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Executive Remuneration Policy At Banks In Poland After The Financial Crisis - Evolution Or Revolution?

Abstract

The executive remuneration policy of financial institutions has been indicated as one of the key factors that led to the recent financial crisis. As a consequence a number of legislative initiatives and best practices have been imposed, aimed at strengthening existing and creating new standards of good corporate governance at banks. The purpose of this article is to assess the effectiveness of Poland's new regulations concerning banks' executive pay, which were introduced in the aftermath of the recent financial crisis. The research results indicate that the new legal rules have not been fully enforced. Public banks in Poland are not fulfilling the reporting obligations imposed by law and international principles. Given the crucial importance of executive remuneration policy in the financial sector to the stability of the banking sector, the inability to evaluate the progress made in the adjustment of executive remuneration practices to the new regulations may be perceived as one of the important risk factors that has not been effectively eliminated or even reduced in Poland yet.

Keywords: *corporate governance, compensation policy, banking sector, financial crisis*

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1. Introduction

The recent financial crisis, for which the collapse of Lehman Brothers in 2008 is considered to be the symbolic beginning, showed the importance of executive remuneration policy in financial institutions. The inefficient system of executive pay was pointed out as one of the possible causes of the crisis. It was predominantly short-term oriented, which encouraged excessive risk-taking. As a result, many financial institutions were threatened by bankruptcy, and consequently, the stability of global financial systems was jeopardized. Hence, a number of legislative initiatives and best practices were introduced by international and national institutions responsible for the supervision of financial sectors. They aimed at improving existing and creating new corporate governance standards in the area of executive remuneration.

The purpose of this paper is firstly to examine the evolution of regulation on executive remuneration in public banks operating in Poland. The actual binding law with regard to banker's pay will be compared with international principles. Secondly, the paper focuses on disclosure of the level and the structure of bank's executive pay as well as the remuneration policy, in particular with regard to the use of long-term incentive programs based on shares. We run the analysis using the sample of all the banks listed on the Warsaw Stock Exchange during 2008-2012. This was a period characterized by a high volatility of macroeconomic conditions and the stock market, as well as a numerous legal changes. It is therefore important to investigate the extent to which banks operating in such a turbulent economic and regulatory environment adapted their practices to the new recommended standards.

2. International regulation for sound executive remuneration practices in the banking sector

Executive remuneration policy is one of the most important instruments of corporate governance. It has attracted a lot of attention at the beginning of this century, when a number of corporate frauds and accounting scandals related to the excessive pay in underperforming companies were revealed. As a response to the situation, legislative initiatives were introduced to compensate executives in a more effective manner. They focused on improving procedures of setting executive pay and disclosure of executive remuneration systems (Urbanek 2010, pp. 85-86). The most important goal was to link executive income with the corporate results. As a consequence, a significant part of the executive remuneration became variable components - bonuses and deferred share-based

compensation. An important role in the improved process of executive pay setting was played by board remuneration committees.

Issues of executive remuneration policy were raised for the first time in the *OECD Principles of Corporate Governance*, published in 1999 and updated in 2004. The international standards indicate the necessity of establishing board committees that should focus on key selected areas of board responsibilities, among others executive selection and designing their remuneration scheme. The committees should also have independent board members. OECD principles require public companies to disclose the level and the structure of executive and non-executive remuneration. The scope of the disclosed information should be sufficient to assess how the executive remuneration may impact corporate performance, as well as to analyze costs and benefits from remuneration schemes and long-term incentive programs. Despite the fact that the OECD principles are quite general, they have become a benchmark for creating national versions of corporate governance codes, including with respect to executive remuneration.

In 2004 the European Commission also issued recommendations for Member States on executive remuneration in public companies. They aimed at improving disclosure of remuneration. Public companies should disclose the executive remuneration scheme, including individual compensation amounts, in the form of a separate report attached to the annual financial statements, which should be available on the company's website. The report should present the criteria for payout of compensation elements that are based on shares. Additionally, long-term incentive programs based on shares should be approved by the general meeting of shareholders. The next set of the European Commission recommendations, released in 2005, focused on a remuneration committee, which should consist of a majority of independent directors. The most important tasks of the committee encompass design of the executive remuneration scheme, monitoring the level and structure of executive remuneration, presenting opinions to the board on the choice between granting options to subscribe or to purchase shares.

In April 2009 the European Commission issued recommendations on the remuneration of directors of listed companies that completed the EC Recommendations issued in 2004 and 2005.¹ These recommendations seek to address the design of pay packages and remuneration policies in order to promote the growth of the company in the long run by maintaining a proper

¹ European Commission Recommendation of 30 April 2009 on remuneration policies in the financial services sector (2009/384/EC) complementing Recommendations 2004/913/EC and 2005/162/EC as regards the regime for the remuneration of directors of listed companies.

balance between all remuneration components. Great attention is paid to the process of setting variable components of remuneration, severance payment and stock-based pay. In addition, a number of new mechanisms, such as cash incentive deferral, reduction of bonus in the case of subdued or negative corporate performance in the long-term (malus), or reclaiming bonuses paid based on results that later were proven to have been misstated, are introduced. Adoption of the clawback arrangements can be incorporated also in situations where there was a breach of the internal procedures of the company. Also, severance pay has been changed by the EC recommendations. Its level should be narrowed down and it shouldn't be paid out if the relevant results are not delivered. The performance criteria which are a basis for remuneration payments should be aligned with long-term value creation and prudent risk-taking.

Until 2009, there was no separate regulation on executive remuneration for financial institutions which took into account the specific nature of the corporate governance of banks. This specificity is made up of a number of factors: systemic risk, the scale and nature of banking operations, interdependencies between the entities of the financial sector, innovative financial instruments, the complex structure of ownership and control of large financial groups as well as the dynamic changes which take place in banks' business models. An area that is closely linked with corporate governance is bank's risk management. Failures and weaknesses of bank's corporate governance can, to the large extent, be viewed as contributing to the recent financial crisis. The pre-crisis practice of executive remuneration in banks was not aligned with prudent risk-taking behaviour, as pay structures were too much focused on short-term gains, which led to excessive risk taking.

Drawing lessons from the crisis, the European Commission in 2009 formulated Recommendation 384 - that executive remuneration policy should be tied to the level of bank's risk appetite. This postulates that the current and future risk, cost of capital and liquidity ratios should be taken into account during the process of determining the criteria for measuring a bank's performance and the goals achieved by the individual members of the management board. The rules for setting the executive remuneration components policy also stress that executive pay should be linked to the bank's performance, that the criteria used for measuring both a bank's performance and the individual results should be the risk-adjusted, and that the eligibility criteria for share-based compensation should be clearly formulated. Most of the European countries did not follow the European Commission recommendations at a satisfactory level.² As a result, the Commission decided to issue principles on remuneration in financial institutions

² European Commission, Green Paper. Corporate governance in financial institutions and remuneration policies, Brussels, 2010.

through a directive, including them in the revised Capital Requirements Directive (CRD III).³ The national banking supervisory authorities are obliged to oversee the remuneration policy and, if necessary, to enforce the Directive's requirements through a system of sanctions.

The provisions of CRD III coins a new term - Material-Risk-Takers (MTR) - which indicates a group of people whose professional actions can have a material effect on a bank's risk exposure. The group encompasses " ... at least executive directors, individuals who make decisions regarding risk, staff engaged in control functions and any employee whose total remuneration, including discretionary pension benefit provisions, is at the level of executive directors and of individuals who make decisions regarding risk."⁴ For them, the ratio between cash payments and share-based remuneration must be adjusted to the level of risk taken. CRD III strictly defines, and sets minimum requirements, on what part of variable remuneration should be deferred and for how long, as well as how much should be paid in shares or in their equivalent. The proportion of deferred component is to be set at minimum of 40% over at minimum of three years, and for senior executive directors such as CEOs, at minimum of 60%. A minimum of 50% of the variable compensation shall be awarded in shares or in other non-cash instruments. Furthermore, financial institutions are required to establish a board remuneration committee. Last but not least, there is a great emphasis on the important role played by the disclosure of compensation practices. All the procedures related to setting the level and the structure, as well as the criteria, for executive remuneration payout should be disclosed .

Table 1. Evolution of international principles concerning executive remuneration policy in public banks

	2005 ^a	2005 ^b	2005 ^c	2009 ^d	2009 ^e	2010 ^f
Transparency of executive remuneration policy - the scope of disclosure:						
- description of the main design characteristics		+			+	+
- description of long-term incentive programs paid in shares or share-linked instruments.		+		+		
- individual disclosure		+				

³ Directive 2010/76/EU of the European Parliament and of the Council of 24 November 2010 amending Directives 2006/48/EC and 2006/49/EC as regards capital requirements for the trading book and for re-securitisations, and the supervisory review of remuneration policies.

⁴ Ibidem, point (3).

- Disclosure of all executive pay elements and the parameters for their payout		+		+	+	
- severance payments		+		+		
- other non-cash remuneration components		+		+		
- annual reports on executive remuneration		+				
Mechanisms for Pay and Governance Structure:						
- Existence of a Remuneration Committee	+		+	+		+
- Composition of the Remuneration Committee and its tasks.	+		+	+		
- procedures for executive remuneration schemes				+	+	+
- components of executive remuneration					+	+
- recommendation for using long-term incentive programs paid in shares or share-linked instruments.						+
- shareholders' approval for long-term incentives programs paid in shares or share-linked instruments		+				

a - OECD Principles of Corporate Governance, 2004.

b - European Commission Recommendation 2004/913/EC fostering an appropriate regime for the remuneration of directors of listed companies (Official Journal 385/55).

c - European Commission Recommendation 2005/162/EC on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board, (Official Journal 52/51).

d - European Commission Recommendation of 30 April 2009 complementing Recommendations 2004/913/EC and 2005/162/EC as regards the regime for the remuneration of directors of listed companies 2009/385/EC [Official Journal L20/28].

e - European Commission Recommendation of 30 April 2009 on remuneration policies in the financial services sector (2009/384/EC) complementing Recommendations 2004/913/EC and 2005/162/EC as regards the regime for the remuneration of directors of listed companies. (Official Journal L20/22).

f - Directive 2010/76/EU of the European Parliament and of the Council of 24 November 2010 amending Directives 2006/48/EC and 2006/49/EC as regards capital requirements for the trading book and for securitizations, and the supervisory review of remuneration policies (Official Journal L329/3).

Source: Own analysis based on the following documents.

Table 1 summarizes the most important international standards regarding executive remuneration policy in financial institutions, and it demonstrates some trends. In the pre-crisis period legal initiatives on executive remuneration were directed to all companies, irrespective of their sector. The main emphasis was put primarily on disclosure of executive remuneration in accordance with the assumption that market allocation mechanisms, acting on the basis of price signals coming from the labour market for executives, play a major role in the

process of setting executive pay. In practice, this would mean that well-informed shareholders and capital markets are capable of putting pressure on the boards and making them create effective systems of remuneration. During this period the establishment of boards remuneration committees, composed mainly of independent board members, was highly recommended. Shareholders were advised to get involved to a greater extent in the process of creating the rules of executive remuneration policy through approval of their long-term incentive programs based on shares.

However, the experience of the recent financial crisis experience has shown that it is necessary to mobilize - complementary to market mechanisms - methods of influence on the executive remuneration. The European Commission recommendation of 2009 put special emphasis on the procedure for setting executive remuneration, in particular on performance criteria, the structure of executive pay and rules of payout, as well as limitations on granting severance pay. Special regulations dedicated solely to financial sector institutions have emerged.

3. Regulation of executive remuneration in public banks in Poland

In Poland, the first regulation on executive remuneration was introduced to Accounting Act⁵ and Council of Ministers Directives,⁶ which concentrated solely on disclosure and were applicable to all public companies. Both required disclosure of the total remuneration of all executive directors and board members.

The corporate governance code - so-called the Best Practices of Public Companies - was published in 2002 and brought about a significant breakthrough. Section 39 stated that "[t]he total remuneration of all executive directors should be disclosed in the annual report, broken down into all components of remuneration. If the remuneration of individual executive directors differs significantly, it is recommended to publish appropriate justification."⁷ In 2005 significant changes were introduced to the disclosure procedures with respect to executive remuneration. In the revised version Section 39 was replaced by the following: "[t]he total remuneration of all executive directors, as well as the

⁵ The Accounting Act of 29 September 1994 (Official Journal No 121, item 591).

⁶ The Council of Ministers Ordinance dated October 16, 2001 regarding the type, form and scope of current and periodic information and dates of its passing by issuers of securities admitted to public trading (Official Journal No 139 item 1569); The Council of Ministers Ordinance dated August 11, 2004 on detailed requirements applicable to the issuance of prospectuses and abbreviated versions of such prospectuses (Journal of Laws No. 186, item 1921).

⁷ Code of Best Practice for WSE Listed Companies as of 2002, Warsaw Stock Exchange, p. 10.

individual pay, together with a breakdown of its various components, should be disclosed in the annual report with information on the procedures and principles of its establishment.” The greatest novelty laid in the appointment of two supervisory board committees: the audit and remuneration committees –in Section 28. Their tasks should be set forth in detail in the Supervisory Board Rules. The committees should submit annual reports on its activities to the supervisory board, which should also be available to shareholders.

In the next edition of the corporate governance code, as of 2005, the section on disclosure of executive remuneration was missing. It was removed and established as hard law, namely the Minister of Finance Directives on current and periodic information to be published by the issuers of securities.⁸ According to this document the scope of mandatory disclosures include “... the value of salaries, bonuses and additional benefits, including those arising from long-term incentive programs usually equity-based as well as programs based on senior bonds, convertible bonds, subscription warrants (in cash or non-cash), paid, accrued or potentially payable to each of the board members regardless of whether they were included in the company's costs or resulted from profit sharing. If the issuer is a parent company, jointly controlled entity or a significant investor - separate information on remuneration and rewards received with regards to all duties in the subsidiaries should be included; if the information is presented in the financial statements - the obligation shall be deemed satisfied by an indication of their inclusion in the financial statements”.

The next editions of the Polish corporate governance codes, as of 2010 and 2012, refer directly to the European Commission Recommendations of 2004 and 2009. The stock exchange requires all public companies to follow the European Commission recommendation on executive remuneration, while it completely ignores the recommendation on executive remuneration in the financial institutions. The Financial Markets Supervisory Authority in Poland has been in charge of implementing the European standards on executive pay in the financial sector only since 2011. Poland was one of the last Member States of the European Union to take legislative steps to adapt to the CRD III Directive. It did so by amending the Banking Act,⁹ the Act on Capital Market Supervision, and the Act on Trading in Financial Instruments .

According to the new law, the Financial Supervisory Authority is in a position to determine the variable remuneration policy for executive board

⁸ Decree of the Ministry of Finance dated 19 October 2005 on current and periodic information provided by issuers of securities (Official Journal from 2005, No 209, item 1744 § 95).

⁹ The Banking Law Act of 1997, as amended 28 April 2011 and the Act on trading in financial instruments and certain other laws (Official Journal from 2011 No 131, Item 763).

members at banks by issuing a resolution.¹⁰ As a result, an FSA resolution has become the most comprehensive Polish piece of law on variable remuneration policies in the banking sector. One of its chapters is devoted entirely to the issue of executive remuneration in banks. This new regulation will certainly bolster the authority of the remuneration committee. It should be established at a bank that fulfils at least *one* of the following conditions: is listed on the stock exchange; holds at least 1% of the assets of the banking sector; holds at least 1% of deposits of the banking sector; or holds at least 1% of the own funds of the banking sector. The regulator's resolution does not delineate the tasks of the remuneration committee. It just mentions one - issuing an opinion on the policy applicable to the variable component of executive remuneration that should support the long-term growth of the bank's and shareholders' value.

The FSA resolution focuses on determining the variable remuneration components. The Supervisory Board is responsible for designing remuneration policy for the variable components, including unspecified pension benefit provisions, which must be preapproved by the remuneration committee. The policy should encompass all executive directors as well as individuals reporting directly to the management board members, regardless of the basis of their employment, branch directors and their deputies, chief accountants, those employees responsible for control/supervisory functions in the bank, and any individuals whose activities significantly impact the bank's assets and liabilities. It is further provided, however, that the list should cover all people who have a material impact on the bank's risk profile.

The total executive remuneration should be set in such a way as to maintain a balance between fixed and variable remuneration, in order to enable decreasing or disallowing the variable components if the goals are not met. When setting the variable remuneration, not only should the individual results be measured and assessed, but also the results of the entire bank should be taken into account. Each component should be linked to the bank's performance, however the performance measures shall be risk-adjusted, imposed by the bank's activities as well as the bank growth cycle. It provides that the individual evaluation should take place at least after 3 years, or when the risk materializes.

In order to encourage bank executives to take into account the long-term growth of the company, at least 50% of variable remuneration must be based on shares or corresponding non-cash instruments that reflect the quality of credit

¹⁰ Resolution no. 258/2011 of the Polish Financial Supervision Authority of 04 October 2011 on Detailed Principles of Functioning of the Risk Management System and Internal Control System and Detailed Conditions of Internal Capital Assessment by Banks and of Reviewing the Process of Internal Capital Assessment and Maintenance and the Principles of Determining the Policy on Variable Components of Remuneration of Persons Holding Managerial Positions at a Bank.

institutions. In addition, banks should have a share retention policy in place, and 40% of variable pay -and in the case of particularly large amounts up to 60% -is subject to a mandatory deferral for a period of three to five years. The payout, in equal annual instalments payable in arrear, is subject to the individual performance and its evaluation, which takes into account the goals set for the individual and the bank as a whole, as well as the bank's risk level, business cycle, the nature of the business, its risks and scope of responsibilities of the evaluated executive director.

When the contract with an executive director is terminated, his(or her) severance payment should depend on his productivity and the quality of his work, so as not to reward poor performance. His retirement benefits should be based on bank shares. The FSA resolution stipulates, however, that the benefits are payable only after five years from the date of termination. In the case of an executive director who has reached retirement age, the bank pays their pension benefits in the form of shares or their equivalent, provided that the employee sells them after a period of five years from the termination of the contract.

Table 2. Evolution of the regulation of executive remuneration policy in public banks in Poland

Code of Best Practice for Warsaw Stock Exchange (WSE) Listed Companies	2002	2005	2007		2010		2012
Legal rules		2005 ^a		2009 ^b		2011 ^c	33
Transparency of executive remuneration policy - the scope of disclosure:							
- description of the main design characteristics		+		+	+		+
- description of long-term incentive programs paid in shares or share-linked instruments.					+		+
- individual disclosure	+	+		+			
- Disclosure of all executive pay elements and the parameters for their payout		+		+	+		+
- severance payments		+		+	+		+
- other non-cash remuneration components		+		+	+		+
- annual reports on executive remuneration							
Mechanisms for Pay and Governance Structure:							
- Existence of a Remuneration Committee		+	+		+	+	+

- Composition of Remuneration Committee and its tasks.		+	+		+	+	+
- procedures for executive remuneration schemes					+	+	+
- components of executive remuneration					+	+	+
- recommendation to use long-term incentive programs paid in shares or share-linked instruments.						+	
- shareholders' approval for long-term incentive programs paid in shares or share-linked instruments					+		+

a - Decree of the Ministry of Finance dated 19 October 2005 on current and periodic information provided by issuers of securities,¹¹

b - Regulation of the Minister of Finance dated February 19, 2009 on current and interim information delivered by issuers of securities and conditions for recognizing as equivalent the information required by the laws of a non-member state,¹²

c - The Banking Law Act of 1997, as amended 28 April 2011; Resolution no. 258/2011 of the Polish Financial Supervision Authority of 04 October 2011 on Detailed Principles of Functioning of the Risk Management System and Internal Control System and Detailed Conditions of Internal Capital Assessment by Banks and of Reviewing the Process of Internal Capital Assessment and Maintenance and the Principles of Determining the Policy on Variable Components of Remuneration of Persons Holding Managerial Positions at a Bank.

Source: Own analysis based on the following documents.

Analysis of the evolution of the regulations related to bank executive remuneration indicates the presence of several regularities (Urbanek, Wieczorek 2012). First, most of the rules on executive remuneration were contained in the corporate governance code, although in a generic manner, prior to their introduction into the law (Table 2). This sequence derives from the fact that the corporate governance code is much more flexible and its implementation does not require passing through an arduous parliamentary legislative procedure. It also makes it possible to reach high corporate governance standards by trial and error. Hence those rules that well fit the country's institutional context are moved into the hard law. Secondly, there is a gap between the time when international standards are introduced and the period of implementation to either Polish regulations or the corporate governance code. The delay in implementation of the European Commission recommendations of 2004 amounted to almost three years. Thirdly,

¹¹ Decree of the Ministry of Finance dated 19 October 2005 on current and periodic information provided by issuers of securities (Official Journal from 2005, No 209, item 1744 § 95).

¹² Regulation of the Minister of Finance dated 19 February 2009 on current and interim information delivered by issuers of securities and conditions for recognizing as equivalent the information required by the laws of a non-member state (Journal of Laws No. 33 item 259 § 91).

the analysis of different versions of Polish corporate governance codes reflects an evolutionary approach to the issues surrounding executive remuneration. Until the recent financial crisis, the Warsaw Stock Exchange Council recommended to public companies a relatively narrow range of disclosures, and no procedures with respect to setting executive remuneration. The real breakthrough appeared in 2010, when the newest version of the Polish corporate governance code made reference to the European Commission recommendations of 2004 and 2005. Also, it took two years to implement the international standards on executive remuneration in financial institutions, which was enforced by the adoption of the CRD III Directive.

Executive remuneration in public banks in Poland - results of empirical research

The analysis of executive remuneration policy was conducted on a sample of all 16 banks listed on the Warsaw Stock Exchange. It is based on unique hand-collected data from annual reports of public banks for the period 2008-2012. The timeframe for which data was collected enables the examination of executive remuneration policy during the economic downturn and upturn. The first two years of the study mark a period of decline in the capital market, while the next three years were characterized by a gradual catching up on losses previously incurred. In latter period there were also significant changes in the regulatory environment of public banks, including extended regulation of executive remuneration. Thus, it seems worthwhile to assess the extent to which banks operating in such a turbulent economic and regulatory environment adopt their practices on executive remuneration.

We commence the analysis of bank's executive remuneration in Poland by scrutinising one of its important features - transparency. This is considered to be one of the most important attributes of good corporate governance. High transparency in any aspect of corporate governance bolsters confidence in the capital market and creates an atmosphere of openness. Shareholders and other stakeholder groups have a right to full information about the bank, including information on executive remuneration policy. This disclosure is one of the most important prerequisites for the curbing opportunistic behaviour on the part of managers. An objective evaluation of the quality of the service provided by executive directors requires access to information on the level and structure of other executives pay as well. Disclosure is enforced by sanctions such as reputation and social control based on the rule 'name it and shame it' (Słomka – Gołębiowska 2012).

Taking into account the evolution of the regulatory framework for executive remuneration, in particular its transparency, as well as the significant changes introduced to the corporate governance code since 2010, one could expect a real quantitative and qualitative leap in terms of the scope of the disclosures. In accordance with rule I.1. of the Polish corporate governance code, a company should follow the European Commission recommendation no. 913 of 2004, which imposes an obligation to disclose, *inter alia*, remuneration paid in the form of profit sharing or bonus, severance payments, an estimated value of non-cash benefits, as well as an accurate description of the share-based incentive programs. However, Table 3 shows only very minor improvements in the disclosure of executive remuneration in public banks in Poland during the period 2008-2012. Most of them did not change their disclosure practices on executive remuneration. Only three banks increased the number of disclosed components of the remuneration package, while a few banks actually limited the scope of the disclosure. Last but not least, four banks consistently did not break the total CEO remuneration into any components at all for the entire period of the study.¹³

None of the banks described the remuneration policy in any section of the annual financial statement, despite the fact that such an obligation arises not only from the international principles but also from the Polish banking law.¹⁴ Both the European Commission as well as international organizations such as the FSB stress the importance of transparency of executive remuneration policy. Financial institutions should show the remuneration policy objectives, criteria and time horizon of the assessment, the method of applying risk adjustment to bank's performance measures, linkages between variable executive pay and a bank's overall financial performance, the structure of remuneration packages, incentive programs based on shares or similar instruments, as well as rules of severance payment. The lack of such information results in the anomaly that we know how much banks' executive directors earn, but we do not know why. The answer to the last question is crucial for assessing the merits of executive remuneration policy in banks.

¹³ An example of bypassing disclosure obligations arising from the regulations is offered by the practice of PKO BP SA, which in its annual reports presents only the total remuneration of the CEO. At the same time one can read in the report that the bank complies with Code of Best Practice for WSE Listed Companies: "... PKO Polish Bank SA adopted in 2011 the necessary measures to ensure full compliance with Code of Best Practice for WSE Listed Companies. In the opinion of the Board, in 2011 PKO Polish Bank SA does not depart from the rules contained in the Code ..."

¹⁴ The Banking Law Act of 1997 as amended 28 April 2011 (Journal of Law from 2011 No 131, item 763); Point 111a Section 1: "1. The Bank shall, subject to paragraph. 2, announce to the public and generally make available: ... 2) The rules for determining the executive remuneration in the bank."

In assessing the standards of transparency of executive remuneration policy in the public banks operating in Poland, two important issues can be raised. First, banks, as institutions of public trust, should be role models for non-financial listed companies in implementing good standards of corporate governance. So far, they have not fulfilled the reporting obligations on disclosure of executive remuneration imposed by law. Secondly, given that the flawed executive remuneration policy in financial institutions is perceived as a cause of the recent financial crisis, the lack of ability to assess the executive remuneration practices can be seen as one of the important risk factors for financial stability, and one that Poland has not been effectively eliminated or reduced.

Table 3. Disclosure of the structure of executive remuneration in public banks in Poland – number of disclosed components of the total executive pay

	2008	2009	2010	2011	2012
BOŚ	1	1	1	1	1
BPH	5	3	4	4	4
BGŻ	0	0	3	3	3
BRE	3	3	4	4	5
BZ WBK	2	2	2	2	2
Alior Bank	-	-	-	-	2
Paribas Fortis	3	3	3	3	N.A.
Kredyt Bank	4	4	4	4	4
DZ Polska	1	1	1	-	-
Bank Handlowy	3	3	3	3	3
ING	2	3	3	3	3
Millennium	2	2	2	2	2
Noble Bank	1	2	2	2	2
Nordea	1	1	1	1	1
Pekao S. A.	3	3	3	3	3
PKO BP	1	1	1	1	1

Source: Own analysis based on banks' financial statements.

Our analysis also covers the procedures for determining the remuneration policy. The empirical research results demonstrate that excessive and imprudent risk was one of the main reasons that led to financial problems and the bankruptcy of many financial institutions. The evidence is convincing that poorly designed compensation arrangements encouraged excessive risk taking. Hence, the post-crisis recommendations have imposed new rules for the calculation and payment of variable executive remuneration components, including both bonuses as well as the long-term incentive programs based on

shares. Annual bonuses should be dependent on the bank's performance. This increases the degree of aggressiveness of executive remuneration policy and introduces an element of risk for executive directors. This should ensure executives' dynamism in running a bank and put pressure on them to improve the bank's performance.

Due to the lack of transparency of banks' remuneration policy (Table 4), it is very difficult to assess whether the banks in our sample used aggressive executive remuneration mechanisms. During the period 2008-2012 only five banks revealed information about the amount of bonuses granted to their CEOs. Furthermore, it is highly exceptional to see additional explanations of the period for which a bonus is granted and is paid out. None of the banks disclose the performance criteria on which any entitlement to the variable components of executive remuneration is based. Such practices stand in sharp contrast to the European Commission recommendation no. 913 of 2004, as well as the FSA Resolution according to which "... variable remuneration should be accounted for and paid in a transparent manner to ensure effective implementation of the policy variable components of executive remuneration".¹⁵

Table 4 demonstrates that public banks in Poland pursued conservative as opposed to aggressive executive remuneration policy (Słomka-Gołębiowska 2013, pp. 135-154). The banks' supervisory boards are reluctant to motivate executive directors via granting significant variable remuneration. Only two banks - BPH and Paribas Fortis - rewarded their CEOs with a significant portion of total remuneration in the form of bonuses in each of the studied years. Definitely there are more cases where bonuses were not paid at all or their share in the total pay was negligible. This may reflect the bank's interpretation of the FSA Resolution suggesting that the fixed component should account for a large enough proportion of the total remuneration. This allows for the flexibility of policy variable remuneration, including the lowering bonuses or not paying any out at all.

The analysis does not indicate any significant changes in executive remuneration policy at the public banks in Poland following the recent crisis. There is no increase of the variable remuneration component since 2010, when the bank's corporate results have notably improved. It is also not possible to assess how banks comply with the FSA recommendations requiring the deferment of bonus payments and payments in shares or share-linked instruments.

¹⁵ Resolution no. 258/2011 of the Polish Financial Supervision Authority of 04 October 2011, § 29.12.

Table 4. The ratio of bonuses in total CEO remuneration in public banks in Poland

	2008	2009	2010	2011	2012
BOŚ	N.A.	N.A.	N.A.	N.A.	N.A.
BPH	44,2%	28,9%	39,3%	35,8%	40,5%
BGŻ	N.A.	N.A.	14,5%	26,4%	14,5%
BRE	0,0%	54,1%	3,5%	13,5%	43,4%
BZ WBK	N.A.	N.A.	N.A.	N.A.	N.A.
Alior Bank	-	-	-	-	0,0%
Paribas Fortis	44,1%	28,6%	32,1%	31,0%	N.A.
Kredyt Bank	7,0%	14,8%	0,0%	8,7%	39,1%
DZ Polska	N.A.	N.A.	N.A.	N.A.	N.A.
Bank Handlowy	N.A.	N.A.	N.A.	N.A.	N.A.
ING	N.A.	N.A.	N.A.	N.A.	N.A.
Millennium	N.A.	N.A.	N.A.	N.A.	N.A.
Noble Bank	N.A.	N.A.	N.A.	N.A.	N.A.
Nordea	N.A.	N.A.	N.A.	N.A.	N.A.
Pekao S. A.	34,6%	13,4%	17,2%	20,5%	15,3%
PKO BP	N.A.	N.A.	N.A.	N.A.	N.A.

Source: Own analysis based on banks' financial statements.

Both the international principles and national regulations on executive remuneration strongly emphasize the use of long-term incentive programs that are based on shares for financial institutions. Assessment of the use of long-term incentives by public banks in Poland encounters similar difficulties as the evaluation of payment of bonuses. The supervisory authority has imposed no uniform standards of disclosed information on long-term share-based remuneration. Hence, it is almost impossible to compare different long-term incentive programs in public banks in Poland.

Table 5 shows that ten banks out of 16 had some kind of long-term incentive program involving payment in share-linked instruments. However, only three banks designed them based on its own equity of the issuer. Two other banks offered their executives additional participation in the motivation program that is run within the capital group. Five banks exclusively used long-term incentive programs based on shares of the parent bank. This latter case is inconsistent with the main objective of such schemes, which aim at enhancing bank's long-term value creation for shareholders and other stakeholders. Such programs serve to motivate executives' efforts. In addition, the interpretation of the FSAResolution¹⁶ is clear. It stresses that the payment of share-based remuneration should not be made in shares of the parent company. Moreover,

¹⁶ Resolution no. 258/2011 of the Polish Financial Supervision Authority of 04 October 2011.

a substantial proportion (e.g. more than fifty percent) of variable remuneration should be awarded in shares or share-linked instruments in order to create incentives aligned with the creation of long-term value for a bank.

The importance of the long-term incentive programs can be measured by the ratio of share-based compensation to the executive remuneration. Table 5 shows that only Noble Bank and Alior Bank resembled banks from the European Union, as their proportion of shares in total pay is higher than 30%. In other public banks in Poland the income from shares and share options did not exceed 10% of the total executive remuneration. Also, there were no significant differences in the use of share-based programs by banks during the recent crisis 2008-2009 and in the post-crisis period. The low transparency in the reporting makes it difficult to assess whether banks are complying with the FSA resolution.

Table 5. The ratio of the value of long-term incentive programs based on shares or similar instruments to total executive remuneration

	2008	2009	2010	2011	2012
BOŚ	0,0%	0,0%	0,0%	0,0%	0,0%
BPH*	15,4%	7,1%	8,6%	6,9%	6,2%
BGŻ	0,0%	0,0%	0,0%	0,0%	0,0%
BRE***	0,0%	0,0%	7,2%	7,7%	4,5%
BZ WBK**	N.A.	N.A.	N.A.	N.A.	N.A.
Alior Bank**	N.A.	N.A.	N.A.	19,8%	87,47%
Paribas Fortis*	1,2%	1,3%	1,1%	1,3%	6,6%
Kredyt Bank	0,0%	0,0%	0,0%	0,0%	0,0%
DZ Polska	0,0%	0,0%	0,0%	0,0%	0,0%
Bank Handlowy*	5,5%	2,4%	4,1%	11,9%	7,7%
ING*	0,0%	0,1%	0,5%	0,7%	1,9%
Millennium	0,0%	0,0%	0,0%	0,0%	0,0%
Noble Bank**	0,0%	0,0%	35,8%	46,2%	13,4%
Nordea*	6,3%	6,0%	10,1%	3,9%	N.A.
Pekao S. A.***	2,9%	3,5%	17,0%	16,0%	6,8%
PKO BP	0,0%	0,0%	0,0%	0,0%	0,0%

* programs based on shares of the parent bank

** programs based on the equity of the issuer

*** programs based on shares of the parent bank and ** programs based on the equity of the issuer

Source: P. Urbanek, Programy partycypacji we własności jako narzędzie polityki wynagradzania kadry kierowniczej na przykładzie banków publicznych w Polsce (Participation programs in equity as a remuneration policy instrument for supervisory directors: the case of Poland), "Law and Economics" conference proceedings, Toruń 2013.

4. Conclusions

The recent financial crisis revealed the consequences of inefficient executive remuneration practices in financial institutions. Executive remuneration policy which encourages excessive risk-taking in the banking sector may threaten the viability of a bank and the stability of the financial system. In reaction to the financial crisis certain actions were undertaken, among them amendments to the supervisory framework for the financial sector. A number of legislative initiatives were adopted by international organizations and national regulators which aimed at strengthening existing and creating new standards of executive remuneration policy.

The above analysis shows that the specific regulatory gap that existed between the regulations binding in Poland and those legal rules applicable to foreign financial institutions was removed in 2011 due to implementation of the CRD III Directive. However, the research results indicate that the new legal rules have not been completely enforced. Public banks in Poland are not fulfilling the reporting obligations imposed by law and international principles. Hence, it is hardly possible to assess whether they comply with the FSA recommendations on the structure of the variable component of bank's executive pay. Given the crucial importance of executive remuneration policy in the financial sector to the stability of banking sector, the inability to evaluate the progress in adjusting executive remuneration practices to the new regulations may be perceived as one of the important risk factors that has not been effectively eliminated or even reduced in Poland yet.

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Streszczenie

POLITYKA WYNAGRADZANIA KADRY ZARZĄDZAJĄCEJ W SEKTORZE BANKOWYM W POLSCE PO KRYZYSIE FINANSOWYM – EWOLUCJA CZY REWOLUCJA?

Polityka wynagradzania osób zarządzających instytucjami finansowymi została zidentyfikowana, jako jeden z kluczowych czynników, który doprowadził do ostatniego kryzysu finansowego. Reakcją na dysfunkcjonalności tej polityki są liczne inicjatywy legislacyjne i środowiskowe mające na celu wzmocnienie istniejących i tworzenie nowych standardów regulujących ten obszar nadzoru korporacyjnego. Celem artykułu jest ocena skuteczności nowych regulacji obowiązujących banki publiczne w Polsce wprowadzonych po ostatniego wybuchu kryzysu finansowego. Stosowane przez banki praktyki zostaną skonfrontowane ze standardami prawnymi i środowiskowymi.

Słowa kluczowe: ład korporacyjny, polityka wynagradzania, banki, kryzys finansowy