



The Independent Non-executive Director within an SME Bank/Fee Guide/COVID-19

Introduction

Sayer Haworth conducted research of the Independent Non-Executive Director within Small to Medium sized regulated entities in the UK. Martin Stewart Chaired a round table event with INEDS from a variety of regulated firms in the UK, this was hosted by James Sayer from Sayer Haworth. This paper highlights key topics discussed at this round table.

This research paper highlights further topics outside of the round table event, including a Fee Guide for INED's and the impact of COVID-19.

About Martin Stewart

Martin is an advisor to banks, regulators and international financial institutions on risk and regulatory policy; a visiting professor at the London Institute of Banking and Finance and a non-executive director Coventry Building Society and Danske Bank UK.

From 2013 to 2018 he was Director of Supervision - Banks, Building Societies and Credit Unions at the Bank of England's Prudential Regulation Authority (PRA) and chairman of the International Credit Union Regulators Network (ICURN). Martin became a regulator in 2010 when he joined the Financial Services Authority (FSA), to lead the post financial crisis supervision of UK banks and building societies and to be part of the team that designed the UK's "twin peaks" regulatory approach and established the PRA in 2013.

Martin has over two decades of board level experience across the UK and Europe.

Executive Summary

- With the increased personal accountability and liability to INEDs under Senior Managers and Certification Regime (SM&CR), it has made it increasingly challenging for firms to source qualified INEDS
- The average fee for an INED as an annual reward is from £37,500 - £85,600, a median fee level of £62,000
- The average compensation for a Chairperson is £100,000 – 225,000, a median fee level of £155,000
- There is increased pressure from INEDS for the compensation to increase due to the personal accountability and liability under the Senior Managers Regime
- Fee level is on the whole not an important consideration for the majority of INED applicants
- COVID – 19 has created challenges within the Board Room, on what does good look like running a Board meeting and working effectively with the executive team in a virtual world
- Full transparency to be shared during a selection process with a Non-disclosure agreement in place
- A positive drive to ensure there is diversity on the Board

The changing role of an INED under the Senior Managers & Certificate Regime (SM&CR)

The roundtable 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.

The round table 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 and Certification Regime (SM&CR) 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 and Certification Regime (SM&CR) came into effect in 2016 to increase the personal accountability of senior people in the financial services industry and covers both domestic and international firms with UK operations. The SM&CR 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 has resulted in a shortage of qualified professionals to fill the posts.

“The talent shortage for INEDs within financial services is very real and the heightened regulatory environment – whilst vital for the industry – is creating additional barriers to entry for potential board members,” said Martin Stewart, board advisor and managing director of Clayton Stewart and former Director of Supervision – Banks, Building Societies and Credit Unions at the Bank of England’s Prudential Regulation Authority (PRA).

“We need a brilliant banking industry in the UK, so we need to have brilliant people on the boards. If we don’t have the best on the boards then we’re not going to thrive.”

Martin Stewart

Roundtable participants identified six key issues that have made it both harder to identify as well as retain INEDs under the SM&CR:

- 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 SM&CR 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 SM&CR 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.
- 6. Formal application process:** A positive evolution from SM&CR 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.

Roundtable participants 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 SM&CR 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.



Fee guide for an INED

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

In the instance where an individual holds a Chair of a Committee or is a Senior Independent Director (SID), which carries an SMF responsibility, there is an average additional annual fee of between £7,400 - £13,600 on top of the standard annual fee for all INED's.

Membership of a committee Fee levels range from £5,000 – 10,000 per annum, in most SME Banks this is not offered.

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.

Compensation guide for the Chairperson

The compensation for a Chairperson for a Small to Medium Sized Bank is an average annual payment of £100,000 – 210,000, the median annual payment for a Chairperson is £155,000.

Time Commitment

The time commitments can vary widely with each Bank, however our research revealed that 30 days a year was the average number of days an INED was expected to commit 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.

It is important in striking the right balance between independence and operational involvement, especially in a time where all meetings and interactions are now on the whole virtual. Executives can on occasions feel there can be too much involvement and interference from Board members.

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 to short-listed individuals, is in our opinion, 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 for any challenging issues and deciding to leave within a short period of time after 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.

Demonstrating an independent selection process is also advised especially for a role that is to be holding SMF responsibilities. Using a search firm to conduct an independent search and benchmarking is a common method to demonstrate this, in the scenario the regulator challenges why a candidate was selected for the role.

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. 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. Sayer Haworth Executive Development offer this service.

COVID-19

As the impact of COVID-19 continues to affect the wider economy and the way of working, it is an uncomfortable time for INEDs, the Banks on whose boards they sit are facing unprecedented challenges.

Most Banks have had remote working practices since March of 2020, with a view that this will continue well into the middle of 2021.

COVID-19 has shown the value an INED can bring in these uncharted times, INED's on many occasions during their executive career have led a Bank through unprecedented times, such as the global financial crisis or the SAR's outbreak.

INED's can quickly bring this experience into the business and add significant value to the Executive team. INED's can also provide a good sounding board for the executive to discuss any challenges they are presented with.

INED's will on many occasions hold a number of other Board positions, this will expose them to other challenges that Banks are experiencing, which can be shared.

Two areas of consideration that an INED may consider as they sit on the Board of a Bank is:

1. Does the CEO and the Management team have the skills and experience to navigate through this crisis?
2. As an INED, do they have the skills and experience to add to the debate.

The answers to these questions will ultimately determine the amount of interaction with management.

In some examples there is a separate Crisis Management Committee (CMC) that has been created, instead of the whole Board being involved in discussing particular issues that have arisen. This enables a more nimble and efficient method to address matters which on occasions a quick decision is needed. Co-ordinating a whole Board to be present at short notice can at times be a challenge. Where good governance and demonstration of decision making has been shown, a CMC can enable this.

The challenge of Operational Resilience and Cyber Risk have been key issues that Banks have had to deal with as they have moved to remote working. These continue to be in the spotlight. INED's have increasing responsibility to ensure that policies are sufficiently robust to respond to these unprecedented circumstances, INEDS have a critical role in ensuring business continuity.

Summary

Overall the Banking industry has demonstrated its resilience since the outbreak of COVID-19. 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 they choose to join. The Senior Managers Regime has resulted in an increase in the compensation expectations of candidates.

There is a focus on the diversity of the Board of a firm, this is a positive step, however, there is a limited pool of qualified candidates.

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

Sayer Haworth Board Appointments contacts:



James Sayer – Managing Partner

James has been within Executive Search in the Financial Services sector for over 20 years, having lived and worked in the UK, Europe and the Middle East. James has acted as a trusted business partner to source Board and Executive talent within SME Banks. James focuses on forming long-term partnerships with his clients in order to offer a truly consultative service built on time investment, integrity and a considered service delivery to generate the right solution.

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Andrea Mynard – Practice Leader

Andrea has worked in the sector for more than 20 years. Andrea delivers a uniquely personalised service – focusing on understanding a client’s needs and matching requirements with a tailored search including market mapping, identification of talent, engagement and screening.

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