INCENTIVES, CHALLENGES FOR BOARDS - CULTURE, DIVERSITY AND ESG

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UK CORPORATE GOVERNANCE CODE AND REGULATORY EXPECTATIONS

- Structural changes in remuneration for financial services firms post crisis – to create longer term remuneration linked to worth of the firm with malus and claw back.
- 2018 Revision to the corporate governance code broadened the Remco remit to include issues such as culture and fair and proportionate pay.
- Regulatory expectations that culture and conduct behaviour should influence individual remuneration
- 2021 FCA and PRA Looking to accelerate change on diversity and inclusion. NomCos already required to set gender targets. They suggest all Senior Managers who manage staff should should have performance against diversity objectives reflected in variable remuneration.

RISK CULTURE

- The Board must own the risk culture – set expectations, oversee monitoring metrics, consider what drives culture
  - The incentives structures must be considered carefully by the board. Not just remuneration/variable pay but are financial targets set for business areas appropriate – latter have done considerable damage in the past. Profit targets for Treasury in banks one cause of the financial crisis. Profit targets for payment protection insurance enhanced mis-selling.
  - What are the negative incentives –as powerful as positive incentives
- To understand the culture there needs to be data to monitor (eg staff turnover rates. staff engagement, late training, late audit actions). But also results of surveys and in particular focus groups.
- Boards also need to consider events and what they say about culture, view of internal audit.
- Culture/ conduct metrics need to be included in balanced scorecards but challenge not to include just the negative

DIVERSITY

- Board targets for percentage of senior roles taken occupied by women –
- Challenges re delivery
  - Have to tackle it across a broad front
    - Recruitment
    - Promotions
    - Development of staff
  - How does the board decide if actions being taken are enough
    - Monitoring data, new hires, promotions, rate of progression
    - Feedback from focus groups
  - Try to build in incentives – balanced score card, but needs a large judgemental element

ESG

- Companies are considering the approaches to ESG and boards need to provide oversight
  - Targets? Driven by social responsibility/ reputation sensitivities/ market expectations
  - Risks – understanding risks, models eg VaR/ Credit Risk likely to under read, risk of Minsky moments. Setting risk appetite.
  - Stress testing challenges – different scenarios
  - Change in business strategy to reflect green activities
- Challenges
  - Companies are setting targets for neutrality and lending neutrality by 2050 but how do you get there- what does it mean for short and medium term targets.
  - Limits vis a vis brown industries – what about financing the transition for those industries but how do you know that's where the funding is going.
  - Issues of green washing
  - How can this be linked to incentives.

OVERALL

- Boards must consider what they are really trying to achieve across a broad front and is the management incentivized to achieve it.