show any additional benefits for each director of any long term incentive plan (if not already covered by the previous material on share options).
- Contain information on each director's pension entitlement from the company. If the director participates in a defined benefit scheme the report must show any changes during the financial year in the director's accrued benefits and the value of the total accrued benefits at the end of that financial year. If the pension is via a money purchase scheme, the report must show the contribution made by the company to the scheme in that financial year.
- Show for each director any payment made by third parties to the company for making available the services of that person.

More general requirements for quoted companies include:

- A list of the names of every director who is a member of a remuneration committee. In addition any individual who is not a director but who provided the remuneration committee with "advice or services that materially assisted the committee in their consideration of any such matter" must be listed.
- Contain a statement of the company's policy on directors' remuneration for the following financial year. This must include for each director a detailed summary of any performance conditions affecting entitlement to share options and any long term incentive scheme.

- Contain a linear graph comparing the performance of the company's share price and overall return against a relevant market index.

The key provisions were set out in Schedule 8 of the 2008 Regulation. This was substituted with revised provisions by the Schedule in the 2013 Regulation. It can be seen in full here. One of the key features is that companies (quoted) must produce a single figure of remuneration for each director. As any user of account could attest it was very difficult to come up with a figure for remuneration given the wide range of sources of reward open to large companies. The requirements are very detailed, setting out for example what column headings should be employed:

> 7. (1) Subject to paragraph 9, in the single total figure table, the sums that are required to be set out in the columns are—
>
> (a) in the column headed "a", the total amount of salary and fees;
>
> (b) in the column headed "b", all taxable benefits;
>
> (c)in the column headed "c", money or other assets received or receivable for the relevant financial year as a result of the achievement of performance measures and targets relating to a period ending in that financial year other than—
>
> (i)those which result from awards made in a previous financial year and where final vesting is determined as a result of the achievement of performance measures or targets relating to a period ending in the relevant financial year; or
>
> (ii) those receivable subject to the achievement of performance measures or targets in a future financial year;
>
> (d)in the column headed "d", money or other assets received or receivable for periods of more than one financial year where final vesting—
>
> (i) is determined as a result of the achievement of performance measures or targets relating to a period ending in the relevant financial year; and
>
> (ii) is not subject to the achievement of performance measures or targets in a future financial year;
>
> (e) in the column headed "e", all pension related benefits including—
>
> (i) payments (whether in cash or otherwise) in lieu of retirement benefits;
>
> (ii) all benefits in year from participating in pension schemes;
>
> (f) in the column headed "Total", the total amount of the sums set out in the previous columns.

Government reforms (Post-Walker)

The government's response to Walker (et al) was limited to those aspects where it has jurisdiction (most financial services law is the responsibility of the FSA and hence off limits to government).

The Coalition Government published its plans for remuneration disclosure and 'shareholder engagement' in January 2012.[22] These became amendments to the *Enterprise and Regulatory Reform Bill 2012*

[22] HC Deb 23 January 2012 c23

and which are now Sections 79 to 82 of the Enterprise and Regulatory Reform Act 2013. The new sections include, for quoted companies:

- Member's approval of directors' remuneration policy: an ordinary resolution is required to approve any change in a directors' remuneration policy document
- Remuneration or loss of office payments to ex directors must be approved by shareholders

Project Merlin[23]

Whilst the remuneration packages of the senior directors on the banks' boards was of particular interest to politicians, the media and the general public the remuneration packages of other highly paid bank staff was also of interest to all of these groups Project Merlin covered many aspects of bank activity including remuneration.

After a long period of negotiation agreement was reached on 9 February 2011. Part of the agreement related to bonus payments. Extracts relating to this aspect from the Treasury press release are shown below:

> 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 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

[23] Project Merlin is the outcome of negotiations between the banks and government on a number of issues. Its intention was a combination of 'peace' talks and 'reparations'. The Banks wanted a more normal relationship with government (and public). The Government wanted signs of renewed commitment from the banks to the public good, reflecting the public support given to them during the crisis and since.

> Executive Directors' salaries already disclosed - ought to be published annually.[24]

The Project Merlin agreement was the original basis for much of the disclosure on pay still in existence. The table in the last Section of this Paper sets out the latest available information.

[24] HM Treasury press release 9 February 2011

3. The Current FCA Code

Details of the FCA code(s) can be found on its website here.

Codes, because there are in fact five separate codes applied to different types of firm – banks, investment finds, collective investment schemes and dual regulated firms etc.

The main principles are that

> all applicable firms must make sure their remuneration policies and practices are consistent with and promote sound and effective risk management.
>
> This includes the following:
>
> - At least 40% of a bonus must be deferred over a period of at least three years. At least 60% must be deferred for the most senior management (for SYSC 19A and SYSC 19D only) or when an individual's bonus is a particularly high amount.
> - At least 50% of a bonus must be made in shares, share-linked instruments or other equivalent non-cash instruments (or units of shares of the alternative investment fund for firms subject to SYSC 19B or units or shares of the UCITS, equivalent ownership interests in the UCITS, share-linked instruments relating to the UCITS concerned, or equivalent non-cash instruments with equally effective incentives). 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 remuneration policy and ensures its implementation as well as disclosure of details of their firm's remuneration policies at least annually.
> - Variable remuneration is risk-adjusted and ensures performance is assessed with respect to financial and non-financial factors and is based on the performance of the individual, business unit concerned and the overall results of the firm.
> - 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 performance of the firm, the business unit and the individual concerned.[25]

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

25 FCA website

4. Components of executive remuneration packages

Introduction

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 2012 remuneration report of Barclays Bank, to take a typical example, is 30 pages long.

In the period shortly before the resignation of the Chief Executive of RBS, Stephen Hester, there was considerable interest in elements of the share bonus allocated to his remuneration package. Below is shown the method of calculating such bonuses within RBS, demonstrating the difficulty of calculating the actual value of an award and the performance 'source', i.e. to which year it is associated with, of any amounts paid in any particular year. The notes are taken from the summary of the RBS remuneration report 2010:

> 2010
>
> The 2010 targets covered progress against the Strategic Plan, financial performance, risk efficiency and control measures as well as stakeholder and people management. Executive directors have a normal maximum incentive opportunity of 200% of salary (with an exceptional maximum of 250% of salary).
>
> The Remuneration Committee has reviewed the annual incentive awards for the executive directors for 2010 performance, taking into account performance against targets set at the beginning of 2010. Performance was assessed across a broad range of quantitative and qualitative measures and was supported by a robust performance management framework including a formal half year review.
>
> During 2010, performance has been strong and all the Group's main performance indicators are ahead of the Strategic Plan both in terms of timing and outcomes. More information on the Group's performance can be found on pages 12 and 13. There are, however, a small number of areas where the Group is not performing well ahead of the targets which have been set. Accordingly, the Remuneration Committee has recommended, and the Board (excluding executive directors) has agreed, that the Group Chief Executive and Group Finance Director should receive annual incentive awards of 170% and 186% of salary respectively.
>
> For 2010 performance, the executive directors' annual incentive will be delivered entirely as an allocation into Share Bank. The allocated shares will vest in two equal tranches in March 2012 and 2013, and must then be held for a further six months. The Group Chief Executive has voluntarily agreed to a total holding period of twelve months after vesting. Clawback provisions will again apply prior to vesting of the shares.
>
> 2011
>
> The maximum potential allocation of shares in respect of the 2011 financial year under Share Bank will be 6.0 million shares for the

> Group Chief Executive and 3.75 million shares for the Group Finance Director. These allocations were agreed following consultation with shareholders at the beginning of 2011. The potential allocations represent normal maximum annual incentive levels for executive directors based on the share price prevailing at the start of the consultation period and will be assessed for final allocation in 2012 on that basis. Depending on share price movement during the performance period, the value of the final allocation could further increase or decrease.
>
> Between 0% and 100% of the maximum potential allocation will be formally allocated into Share Bank in March 2012 based on 2011 performance across five performance categories: strategic direction; business delivery and financial performance; stakeholders including delivery against UK government lending commitments; risk and control; and capability and development. Fixing the number of shares in this way avoids unintended consequences arising from share price volatility around award dates and provides a clear alignment with shareholder interests through the year The Remuneration Committee will determine the actual allocation to Share Bank by reference to the extent to which executive directors have met the performance targets. Shares allocated in respect of 2011 performance will vest in two equal tranches in March 2013 and 2014 respectively. Clawback provisions will apply to shares allocated to Share Bank for the period prior to their vesting.[26]

A typical remuneration package consists of at least five different elements. These are the base salary, an annual performance incentive, deferred incentive awards, long term incentive awards and retirement benefits.

Base salary

The base salary element is the most straightforward part of the package to deal with. It is not dependent on other variables and is a fact not subject to interpretation. This figure is stated in the accounts as the amount paid to the director in that financial year. For most of the bank executives this is a relatively small part of their remuneration package. For example in the case of Robert Diamond, the Chief Executive of Barclays PLC, a base salary of £250,000 was paid in 2010 whilst his total remuneration for the year was £9,000,000.

Annual performance incentive

Each company is free to define its own performance criteria. Typically the maximum possible award is 250% of base salary. Barclays PLC remuneration report defines the performance criteria as follows:

> Annual performance incentives are awarded on a discretionary basis, based on Group, business, team and individual performance
>
> — The aggregate level of annual performance incentives is determined by reference to Group and business unit metrics. These include a range of risk-adjusted financial metrics including profit before tax (PBT) and return on risk weighted assets (RoRWA)
>
> — Individual annual performance incentives are strongly differentiated based on individual performance (both financial and

[26] RBS 2010 Annual Report.

> non-financial). Adherence to applicable risk and control frameworks is part of performance assessment
>
> — The structure of individual annual performance incentives may vary based on amount, and may include cash and deferred incentive awards. Details on deferred incentive awards are set out below
>
> — 50% of non-deferred annual performance incentives for 2010 for executive Directors (100% of non-deferred for Mr Diamond) and other Code Staff is in the form of Barclays shares subject to a six month holding period

As these incentive payments contain elements that can be deferred to following years there is considerable scope for disagreement on which figures to include in the time frame of the award. The payments themselves are also made in the form of both cash and shares which allows commentators to make differing assumptions as to the value of the award.

Again using the example of Barclays the company decided to award its senior directors the following annual performance incentive:

> It is proposed to be delivered in three elements for Mr Varley and Mr Lucas: 20% in cash, 20% in Barclays' shares which are subject to a six month holding period and 60% in the form of a deferred incentive award. Mr Diamond's 2010 annual performance incentive is proposed to be delivered 28% in Barclays' shares which are subject to a six month holding period and 72% in the form of a deferred incentive award.

Deferred incentive awards

From the Barclays' example it is clear that in practice there is little real difference between annual performance incentives and deferred incentive awards. Deferred incentive awards are usually regarded as aiming to align the recipient's award with growth in shareholder value and to help retain staff for at least the deferred period. For 2010 the Barclays directors had 60% of their annual performance incentives deferred.

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"

The criteria for awarding these awards is complicated, the Barclays arrangement is quoted below as an example:

> Long term incentive awards are subject to risk adjusted performance conditions, normally measured over a three year performance period
>
> — The vesting of long term incentive awards is subject to the discretion of the Committee to ensure that awards only vest for appropriate performance. Delivery of vested long term incentive awards includes awards in Barclay's shares

> — Vesting of both deferred incentive awards and long term incentive awards is subject to malus and prudent financial control provisions in accordance with the FSA Code
>
> — Barclays operates a number of deferred incentive award plans and long term incentive plans. Details of the principal plans under which awards were made in 2010 are included in Table 24 and new plans proposed for 2011 in Table 25
>
> — Deferred incentive awards for 2010 for executive Directors, other Code Staff and other senior executives will include awards in the form of contingent capital awards, which are subject to a vesting condition that Barclays Group Core Tier 1 capital ratio is at least 7% on the vesting date

It should be noted that the amounts payable are typically spread over several years and can be reduced from the sums originally indicated as they are subject to clawback provisions. In the debate on levels of remuneration these points are often ignored.

Retirement benefits

Pension entitlements generally take two forms. One option is participation in the company's own pension plan. In the past these plans were often defined benefit schemes, now they are more likely to be 'money purchase'. They are not linked to performance.

The second form of pension provision is the receipt of an annual allowance. This may be used to supplement a personal pension scheme and is usually worth a fixed proportion of the recipient's base salary.

The transfer value of a pension represents the accrued value of pension benefits available to that employee that could be transferred to another pension scheme should they change their employment. It can be thought of as a 'pot' with which an annuity can be bought on retirement. It should be noted that this is not a sum paid or due to an individual but a liability on behalf of the pension fund. The annual increase in the transfer value of the pension fund represents the contributions to the funds accrued for that year. It does not provide estimates of the pension that such a sum will actually realise years hence. Consequently, it is hard to equate pension contributions with the individual's total remuneration for that year.

An end to complexity?

As mentioned above 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).[27] Part of its explanatory note is shown below:

> Schedule 8 specifies the information to be included in the directors' remuneration report which the directors of a quoted company are required to prepare under section 420 of the Act.
>
> Part 2 of Schedule 8 provides that the report shall contain a summary statement by the chair of the remuneration committee.
>
> Part 3 of Schedule 8 requires the report to contain information about the remuneration of the directors in the financial year being reported on ("the relevant financial year"), including:

---

27 SI 2013/1981

> a single total figure table of remuneration in respect of each person who was a director during the relevant financial year,
>
> payments made to directors for loss of office,
>
> a performance graph which sets out the total shareholder return of the company on the class of equity share capital, if any, which caused the company to fall within the definition of "quoted company" in section 385 of the Act,
>
> the percentage change in the remuneration of the chief executive officer, the relative importance of spend on pay,
>
> a statement of how the directors' remuneration policy of the company will be implemented in the financial year following the relevant financial year,
>
> the consideration given by directors to the matter of remuneration and a statement of the result of the voting on any resolutions in respect of the directors' remuneration report or policy at the last general meeting of the company.
>
> Part 4 of Schedule 8 sets out the requirements relating to the company's future directors' remuneration policy and requires a future remuneration policy table, an illustration of the application of that policy to the directors, the company's policy on payment for loss of office and a statement regarding consideration of the company's overall pay policy and the views of shareholders in the formulation of the policy.
>
> Part 6 of Schedule 8 sets out the requirements for a revised directors' remuneration policy, and Part 5 defines the auditable part of the report.

The SI came into force from 1 October 2013. It has consequentials for the UK Listing Rules which are the responsibility of the FCA. It produced a consultation in August 2013.[28]

[28] FCA, CP13/7

5. Remuneration Packages of UK Banking Executives 2016.

Given all the difficulties previously mentioned, it is difficult to produce comparable financial information between the five largest retail banks in the UK. Although there may be some inconsistencies as between companies the approach adopted here is to simply reproduce the summary information given in each company's remuneration report.

UK Sources

The remuneration reports of the largest banks are very lengthy documents and not always susceptible to simple comparisons either over time or between each other. Two tables provide detail of the size and composition of pay. The first is a table showing the pay of the top eight executives at the company. The second is pay in all guises of the Chairman and the top Chief Executive directors. These tables, for 2016, are shown below:

UK Bank Chairman, Chief Executive and highest paid Director Remuneration
2016 Year end; £'000s

	Base salary	Taxable benefits	Bonus	Long term incentive plan	Pension	Total Remuneration 2016	Total Remuneration 2015
Barclays PLC							
John McFarlane	800	1	0	0	0	801	639 *
Jes Staley	2,350	169	1,318	0	396	4,233	277 **
Tushar Morzaria	1,550	44	854	1,008	200	3,656	2,533 ****
HSBC Holdings PLC							
Douglas Flint	1,500	100	0	0	450	2,136	2,496
Stuart Gulliver	1,250	557	1,695	0	375	5,675	7,340
Iain Mackay	700	52	987	0	210	2,953	4,256
Lloyds Banking Group PLC							
Lord Blackwell	714	12	0	0	0	726	712
António Horta-Osório	1,125	143	1,220	1,584	568	5,541	8,470
George Culmer	745	42	574	857	186	2,909	4,661
RBS Group PLC							
Howard Davies	750	8	0	0	0	758	262 ***
Ross McEwan	1,000	113	0	1,030	350	3,493	3,492
Ewen Stevenson	800	26	0	0	280	1,906	1,906
Santander UK PLC							
Shriti Vadera	650	0	0	0	0	650	650
Nathan Bostock	1,600	46	2,330	0	560	4,536	3,958

Notes *Appointed 24 April 2015, includes previous role fees*

***Period from 1 Dec 2015 when joined the Board as Group Chief Executive.*

**** Joined the Board on 14 July 2015 and became Chairman with effect from 1 September 2015*

***** base salary includes 'role based pay'.*

Sources: Company Annual Reports for 2016

UK Bank remuneration: eight highest paid senior executives							
2016 Year end; £'000s		Fixed pay	Variable pay not deferred	Variable pay deferred	Total salary plus bonus	Long Term Incentive Plan	Total Remuneration
Barclays PLC	Individual 1	1,813	400	4,466	6,679	-	6,679
	Individual 2	1,500	400	2,250	4,150	-	4,150
	Individual 3	1,974	400	1,626	4,000	-	4,000
	Individual 4	1,925	400	1,650	3,975	-	3,975
	Individual 5	1,250	400	750	2,400	-	2,400
	Individual 6	1,300	380	570	2,250	-	2,250
	Individual 7	1,170	396	594	2,160	-	2,160
	Individual 8	1,049	210	316	1,575	-	1,575
Total Barclays		**11,981**	**2,986**	**12,222**	**27,189**	-	**27,189**
HSBC Holdings PLC							
Five highest paid (total)							
Total HSBC		15,474	17,916				33,472
Lloyds BG PLC	Individual 1	1,070	240	360	1,670	2,886	4,640
	Individual 2	1,070	660	165	1,895	2,571	4,532
	Individual 3	815	464	196	1,475	2,020	3,558
	Individual 4	1,299	219	328	1,846	780	2,808
	Individual 5	1,230	189	284	1,703	833	2,717
	Individual 6	550	418	432	1,400	884	2,329
	Individual 7	995	154	231	1,380	744	2,271
	Individual 8	505	275	213	993	1,042	2,081
Total Lloyds		**7,534**	**2,619**	**2,209**	**12,362**	**11,760**	**24,936**
RBS Group PLC	Individual 1	800	-	-	-	175	1,775
	Individual 2	800	-	-	-	175	1,775
	Individual 3	675	-	-	-	412	1,762
	Individual 4	688	-	-	-	261	1,637
	Individual 5	588	-	-	-	167	1,343
	Individual 6	638	-	-	-	-	1,276
	Individual 7	575	-	-	-	250	1,113
	Individual 8	450	-	-	-	-	675
Total RBS		**5,214**	**0**	**0**	**0**	**1,440**	**11,356**
Santander UK PLC	Individual 1	1,354	424	636	2,414	-	2,414
	Individual 2	387	172	258	817	-	1,452
	Individual 3	722	270	405	1,397	-	1,397
	Individual 4	716	187	280	1,183	-	1,183
	Individual 5	738	155	233	1,126	-	1,126
	Individual 6	609	173	260	1,042	-	1,042
	Individual 7	506	125	188	819	-	1,034
	Individual 8	645	133	200	978	-	978
Total Santander		**5,677**	**1,639**	**2,460**	**9,776**	**0**	**10,626**
	Note: excluding executive directors						
Sources: Annual Reports for 2016							

The amounts shown for the Long Term Incentive Plans are an approximate notional value verified by external advisors. The actual value of the plans will be dependent on actual performance and share price when they vest.

EU Sources

Alternative figures on pay can be had from EU sources. Part of the CRD III directive included a direction for Member States to collect information on the number of individuals per institution in pay brackets of at least €1 million, including the business area involved and the main elements of the salary, bonus, long term award and pension contribution. The data is published by the European Banking Authority by Member State and collectively in its 'High Earners Report'. UK figures for 2015 are shown below:

UNITED KINGDOM; Banking High Earners Return 2015

Amounts in billions Euro

	Business area				
	Investment banking	Retail banking	Asset management	MB Management function	Total
Total Number of high earners:	2,313	108	626	458	4,133
of which are identified staff *(2012 figures in brackets)*	2,146 (947)	105 (52)	415 (94)	423	3,551 (1,272)
Total fixed remuneration (millions Eur)	2,128	89	225	410	3,257
Total variable remuneration (millions Eur)	2,547	104	1,153	802	5,288
Average total remuneration per individual ('000's Eur)	2,021	1,789	2,201	2,648	2,067
Ratio variable/fixed remuneration %	120%	117%	513%	196%	162%

Source: European Banking Authority

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