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Banker Remuneration and Accountability

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Author:
Professor Kevin Davis

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With much commentary about who should bear responsibility in the current Commonwealth Bank of Australia anti-money laundering compliance issue, and the pending introduction of the Bank Executive Accountability Regime (BEAR), it is worth considering what we know about banker remuneration. The answer: not much despite very large (and hard to digest) remuneration disclosures in Annual Reports.

While banks delegate limited decision-making down through the ranks, it is executives and managers nearer the apex of the institution who should ultimately take responsibility for operational failings that (a) reflect their decision-making and oversight responsibilities, and that (b) they could reasonably be expected to have prevented.

Moreover banks should have remuneration structures which provide proper incentives to staff. That relates not just to the nature of remuneration for any individual (for example, fixed versus bonus component; cash versus option or shares components). It also relates to the structure of remuneration scales throughout the institution. Staff can be incentivised, and their actions affected, by both the way their remuneration is determined but also by the prospect of promotion to higher levels where remuneration is (possibly substantially) higher.

Unfortunately, we know very little about the structure of remuneration within banks. It wasn't always so. Up until 2003, banks were required to include in Annual Reports the numbers of staff earning amounts above \$100,000 within specified bands. From those reports we could identify, for example, that the National Australia Bank (NAB) had 13 Australian staff earning more than \$1 million in 2002 (and only 9 in 2003).

Those reports weren't necessarily all that informative. They could exclude staff offshore (some of whom were among the very big earners). They didn't include a "fair" value of option-based remuneration, which could also be substantial.

But they were probably more useful than the current remuneration disclosures which came into effect with changes to the accounting standard AASB 1046 – Director and Executive Disclosures by Disclosing Entities in January 2004. Much more data (not necessarily useful information) was required to be disclosed about remuneration of Directors and Key Management Personnel (KMPs), with the latter numbering maybe a dozen for each of the large banks. The reports are in the order of 30 pages with a range of arcane details about the nature of remuneration, which even skilled analysts would have difficulty interpreting.

Taking NAB again as an example, in 2016 there were only six KMPs identified who were employed for the full year (with a number of others employed for part of the year). The lowest level of remuneration reported was in excess of \$2 million.

But we have no information on how many NAB (or other bank) executives and managers earned in excess of, say, \$1 million or \$500,000. Probably quite a lot! At those levels of pay, significant decision-making responsibility and accountability should be characteristics of the role.

Why should such information be made public? One answer is: why not? It is not apparent that there were any adverse effects from the pre-2003 regime, and the production of such information should have been a low cost exercise of asking a query of the bank's remuneration database. Shareholders should be entitled to information about the structure and size of remuneration being paid by the company of which they are part-owners, to at least be able to ask the question of whether it is atypical of the industry.

One argument against making such information public is that it may lead to salary inflation as employees are influenced by, and bargain for, the highest remuneration levels observed industry-wide for their role. However, by not disclosing what roles are associated with the salary levels indicated, this argument does not hold water. It has much more relevance for the current regime where names and positions are attached to the (small number of) KMP remuneration disclosures. It may, however, alert employees at the lower end of the salary scales to their relative remuneration and induce discontent or union action for greater equality (for either the right or wrong reasons).

There are positive reasons for requiring such disclosures (and not just for banks). One is so that cross-industry comparisons can be more easily made. Are banks havens of exorbitant remuneration throughout a large part of their workforce, perhaps because of the mystique of banking? We just don't know.

Many academics have done arcane studies of links between executive remuneration and company performance, but without better information on the overall profile of remuneration structures throughout the firms, the confidence that can be placed in such studies is (in my personal view) very limited.

And then there is the accountability issue. At what point in the organisational structure does responsibility for operational failings associated with the oversight of a set of activities become significant? This is the sort of question which needs to be addressed in the planned

implementation of the BEAR. Information about salary structures would be helpful in answering that important question.

This Financial Policy Brief was prepared by Professor Kevin Davis, Research Director of the Australian Centre for Financial Studies

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