

INDEPENDENT DIRECTORS' REMUNERATION IN VARIOUS CORPORATE GOVERNANCE SYSTEMS: EMPIRICAL EVIDENCE FROM BANKS

KOSTYUK O. M.

PhD, DBA, Professor

GOVORUN D. A.

PhD candidate

SARKIZOVA O. O.

MANZHULA I. P.

SHABLIY A. V.

Sumy, Ukraine

Introduction. Financial Crisis of 2008 showed that banking industry is quite important chain in the world economic system. In respect of this, governance of such industry looks very important. Lots of conclusions were made after 2008. The number of laws and other documents were issued in corporate governance and banking regulation. However, the results of such changes obviously we will see later.

Some evidences show that over the period from 2003 to 2008, the percent of independent directors on the board increased from 72% in 2003 to almost 80% in 2008 (Minton et. al. 2011). Many efforts were made around the problem of excessive risk-taking and the independent directors (Kirkpatrick (2009), Walker (2009)). So the role of independent directors and the importance of their appropriate remuneration are the issues under the consideration.

Last publications review. The issue of independent members of the board of directors is not new, but there are some debates around their role and duties. In practice, there are many different criteria for the director independence. Various numbers of companies and banks as well have different remuneration policies. Other point of view is that the independence of directors and their role is a result of their own qualities (Stein (2011)) but not the result of regulations and requirements.

The issue of directors' remuneration was also under the investigation of Hahn and Lasfer (2010). Remuneration practices may vary from country to country. As for the remuneration of directors in terms of Anglo-Saxon countries, Lear (1979) mentioned that annual fees, committee fees are similar between USA and UK corporations. With the changes in economy and other conditions, some countries have changed the structure of remuneration and some didn't (Stathopoulos et al. 2004). Changes in the US were studied by Perry (1999) and Bryan et al. (2000), who pointed the positive relation between firm growth and remuneration for non-executive directors.

Some literature has evidences that in UK (Hahn and Lasfer (2008)), Australia (Evans and Evans (2002)) there was a strong correlation among director remuneration, CEO compensation and market capitalization and at the same time absence the correlation with corporate performance.

As for the researches from Europe, Steger and Jahn (2008) found that the supervisory boards in Germany, which are entirely nonexecutive, but include members of the labor force, are more focused on monitoring related activity than advisory. Bouton (2002) studied the instructions of the corporate governance code about the performance alignment and monitoring incentives as for the directors of the board of directors.

Liu Hanminand with Tang Mudan (2011) tried to investigate the relations between the directors' remuneration and different factors. Felix Suntheim (2010) investigated the issue of managerial remuneration in financial sector, especially during the crises.

In respect of mentioned above, the role of directors in corporate governance is under the interest of the researchers all over the world. Talking about the place of the independent non-executive director in the board of directors we should refer to the decision making model. Fama and Jensen (1983) proposed to represent the decision making process in four steps: decision initiation; decision ratification; decision implementation; monitoring.

They defined decision management and decision control like components of the organization's decision system. Under the term «decision control» they propose to understand decision ratification and monitoring. In terms of «decision control» independent directors are responsible for ensuring objectivity of approved decisions and appropriate control (monitoring). Appropriate remuneration system jointly with appropriate level of directors' expertise will form objectivity in judgments and actions will form relevant motives for independent directors.

Aim of the article. The aim of this research is to investigate present practices of remuneration of independent directors in banks, its differences depending on the system of corporate governance; to find out the similarities in the structure of remuneration packages and to see if changes were made after the crises. The main hypothesis is that the structure of directors' remuneration has been influenced and changed after the crises.

Description of main material. 36 banks among various countries, which would represent main corporate governance systems, were chosen. Banks were chosen as the banks with the biggest assets. They were divided into three main groups: one represents Anglo-Saxon system, other represents Continental corporate governance and the last group is represented by banks from the Asian region (see table 1). As for the Asian region, banks from China, Hong Kong, Japan and Thailand were taken under the investigation. Corporate governance systems of these banks have some specific features that significantly distinguish corporations in Asian region from Europe and America. European system includes various banks from Europe: twelve largest

banks of Germany, Switzerland, Italy, Spain, Norway and France were chosen. Anglo-Saxon group includes banks from the USA and the UK. The empirical data was collected from the disclosed information, which was given in the annual reports of the bank during five year period (2006-2010). The period was taken specifically to see if there are some changes after the Crisis in absolute and relative figures.

Asian banks. During the period under review the average pay for independent directors tended to continuous stable growing or remained unchanged in almost all considered banks. The reason of this is a slight level of using variable remuneration for non-executive directors in Asian companies. A common practice in most banks is that non-executives receives their remuneration for participation in committees and board of directors or for the presence at the meetings, while variable bonuses and share-option schemes often used for compensation of executives. At the same time there was decline of variable remuneration in banks that uses this component during the financial crisis.

Specifics in China. Another specific feature of corporate governance in Chinese companies is the inability to use the payment in the form of shares as an incentive: pursuant to the government regulations, directors, as well as their family members, shall not receive shares of the corporation, or one of the affiliated group companies. Despite this limitation some of the directors still have a small number of shares they received in the early 2000s before setting this limitation. Consequently, the Share Appreciation Rights Plans in Chinese corporations have their own specific characteristics: these plans provide cash-settled payment only which are based on equivalent of stock rates growing according to their market price on the date specified in the plan.

Also, the state may define the conditions that govern the director's remuneration process. For example, banks should defer the payment of 50% or more of the performance bonus for a minimum 3-year period^{1,2}. However, according to the information provided in reports, independent directors of Chinese corporations received only standard fee for participation in committees and board of directors. There are no bonuses displayed in the structure of independent directors, so we can conclude that Chinese banks in general do not use performance bonuses to directors.

Another important feature of the corporate governance in Chinese corporations is that most independent directors are usually employed by corporate shareholders of the bank and do not receive remuneration from the bank and gets fees by their respective employer. In case of remuneration of independent director services by the bank, amount of remuneration is usually paid to the director's employer company.

Specific in Japan. Considered banks and financial groups of Japan which employs the «corporate auditor» governance model under the Japanese Companies Act is not obligated to have any outside directors or to have any Audit, Nomination or Compensation Committees^{3,4}. However, all

of these companies enhance corporate governance structure by adding outside (independent) directors to the board of directors. But the number of external directors in these banks is significantly less than in Chinese or Taiwanese banks.

Specifics in Thailand and Hong-Kong. The main part of fixed remuneration of independent directors in Hong Kong and Thai Corporation is the fee for membership in the board of directors and committees. Smaller part is the fee for attending the committee's meetings. It's also notably that fixed annual rate and pay for presence higher for Chairman than for other members. In addition, banks under review uses variable remuneration – comprising both cash bonus payments and/or share options, based on the director's performance⁵. Using of variable remuneration for independent directors is more common for banks in Thailand, while such type of corporations in Hong Kong is rarely used.

Principles of bonus calculation are disclosed in reports of Siam Commercial Bank: directors' bonus paid at the rate of 0.5% of dividends⁶. Thus, in addition to fixed payments independent directors receive variable performance bonuses depending on the size of dividends receiving by shareholders. And one more thing – directors here receive remuneration monthly (in general directors receive their remuneration on annual basis).

Another specific feature of the considered banks is the features of the fixed payments structure. There is significant preference to the audit committee: members and the chairman of this committee gets roughly twice more fee than members and chairman of other committees. Payments for participation in the committees of the board have risen slightly during last five years while there were no changes in the structure of payments.

European banks. Remuneration policy is developed and set separately by each bank. In general, structure of independent directors' remuneration consists of a fixed payment for participating in the meeting of the board of directors, as well as in individual committees where they are members and take part in committee meeting. The average number of meetings of the board is 7–10 times a year and committees – 10–16 times. All payments are annual. The average remuneration for independent directors in continental Europe is 351,69 thousand US dollars. It should be noted that there is a gap in payment for executive and independent directors. Remuneration of executive members of the board exceeds 7–10 times salary for independent directors.

Amount of remuneration for the period of 2006-2007 years increased for all banks. In the times of complicated financial situation in banks during years 2008–2009 there was a common practice of voting of Compensation Committee directors for voluntary reduction of all fixed fees by 30–50%. Then in 2010 independent directors received full remuneration, the amount of it slightly exceeded the costs of pre-crisis period. But significant changes in remuneration policy have not been identified.

¹ China Construction Bank Corp. annual proxy statements. – Access from: <http://www.ccb.com/en/newinvestor/annals.html>.

² Bank of China Limited annual proxy statements. – Access from: <http://www.boc.cn/en/investor/ir3/>.

³ China Merchants Bank Co. Ltd. annual proxy statements. – Access from: <http://english.cmbchina.com/cmbir/en/intro.aspx?type=report>.

⁴ Mizuho Financial Group, Inc. annual proxy statements. – Access from: <http://www.mizuho-fg.co.jp/english/investors/financial/annual/index.htm>.

⁵ Sumitomo Mitsui Financial Group annual proxy statements. – Access from: <http://www.smfg.co.jp/english/investor/financial/annual.html>.

⁶ Bank of East Asia Ltd. annual proxy statements. – Access from: http://www.hkbea.com/hk/ci/investor_comm/annual_and_interim_reports/index.htm.

There is no such bank among analyzed which is characterized by continuous growth of remuneration per independent director during the last five years. For most of banks a reduction of directors' fixed fee in 2008 is typical, for other banks – in 2010 because of long-term consequences of the crisis period and cautious policy of increasing liquidity and minimizing risks.

We can admit that PNP Paribas and Postbank used remuneration policy of independent directors with fixed remuneration and also variable component, depending on the performance of work and decisions of directors, by 2008^{7, 8}. During financial crisis the Remuneration Committee refused variable payment leaving only the fee for participation and attendance of board and committee meetings. At the same time Credit Suisse Group and Deutsche Bank have introduced the concept of variable remuneration which depends on the performance of independent directors by reducing the size of a standard payment for meeting attendance^{9, 10}.

Anglo-Saxon banks. Remuneration of independent and executive directors depends on their functional responsibilities. American independent directors have the highest level of remuneration among analyzed banks as they perform strategic, controlling and advisory function.

As for analyzed Anglo-Saxon banks, directors' remuneration consists of fixed (base salary) and variable (additional) parts. Base fee is represented by annual cash award for independent member of the board and may be paid annually, quarterly or monthly. The Audit Committee Chairman and members still have the highest fee, although there no significant increase in the level of committee fees over the last 5 years.

In terms of dynamics of main components of the remuneration the trends are as follows. Fees earned or paid in cash decreased in 71,4% of analyzed banks, while the total remuneration decreased in 46,2% in comparison with 2006 figures. Such trends could be explained by opportunity for American non-executives to defer all or any portion of their cash retainer. The most marked decrease could be monitored in 2007–2008.

American non-employee directors can elect to defer all or any portion of their cash retainer (e.g. through the «Director Deferral Plan», Bank of America). Another important point is that directors also may elect to receive their cash retainer in the form of an option to purchase shares of common stock (57.1% of analyzed banks).

Receiving a share in the bank, board members become interested in improving its capitalization by all means and lose their independence. All this adversely affects the stability of the bank. In order to «smooth» the negative impact of this form of remuneration, banks often uses such techniques as different delays and restrictions, e. g. shares can be sold only at the end of the term of being a member of the board of directors.

Some banks has a common practice to reimburse its board members for expenses for attending board and committee meetings or performing other services for bank as directors. Such expenses include food, lodging, transportation etc. The Code of Corporate Governance Principles, set out in the UK for non-executive directors, is stricter: for non-executive directors of public companies are prohibited all forms of remuneration related to performance of the company: they do not receive any other benefits and do not participate in any incentive arrangements.

Conclusion. The role of independent directors in the boards is significant in terms of monitoring and controlling the decision-making process. One aspect as for the independent directors after the crises is their increasing role in risk committees.

As for the structure of the remuneration, the results are in the same direction with those of previous researchers. However, there are some specifics around the analyzed groups and in some cases even inside of them. Taking into account remuneration structure on the whole and above mentioned peculiarities as for the remuneration of directors in Anglo-Saxon banks we can say that it is based on the developed stock market, giving an opportunity to defer the part or the whole salary, especially in American banks. After the crisis many banks reviewed their remuneration policies (one of the reason is the legislation and various recommendations from global institutions), however, it hasn't influenced significantly yet on directors' remuneration.

In some European banks we can see changes in understanding the role of fixed remuneration of directors after the crisis. The result is in introduction of variable compensation on the basis of performance related tasks of independent directors. The fact of changing the approach in remuneration even in several banks is evidence of searching new ways for improvement.

In European banks directors in average get more for committee membership and committee attendance rather than for membership in the board of directors. In contrast of that directors from Asian banks get more fees just for being a member of the board. The specific is that they get less in average then their colleagues in other banks. However it doesn't mean that they have fewer responsibilities. In contrast, while getting less, they have to follow more responsibilities. It is should be also noted that Japanese banks are more closed as for the information of the directors' remuneration.

One of the major conclusions is that the so called «pay for presence» approach is still present actually for the independent directors in banks. This could be seen as the weakness of their motivation for executing own controlling responsibilities. However, at the moment we can't see some radical changes. We can only see some movements after the crises to introduce new framework of independent directors' remuneration in banks. Future more deep analysis could be done through using regressions for approving various hypotheses according the directors' remuneration. ■

⁷ Siam Commercial Bank annual proxy statements. – Access from: <http://www.scb.co.th/en/about-scb/invester-relation/financial-information/annual-report>.

⁸ BNP Paribas annual proxy statements. – Access from: <http://invest.bnpparibas.com/en/pid544/results.html>.

⁹ Postbank annual proxy statements. – Access from: <https://ir.postbank.com/cgi-bin/show.ssp?id=3100&companyName=postbank&language=English#>.

¹⁰ Credit Suisse Group annual proxy statements. – Access from: https://www.credit-suisse.com/investors/en/reports/annual_reporting.jsp

Table 1

Main characteristics of directors' remuneration in various countries

CG System	Remuneration structure		Remuneration, th.USD			Remuneration to Total Assets**	Changes made after the Crisis	«Pay for presence practice
			In average	Min.	Max.			
Anglo-Saxon banks	Annual remuneration for being the chairman	Board of directors	–	–	–	0,00000023106	Directors has relatively higher remuneration; Remuneration payed in cash decreased; Delays and restrictions became more popular after the crises; Institutional environment tends to implement changes	Still used
		Audit Committee	72,5	46,0	99,0			
		Other Committees	36,7	25,3	48,0			
	Annual retainer for being a member of	Board of directors	-	-	-			
		Audit Committee	35,0	27,0	43,0			
		Other Committees	29,3	23,5	35,0			
Remuneration per meeting*	1,8*							
European Banks	Annual remuneration for being the chairman	Board of directors	–	–	–	0,00000035134	Regulation became more strict; Significant changes in structures have not been identified	Still used
		Audit Committee	43,4	29,3	84,7			
		Other Committees	22,4	12,2	32,5			
	Annual retainer for being a member of	Board of directors	36,9	5,0	68,8			
		Executive Committee	19,0	10,1	28,0			
		Audit Committee	22,3	2,2	42,4			
		Other Committees	11,4	6,5	16,4			
	Remuneration per meeting of	Board of directors	4,9	0,3	9,4			
		Executive Committee	1,5	0,3	2,6			
		Audit Committee	2,4	0,3	4,4			
		Other Committees	2,2	1,3	3,0			
	Asian banks	Annual remuneration for being the chairman	Board of directors	39,7	39,6			
		Audit Committee	18,8	13,37	27,61			
		Other Committees	10,0	8,0	12,0			
		Board of directors	37,0	26,5	55,2			
	Annual retainer for being a member of	Audit Committee	12,2	8,0	18,4			
		Other Committees	6,6	5,3	7,9			
		Board of directors	–	–	–			
	Remuneration per meeting of	Audit Committee	0,3	0,3	0,3			
		Other Committees	0,3	0,3	0,3			

** Total remuneration was calculated by suggesting the common conditions for various systems, i. e. number of board meetings, committee meetings attended etc. Total assets were calculated among banks from samole

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