



The Evolution of the Independent Non-Executive Director Under the Senior Managers Regime

Introduction

Sayer Haworth conducted research of the Independent Non-Executive Director within the Small to Medium sized regulated entities in the UK.

Executive Summary

- With the increased personal accountability and liability to INEDs, it has made it increasingly challenging for firms to source qualified INEDS
- The average compensation for an INED as an annual reward is from £37,500 - £85,600
- There is increased pressure from INEDS for the compensation to increase due to the personal accountability and liability under the Senior Managers Regime
- Full transparency to be shared during a selection process with a Non-disclosure agreement in place
- A positive drive to ensure there is gender diversity on the Board

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The changing role of an INED under the Senior Managers Regime

This paper looked at how the drive to deliver good governance is currently hindered under the regime and how changes to the industry and profession will expand opportunities for both banks and INEDs in the future.

This paper highlighted that INEDs are calling for change if the industry is going to attract the boardroom talent it needs for the future. The Senior Managers Regime (SMR) and its mandate to assign personal accountability and liability to both executive as well as independent non-executive directors (INEDs) has made it increasingly challenging for banks to source and appoint qualified INEDs, particularly from outside of financial services.

The Senior Managers Regime (SMR) came into effect in March 2018 to increase the personal accountability of senior people in the financial services industry and covers both domestic and international firms with UK operations. The SMR seeks to establish clear accountability for senior banking staff including a statement of responsibility, a firm responsibility map and pre-approval by the regulator.

The spirit of the regime was to define and reflect good governance; however, the potential for personal liability for the INEDs as well as restrictions to the number of boards one can be appointed to four (4) has resulted in a shortage of qualified professionals to fill the posts.

This paper identified six key issues that have made it both harder to identify as well as retain INEDs under the SMR:

- 1. Personal accountability and good governance:** There is consensus that corporate governance is good for the industry but that there has been too great a focus on the personal risk involved instead of the wider implications and best practice across the industry. This is particularly challenging for smaller, emerging banks with accountability pushed to more junior staff members who do not want the responsibility nor are remunerated in line to the amount of risk they undertake.
- 2. Self-preservation:** Indemnity and self-preservation were highly debated topics amongst roundtable participants. Particularly the question of note taking in board meetings was discussed as while it could help one justify their stance on sensitive situations, it could also be accessed by lawyers. This is problematic if any inconsistency to the formal board meeting minutes and INEDs are justifiably cautious about how this impacts their roles.
- 3. Remuneration:** With increased personal liability, financial institutions struggle in how to offset the reward-risk equation for INEDs. While there is an inclination to offer some variable remuneration, there exists a fine balance as these individuals should operate completely independent from incentives.
- 4. International and cultural differences:** The SMR requires any bank operating within the UK to be compliant and often times, international banks with UK subsidiaries or in some cases only a branch do not understand the SMR nor explain the circumstances to their board members in the UK. These issues are compounded with non-UK based chairpersons and many INEDs are left vulnerable or frustrated when trying to uphold compliance.
- 5. Emerging business challenges:** Boards are increasingly challenged with emerging issues, including cyber risk, and banks are tasked with responding to such issues, often before the full extent of the situation is known. Many banking INEDs feel they lack the IT technical background to advise on these situations, yet the industry struggles to attract technology professionals to the board.

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- 6. Formal application process:** A positive evolution from SMR is how people are being recruited to a board – evolving from what was historically a ‘virtual black book’ of contacts to a formal application process to ensure individuals meet requirements at a strategic level. This is not without its challenges, as the regime and personal accountability requirements has made it necessary to engage executive recruiters with what is an increasingly challenging task.

We identified the potential following solutions to enable the financial services industry to thrive:

1. Establish the regime under law: INEDs should hold ultimate responsibility for corporate governance; however, agreement extends that the regulators have often exerted too much pressure. The regime could be more successful if it was established under law instead of under a regulator.
2. Conduct exit interviews: While the regulator interviews departing INEDs from the boards of the large banks, this is often overlooked as best practice in some of the smaller, emerging banks. INEDs looking to indemnify themselves should always request an exit interview even if one is not offered.
3. Remain responsible for own due diligence: INEDs need to consider their own due diligence and self-preservation, especially if they are working with an international subsidiary or branch. Addressing the institution’s approach to SMR through the application process and/or during an engagement should be a course of action for INEDs looking to protect themselves.
4. Professionalising the profession: Establishing a professional body for INEDs would create an additional layer of professionalism by defining the core competencies and standards required. Creating an independent institute outlining and upholding standards, providing a series of exams and offering professional insurance to INEDs would not only enhance standards, but would create a talent pool from which the industry can draw from in the future.

Compensation guide for an INED

The compensation for an INED within a Small to Medium sized firm is an average annual payment of £37,500 - £85,600, the median annual payment for an INED is £62,000.

In the instance where an individual Chairs a Committee or is a Senior Independent Director (SID), there is an average additional annual payment of between £7,400 - £13,600 on top of the standard annual payment. Membership of a committee Fee levels range from £5,000 – 10,000 per annum.

With the onset of the Senior Managers Regime reaching into the Board, the compensation range has been increasing to attract the talent into the Boards of SME Banks.

In some instances, with new start-up firms, equity is offered to compensate for a lower annual reward, this however in a regulated entity, does not sit well with the regulator, where the INED should be truly independent.

Time Commitment

The time commitments can vary widely with each firm, our research revealed that 30 Days a year was the average number of Days an INED was expected to commit to for Board duties. This has been put under pressure, with the Senior Managers Regime, there is a trend for INEDs to probe further into the firm and liaise more closely with executives in a firm.

On occasions additional days can be added to the normal contracted number of days, these would be compensated through a pro-rata of the agreed standard fee.

The Selection Process

In the selection process, it is advisable for the short-list to sign a Non-disclosure Agreement. This will enable full transparency in relation to the firm. Sharing any regulatory challenges is in our opinion key to ensure that when attracting talent, there is a full and clear picture presented.

Where full disclosure has not been shared during a selection process, this can result in the incumbent not being prepared, and deciding to leave within a short period of time of joining.

The Senior Managers Regime has created a caution in the industry. Candidates are not prepared to take on the personal responsibility, where there is clear and present risk, unless this has been demonstrated in the selection process with the necessary resource to rectify any current challenges.

As an example, if there are any recent or current Section 166 reviews within the firm, it is advisable to share these in a selection process with a Non-disclosure Agreement signed.

Board Evaluation / Assessment

It is now becoming common that regulated firms are performing Board Evaluations, this is effectively the board going through a process to measure their current effectiveness today. This has become a critical process within regulated entities to ensure they are evolving and following good corporate governance.

The results of these assessments can provide good insights into the dynamic of the Board and areas for the Board to develop.

Summary

The expectations placed on Boards within a regulated firm are higher than they have ever been. With the introduction of the Senior Managers Regime, candidates in the market are being cautious in relation to the firms that they join. The Senior Managers Regime now reaching into the board has resulted in an increase in the compensation expectations of candidates to assume roles with a regulated entity.

There is a focus on the gender diversity of the Board of a firm, this is a positive step, however, there is a limited pool of qualified candidates. Firms are needing to be prepared to hire an INED when it could be their first appointment into such a position.

Overall the increased expectations of the INED is seen as a positive in the market, the view it is resulting in a more engaged board of directors. Within the round table event, there was discussion on professionalising the profession, through some formally recognised body. This in turn would enhance the standards of the role of the INED and offer continuous development.

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