Soundness and disclosure of remuneration practice in the financial industry: an empirical analysis for Italian listed banks

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Abstract

This research intends to investigate management compensation in the Italian banking sector, by carrying out a qualitative and quantitative study.
Interest in this issue originates both from the serious role that such practices assumed during the recent financial crisis and from the comparative lack of empirical studies on the remuneration system of Italian banks following the international financial crisis. This study aims to verify: 1) the soundness and the disclosure (towards the market and shareholders) of remuneration policies in Italian banks compared with the current best practices in this area, by noting weaknesses and margins for improvement; 2) what is the influence of good remuneration practices on the stability, risk and performance measurements of these banks.
Findings provide evidence that the remuneration practices carried out by the Italian listed banks have not yet achieved standards of disclosure and soundness adequate and appropriate to the current economic situation, from both a qualitative and a quantitative point of view. In particular, the main criticalities concern the structure and the accessibility of the Remuneration policy that the banks have submitted to shareholders' meetings since 2009, in accordance with the new provisions imposed by the Bank of Italy. The documentation, in fact, is not sufficiently compliant with the legislation because it is inadequate, especially with regard to implementation of the remuneration policy (*ex-post* information). Finally, the study reveals no significant relationships between performance and remuneration practices. This can be explained by the limited number of observations available, but probably also by the tendency of the market not yet to attribute a value to good remuneration practices given the current phase of uncertainty and instability.

JEL Classification: G01, G21, G35

Keywords: *management compensation, Italian banks, Remuneration policy, financial performance, regulation*

Contents

1. The remuneration policies in the banking sector: regulation, implications and objectives of the work

As authoritatively pointed out by numerous scholars and academics, the recent financial crisis highlighted new issues which had previously been little explored because their extreme importance for the stability of financial intermediaries had not been recognized (we refer, in particular, to the liquidity risk of banks and the need to introduce new and more stringent rules as regards securitization mechanisms). The crisis also revived questions already extensively investigated in the past, which have assumed new importance and have shown considerable potential for further investigation. Among the latter, a central role is played by the question of remuneration policies for bank managers, recognized both by the Supervisory Authorities (OECD, 2009; Conti, 2009; European Commission, 2009a, 2009b, 2010; Mieli, 2010; Tarantola, 2009) as well as by analysts and academics (Ruozi, 2010; Bebchuk and Spamann, 2009; Adams, 2009) as a causal and aggravating factor of the international financial crisis. Particularly under fire is the presence – especially in the major international banks – of distorted incentives not only related to the definition of compensation schemes linked to short-term results, but also to weak internal controls and insufficient information both within the organization and outside it, namely with regard to the market.

In light of these considerations, the issue of remuneration policies certainly deserves careful consideration for two reasons: 1) the intense media coverage and regulatory framework which has recently involved it, 2) the theoretical implications associated with the financial value and the stability of financial intermediaries from both a micro- and a macro-economic perspective.

With regard to the first reason, over the last three years a significant legislative process has been started up in multiple national and international organizations. This process intended to regulate compensation not only for top management in banks and listed companies, but also for those whose work can affect the risk profile of the company (so-called risk-takers). There is great heterogeneity among the instruments used, including directives, communications, recommendations, supervisory instructions, etc. Despite this, we can note a homogeneous view by all regulatory frameworks, supported by the conviction of the need to introduce new and more stringent principles with regard to executive pay, especially variable pay schemes. For example, the main regulatory interventions include: a) the Financial Stability Forum's "Principles for Sound Compensation Practices", issued in April 2009 and focusing on significant financial institutions, are intended to reduce incentives for excessive risk-taking that may arise from the structure of compensation schemes; b)

Recommendations no. 384 and 385 dated 30 April 2009, of the European Commission aimed to outline new guidelines for Member States on the structure of remuneration practices, methods of quantification of results, requirements for disclosure in both the banking and non-financial sectors; c) the legislative process aimed at introducing mandatory regulation on managerial remuneration for all financial firms that began on July 2009 with the proposal to amend the Capital Requirements Directive of the European Commission and concluded on December 2010 with the final publication of Directive 2010/76/CE, known by the acronym III CRD (Capital Requirements Directive III). In addition to these provisions, there are other regulatory initiatives at national level, which are very important not only because they anticipated many issues addressed later in Europe, but also due to the detail and depth with which they analyze the issue of compensation. In this case, an example would be the Bank of Italy's Supervision instructions dated March 30, 2008, recently updated in the part relating to remuneration practices, by new provisions published in March 2011 and related to the implementation of the Capital Requirement Directive III. Not only that, again at national level, relevant regulatory authorities have also been promoted by Consob (2007) and the Borsa Italiana (2010), in this case with regard to all listed companies.
As regards the second reason that justifies delving into the topic of remuneration is that there is a twofold relationship between remuneration and incentive policies and economic value; one is a positive quality and the other a negative one. On the positive side, good remuneration systems are certainly fundamental for the development of economic value. In fact, remuneration, especially of key players within the organization, is a means to attract and retain individuals in the company with the best skills and expertise. In this way, by encouraging the growth of human capital, the compensation component can certainly generate a competitive advantage for the benefit of management, good governance and reputation of the bank (Mieli, 2010). On the other hand, however, especially if anchored to a short-term, remuneration policies can be the prelude to a process of deterioration of the economic capital as well as the human one. In fact, if based on distorted incentives and responding to a logic of self-interest, they can induce the players to conduct business life in contrast to the sound and prudent management of the bank and thus lead to the destruction of economic value rather than to its creation.
This paper aims to investigate these issues by framing within the new regulatory framework now in force that, as can easily be seen, has induced financial firms to make radical choices in a field, such as compensation policies, characterized, until a few years ago, by a certain discretion of managers and especially the lack of well-structured disclosure. More specifically, the paper intends to analyze pay practices currently in place in the universe of listed Italian banking groups, proposing to achieve the following objectives:

a) to analyze the soundness of the remuneration policies of the major Italian banks compared with the current best practices in this area, by noting weaknesses and margins for improvement;
b) to verify the level of transparency surrounding information on remuneration practices within these companies, by investigating both disclosure towards the market and towards shareholders;
c) to verify what is the influence of good remuneration practices on the stability, risk and performance measurements of these banks.

As regards results achieved, the development of these goals has allowed us to: a) study an important topic that is still largely unexplored empirically within the Italian banking system (paragraph 2), b) recognize the critical process of compliance of Italian banks with the new supervisory rules (paragraphs 3.1 and 3.2) and c) see if the market reflects the increased efficiency and revenue of financial firms that employ the current best remuneration practices (paragraph 3.3). At the same time, we examined the contents and structure of the new Remuneration policies drawn up by Italian banks since 2009 (paragraph 4), as well as reflecting on the findings achieved and on the need to investigate further and look into related lines of research (paragraph 5).

2. The literature on banking compensation: the state of the art

The literature on management compensation is characterized by multiple research perspectives and disciplines. This issue, in fact, has been explored by many scholars: economists, lawyers, accountants and corporate organizational theorists, human resources, strategy and finance companies, which means that both theoretical and empirical studies are available; the latter aim to test one or more relationships related essentially to the impact that management incentives may have on stability and banking performance.

At a theoretical level, the issue of executive pay (and especially of company employees as a whole) may be framed in a variety of theoretical frameworks: among the most important are the agency theory (Ross, 1973; Jensen and Meckling, 1976; Murphy, 1985), the motivational theory (Vroom, 1964, Porter and Lawler, 1968) and the equity theory (Adams, 1965). Among these, the agency theory is certainly the most important theoretical reference and widely used by studies that have examined the compensation of Top management[1]. The prevalent approach ("*optimal contracting approach*") gives the remuneration policies and, in particular, the performance-related equity incentive (pay for performance) the function of aligning the interests of managers and shareholders, unlike traditional monitoring activities. According to this theory, in fact, by being provided with a proprietary interest, managers would be encouraged to act for the benefit of the company while at the same time increasing their loyalty and identification with the organization and, thereby, reducing agency costs (Murphy, 2002; Core *et al*., 2003; Mieli, 2010).

By contrast, another approach emphasizes how executive pay does not represent an instrument for reducing agency costs, but an aggravation of the same, providing only a way to extract private profits to the detriment of shareholders. In other words, according to this second theory, called "*rent-extraction theory*", the directors can influence their own remuneration, and would use this to gain personal wealth at the expense of shareholders (Bebchuk *et al*., 2002; Bebchuk and Fried, 2003)[2].

At an empirical level, however, the relationships investigated are much more articulated, especially if we consider the extensive international literature relative to all companies and not only to financial ones. The most important contributions appear to be the recent investigations into what implications incentive schemes had in setting off the recent sub-prime crisis. In this regard, it should be noted that not all scholars show a positive relationship. Fahlenbrach and Stulz (2010), Beltratti and Stulz (2009) and Guo *et al*. (2010), in fact, argue that during the recent international crisis, there is no significant evidence that associates greater alignment of interests between shareholders and managers with higher performance. On the contrary, those banks in which the CEOs had better incentives, in terms of the value of their shareholdings, in fact recorded the worst results. This shows that the CEO's did not act in their own interests at the expense of shareholder's wealth, but instead shared the economic losses. They conclude, therefore, that the remuneration schemes did not have a negative effect on the performance of banks during the recent financial crisis. In contrast, however, in the case study conducted by Bebchuk *et al*. (2010) as regards the financial scandals at Bear Stearns and Lehman Brothers, the authors show that the characteristics of the compensation packages of top managers played a decisive role in the failure of these two major international banks. In fact, not only was executive pay strongly focused on short-term results, but

[1] As is well-known, the agency theory focuses on the relationship between shareholders and management, noting that especially in companies with high ownership dispersion, these subjects are in contrast not only because of the inequity of the information available (information asymmetry), but also the desire to reach divergent goals associated with the maximization of profit. This generates costs, monetary and otherwise (agency costs) attributable to the need to put in place measures to monitor the behavior of the agent-manager by the principal (shareholders) so that the former does not produce diseconomies, especially in the long term.

[2] Consequently, in view of this theoretical approach, which especially in recent times has gained many supporters, "*the salaries and incentive variables appear to be congruent with the interests of the beneficiaries, but not necessarily with those of shareholders*" (Melis *et al*., 2010a).

there were no clauses such as "claw-backs" which would force managers to return any bonuses received in the event of poor firm performance.

In addition to these contributions, other important micro-areas of research can be identified, including that related to the links between equity incentives and the riskiness of banks. The main studies (Saunders *et al*., 1990; Mullins, 1992; Chen *et al*., 2006; Harjoto and Mullineaux, 2003; Palia and Porter, 2007; Mehran and Rosenberg, 2008; DeYoung *et al*., 2010) suggest that in financial firms an increase in CEO bonus and stock option leads to a higher risk profile and that this positive relationship may increase the instability of the bank and, therefore, the probability of financial distress (Vallascas and Hagendorff, 2010; Balachandran *et al*., 2010)[3].

Further, no less important are the studies that empirically investigate the relationship between the ownership structure (Barontini and Bozzi, 2009) or the governance of the company (Mehran, 1995; Ferrarini and Moloney, 2004; John *et al*., 2010; Fahlenbrach, 2009) and its management compensation. Overall, in both financial and non-financial firms (Cooper, 2009; Sierra *et al*., 2006), existing studies show that certain characteristics of the board, such as the conspicuous presence of non-executive and/or independent directors (Lambert *et al*., 1993; Boyd, 1994) or the absence of the "interlocking directorship phenomenon" (Hallock, 1997) impacts positively on executive pay by limiting its growth. In addition, again in the area of governance, an interesting topic concerns the remuneration committees and the role played by these bodies in the formulation of executive pay packages (Newman and Mozes, 1999; Anderson and Bizjak, 2003; Daily *et al*., 2008; Vafeas, 2003; Sun *et al*., 2009; Sun Cahan, 2009). In this case, the more recent studies show that the quality of such a committee, arising from several characteristics possessed by their members, positively influences the construction of pay packages and is able to align shareholder and management interests, constituting an important tool for containing agency costs (Sun *et al*., 2009).

Finally, other interesting areas of research concern the disclosure of remuneration policies (Burghof and Hofmann, 2000), which again in this are case more numerous concerning non-financial firms (Conyon 2001; Conyon and Sadler, 2001; Nagar *et al*., 2003; Andjelkovic *et al*., 2002; Laksmana, 2008; Frantz *et al*., 2007; Hitz and Werner, 2010; Gordon, 2005; Lo, 2003; Muslu, 2009; Sheu *et al*., 2010), and the impact exercised by the regulatory framework and, in particular, by the processes of deregulation, on executive pay (Crawford *et al*., 1995; Hubbard and Palia, 1995; Becher *et al*., 2005; Cuñat and Guadalupe, 2009).

As regards the national literature (Cappiello, 2005, 2008; Camuffo, 2009), as already mentioned, the scientific contributions, especially in the field of banking compensation, are less numerous, although they are theoretically interesting (Melis *et al*., 2010b; Desario 2009; Mieli, 2010; Di Antonio, 2010; Di Antonio and Previati 2010a, 2010b; Venturi, 2010; Delli Pizzi *et al*., 2010). Among the more recent analyses, we can cite the studies conducted in 2010, respectively, by Assonime (2010) and ABI-HayGroup (Orlando and Signorotto, 2011). While the first survey finds that, in Italian financial companies, the average level of remuneration of top management is higher than that of other sectors and that equity incentives are very common, the second study points out, however, a growing awareness of the banks' policies for deferral schemes, as well as extensive use of risk-adjusted performance indicators. At the same time, however, the study evidences the importance of improving the involvement of all business functions (especially risk management) in the definition of remuneration policies, and to reflect on the role of remuneration committees, especially in terms of their effective competence and independence (Ambrosetti, 2009; Marchettini and Carosio, 2008; Orlando and Signorotto, 2011).

[3] Overall, these studies are based on an econometric analysis of cross-sectional times to relate bank risk, measured for example by the variance of stock returns and/or by financial leverage, with the sensitivity of CEO pay to performance (Palia and Porter, 2007) or with specific components of compensation packages, including equity-linked instruments or cash bonus plans (Vallascas and Hagendorff, 2010). Indeed, it is important to mention other studies that evidence opposite results, that there is no positive relationship between incentive schemes and bank riskiness (Smith and Watts, 1992; Becher *et al*., 2005; Houston and James, 1995; Palia and Porter, 2004; Guo *et al*., 2010; Fahlenbrach and Stulz, 2010).

3. Methodology of the empirical analysis

In order to answer the above research questions, the study used a twofold approach, both qualitative and quantitative.
For the first two goals a) and b), content analysis methodology (Neuendorf, 2002; Krippendorf, 2004; Beattie and Thomson, 2007) was used to elaborate two different qualitative indicators which we called *Sound Remuneration Index* (SRI) and *Disclosure Remuneration Index* (DRI). While the first indicator (SRI) aimed to analyze compliance of remuneration practices with an ideal model constructed on the basis of recent legislation, the second index (DRI) aimed to understand the degree of disclosure and therefore, of the accessibility produced both inside (toward the shareholders) and outside (toward the market) the organization. In order to elaborate both SRI and DRI indicators, we preliminarily established two different models made up respectively of 38 and 49 basic information items (see Appendix) extrapolated from the latest Italian and international regulations (BCBS, 2010a, 2010c; European Commission 2009a, 2009b; CEBS, 2010b; FSB, 2009; Borsa Italiana, 2010, Bank of Italy, 2011). Then, after giving each of those items a specific score calibrated according to their importance (shown in Table 1 and 2 of the Appendix), we proceeded bank by bank to assign each item a value by carefully analyzing all the corporate documents (Annual Reports, Sustainability Report, Corporate Governance Report, Remuneration Policies, Report on Article 114-bis of the TUF[4], etc.). This led to a final calculation of the two indicators given by the sum of the scores expressed as a percentage of maximum value overtake (if all items had achieved the highest score).
For the third goal, in order to test the relationships between these two indicators (SRI and DRI) and improved financial performance, we carried out a multivariate analysis, including some linear correlation exercises and a multiple regression study, using both qualitative dummy variables, related to the above indicators, as well as quantitative accounting and financial indicators.
After a brief analysis of the sample under investigation, we present the results of this study, pointing out separately for each of the two qualitative indicators (SRI and DRI), the average values reached during the 2007-2010 period, their trends, their most important criticalities and the areas characterized by higher regulatory compliance. In presenting the empirical evidence, it will seek to develop useful considerations for understanding the current process of reform of the remuneration policies in place in the financial industry, especially in Italy.
Finally, concerning the sample, the study, conducted over three years between 2007-2010, covers all the listed Italian banking groups, and a micro-sample of five international banks used as a benchmark of the analysis. The panel of Italian banks, made up of 20 institutions, is representative of the universe of listed banking groups, active and independent as of December 31, 2010. They were selected by consulting the information available from websites of the Bank of Italy, Consob and the Borsa Italiana. In this regard, Table 1 shows the list of Italian banks examined, their total assets and market capitalization at December 31, 2010. Foreign banks used as a benchmark, however, were selected by identifying the first bank by market capitalization belonging to five major European countries (United Kingdom, France, Spain, Germany and Switzerland)[5]. Consequently, this sample was made up of the banks included in Table 2 that, in addition to the country, also reports the total assets and market capitalization of each intermediary at 31 December 2010.

[4] It is, essentially, a form of preventive information that all listed companies must provide to shareholders when deciding to issue equity-linked instruments, particularly stock options in order to apply for approval. This requirement was introduced by Italian Law 262/2005 and must be fulfilled by providing an illustrative report to shareholders utilizing a scheme defined by Consob on 2007 (see art. 84-bis and Scheme 7 of Attachment 3A of Regolamento Emittenti 11791).

[5] The selection of these foreign banks was made by consulting the Monthly Outlook Report of Abi at December 2010.

Table 1 – The universe of Italian listed banking groups *(mln. Euro at 31-12-2010)*

	Bank name	Total asset	Market Capitalization
1	UniCredit SpA	929.488.000	24.054.603
2	Intesa Sanpaolo	658.757.000	25.077.249
3	MPS	244.279.000	3.094.225
4	Banco Popolare	135.155.700	2.519.428
5	UBI Banca	130.558.400	2.274.129
6	Mediobanca SpA	61.105.300	5.365.506
7	Banca Popolare dell'Emilia Romagna	58.498.416	1.830.616
8	Banca Popolare di Milano	54.052.900	625.309
9	Banca Carige	40.009.957	2.323.780
10	CREDEM-Credito Emiliano	29.998.234	1.196.111
11	Credito Valtellinese	26.760.794	744.520
12	Banca Popolare di Sondrio	26.282.400	1.627.488
13	Banco di Sardegna	13.930.000	54.040
14	Banca Popolaredell'Etruria e del Lazio	10.902.800	149.383
15	Banco di Desio e della Brianza	8.163.000	410.959
16	Banca Generali	3.807.900	956.467
17	Banca Intermobiliare di Investimento e Gestioni	3.290.600	612.371
18	Banca Ifis	2.802.000	248.555
19	Banca Profilo	1.978.200	218.529
20	Banca Finnat Euramerica	516.500	150.747

Source: Bankscope

Among the banks included in the benchmark, HSBC stands out, its high market capitalization making it the biggest financial intermediary both in England and in Europe. Instead, with regard to total assets, the top position, both in Europe and worldwide, is held by BNP Paribas (Table 2).

Table 2 - The sample of foreign banks used as a benchmark *(mln. Euro at 31-12-2010)*

	Bank name	Country Name	Country Rank by Assets	World Rank by Assets	Total Assets	Market Capitalization
1	HSBC	United Kingdom	1	nd	1.834.213	145.526
2	UBS	Switzerland	1	18	1.053.123	49.432
3	Deutsche Bank	Germany	1	5	1.906.213	37.543
4	BNP Paribas	France	1	1	1.998.634	63.107
5	Banco Santander	Spain	1	10	1.218.001	69.631

Source: Bankscope

3.1 Soundness and disclosure of remuneration practices: trends

As previously stated, one of the objectives that we intend to achieve through empirical analysis is to verify the existing level of compliance and disclosure of remuneration policies of Italian banks compared to the best national and international practices. To achieve this goal and understand, at the same time, what changes the financial crisis has produced on banking compensation, we constructed two qualitative indicators which we called *Sound Remuneration Index* (SRI) and *Disclosure Remuneration Index* (DRI), capable of summarizing, respectively, the soundness and transparency of the remuneration policies at the banks analyzed. In addition, it seemed appropriate not only to extend the qualitative analysis to the last four years (2007-2010), so as to analyze the complete period covered by the international crisis, but also to compare the values of Italian banks with those of a sample of large international intermediaries in order to verify the ranking of Italian banks at international level over the course of the financial crisis.

The first output of this empirical study is shown in Table 3[6] where, for each bank included in the Italian sample and all four years under investigation (2007-2010), we report the respective values of the *Sound Remuneration Index* and *Disclosure Remuneration Index*. Looking only at the average value for both indicators, it can be seen that it was rather low in 2007, but that by 2010 it had reached approximately 43% (for the SRI) and 48% (for the DRI). Even though these values do not appear to be satisfactory, there is still a clear improvement over the four years, a situation attributable not only to supervisory instruction on compensation introduced as early as the first half of 2008[7], but probably to a greater focus of banks on this issue on which public opinion as well as analysts and institutional investors have focused. It should be noted, however, that the average value of the DRI, below 10% in 2007, during the last year of the survey grew by over 300%; besides, it is five percentage points above the corresponding value of the SRI, indicating that during the past four years, Italian banks have made more improvements regarding disclosure of their remuneration policies rather than their soundness.
Similar considerations come from the analysis of the median and standard deviation that, like the mean, also improved greatly over the four years. A comparison of these statistics, in fact, highlights that those relating to the DRI have higher increases than those recorded by the corresponding median and standard deviation of the SRI (Table 3). This may be due not only to a greater propensity of Italian banks to comply with new disclosure requirements on remuneration policies than to structure them, but also to the fact that already for some years Italian banks have disclosed information on compensation packages granted to its directors and managers, although this information is still disjointed and incomplete because it is contained in various different corporate documents.
In any case, apart from this comparison, Table 3 shows an improvement in the statistics for both qualitative indicators at the end of 2010. As for the median, whereas during 2007, half of the banks were positioned below a value of soundness and disclosure of remuneration policies, respectively, by about 9% and 7%, in 2010 these values had increased significantly (42.21% and 47.72% for the SRI and the DRI, respectively). Similarly, the development of a percentage increase in the standard deviation of both qualitative indicators in the four-year investigation is very positive. The progressive growth of such descriptive statistics highlights the trend of Italian banks to better articulate their compensation policies over time and, therefore, to take choices characterized by less standardization and homogeneity[8].

[6] In bold the banks classified by the Bank of Italy as of systemic importance. Besides, Table 3 also shows SRI equal to 0%. This indicates that in some cases it was not possible to proceed with the analysis, because of the absence (on the websites of the banks surveyed) of key documents, including, in particular, the Corporate governance report, or because the bank was not yet operational (as for Banco Popolare and UBI).
[7] See paragraph 4 of the “Supervisory provisions of the Bank of Italy for the organization and corporate governance of banks” issued in March 2008.
[8] At the same time, however, this may also be interpreted differently because it would highlight a certain inability of the existing rules to promote a minimum level of standardization of practices needed to achieve profitable comparative analysis and to identify the most compliant intermediaries. On this aspect, see paragraph 4.

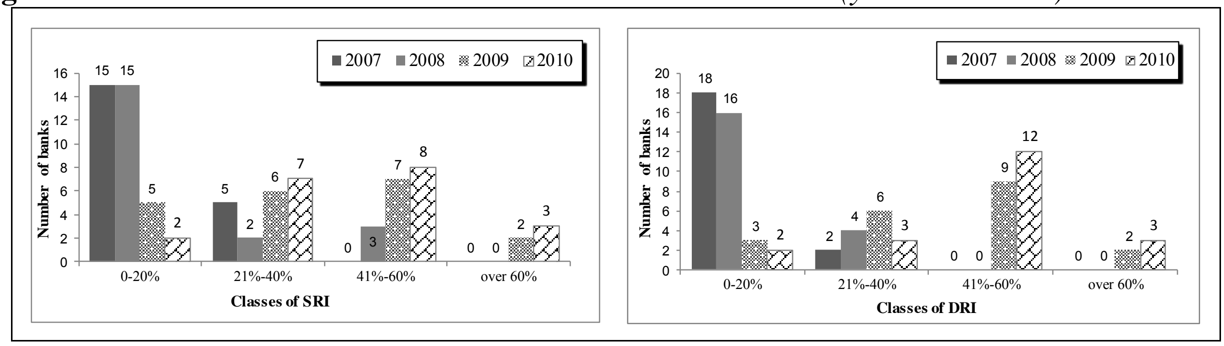
Table 3 - SRI and DRI indicator of Italian listed banking groups *(years 2007-2010)*

	Italian listed banking group	*Sound Remuneration Index*				*Disclosure Remuneration Index*			
		2007	**2008**	**2009**	**2010**	**2007**	**2008**	**2009**	**2010**
1	Banca Carige	6,38%	14,89%	50,00%	55,12%	5,66%	8,49%	56,60%	59,21%
2	Banca Finnat Euramerica	8,51%	11,70%	19,15%	23,24%	8,49%	8,49%	26,42%	32,12%
3	Banca Generali	11,70%	17,02%	60,64%	61,45%	16,04%	25,47%	71,70%	73,00%
4	Banca IFIS	4,26%	4,26%	12,77%	22,32%	3,77%	3,77%	11,32%	18,12%
5	Banca Intermobiliare	3,19%	5,32%	37,23%	42,21%	1,89%	8,49%	52,83%	58,12%
6	**Banca Monte Paschi di Siena**	**32,86%**	**48,57%**	**60,00%**	**62,00%**	**23,91%**	**27,17%**	**55,43%**	**58,12%**
7	Banca Popolare dell'Emilia Romana	0,00%	0,00%	52,86%	56,00%	10,87%	13,04%	59,78%	61,12%
8	Banca Popolare dell'Etruria e del Lazio	14,29%	11,43%	17,14%	35,34%	4,35%	6,52%	6,52%	45,00%
9	Banca Popolare di Milano	24,29%	24,29%	54,29%	58,21%	11,96%	11,96%	45,65%	49,12%
10	Banca Popolare di Sondrio	0,00%	0,00%	10,00%	12,10%	4,35%	6,52%	30,43%	29,12%
11	**Banco Popolare**	**0,00%**	**13,83%**	**32,98%**	**38,32%**	**6,60%**	**8,49%**	**33,02%**	**38,23%**
12	Banco di Desio e della Brianza	9,57%	11,70%	22,34%	32,12%	9,43%	10,38%	39,62%	52,12%
13	Banco di Sardegna	0,00%	0,00%	0,00%	18,00%	4,35%	4,35%	4,35%	18,12%
14	Banca Profilo	8,51%	8,51%	34,04%	43.21%	4,72%	14,15%	41,51%	56,10%
15	Credito Emiliano	0,00%	0,00%	38,57%	39,00%	7,55%	7,55%	38,68%	46,12%
16	Credito Valtellinese	15,71%	15,71%	34,29%	38,21%	5,66%	10,38%	42,45%	46,21%
17	**Intesa SanPaolo**	**22,34%**	**52,13%**	**53,19%**	**58,78%**	**13,21%**	**26,42%**	**57,55%**	**58,12%**
18	**Mediobanca**	**22,34%**	**28,72%**	**43,62%**	**43,51%**	**17,92%**	**18,87%**	**47,17%**	**46,32%**
19	**UBI Banca**	**0,00%**	**8,51%**	**43,62%**	**50,00%**	**0,00%**	**12,26%**	**38,68%**	**42,12%**
20	**Unicredit**	**30,85%**	**43,62%**	**73,40%**	**76,21%**	**24,53%**	**31,13%**	**75,47%**	**76,89%**
	Mean	***10,74%***	***16,01%***	***37,51%***	***43,27%***	***9,26%***	***13,20%***	***41,76%***	***48,17%***
	Median	***8,51%***	***11,70%***	***37,90%***	***42,21%***	***7,08%***	***10,38%***	***41,98%***	***47,72%***
	Standard deviation	***10,77%***	***15,92%***	***19,36%***	***17,13%***	***6,86%***	***8,18%***	***19,48%***	***15,71%***

Source: our figures

Confirmation for these considerations comes from Figure 1 that shows, for each year of the survey (2007-2010) and separately for the SRI and DRI indicators, the number of banks in four different ranges calculated on the basis of the values for the respective qualitative indicators[9].
Over the four years, a substantial re-composition of such ranges can be seen. More specifically, while the first class (0-20%) suffered a sharp decline with regard to SRI, falling from 15 banks in 2007 to only 2 in 2010, the other three classes of values are distinguished by the opposite dynamic. In fact, the number of banks increased over time. This expansion is greater especially at the higher ranges. Indeed, while the second range (21%-40%) between 2007 and 2010 added 2 banks in the case of the SRI and 1 with regards to the DRI, the other two ranges (41%-60% and over 60%) increased, respectively, by 8 and 3 units for the SRI and by 12 and 3 units for the DRI, respectively (Figure 1).

Figure 1 - SRI and DRI indicators: classes of values and trends *(year 2007-2010)*



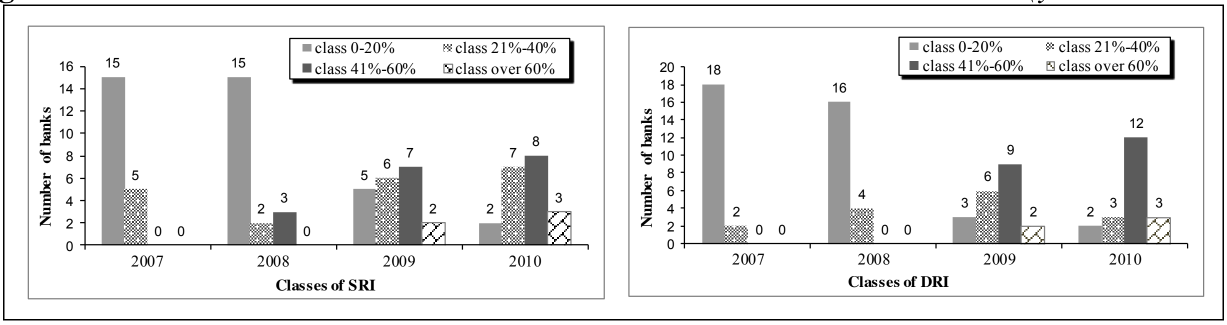
Source: our figures

Similarly, adopting a different but similar visual, whereas during 2007-2008, in terms of relative size, the first class of values stands out (0-20%), in 2009-2010 the mid-to-high SRI and DRI values predominate. In addition, 2010 is the only year in which all classes are represented; in fact, that year

[9] The 0-20% class includes the lowest values of SRI and DRI, the 21%-40% class those with mid-to-low values, the 41%-60% class the indicator with mid-to-high values; finally, in the over 60% class contains the highest values.

at least two banks (Unicredit and Banca Generali) reached a level of soundness and disclosure of remuneration policies of more than 60% (Figure 2).

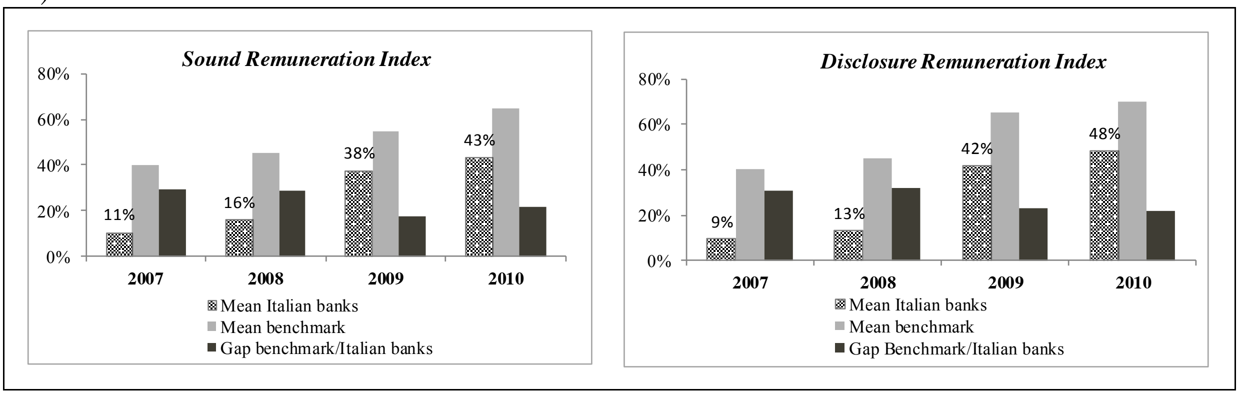
Figure 2 - The indicator of DRI and DRI: classes of values and annual trends *(year 2007-2010)*



Source: our figures

Similarly, a further positive aspect concerns the gradual and significant reduction, especially during 2008-2009, in the gap between Italian banks and the benchmark (Figure 3) consisting, as stated before, of large banks from the five major European markets. This is due not only to a progressive approach which brought Italian banks' remuneration policies into line with the practices of large intermediaries with greater cognitive and experiential background, but also to an increase in the sources of analysis. As regards 2009-2010, in order to calculate the SRI and DRI indicators, we also used the new information contained in the Remuneration policies that all Italian banks started to develop from that year onwards following the Bank of Italy's indications[10].

Figure 3 - Trend indicators of SRI and DRI: a comparison with the benchmark *(years 2007-2010)*



Source: our figures

If we focus only on the last year of the survey (2010), more critical issues emerge, as well as other relevant considerations.

An initial calculation which provided some important information is represented in Figure 4 which shows a dual ranking of all Italian banks examined on the basis of their SRI and DRI value calculated considering only the documentation published in 2010.

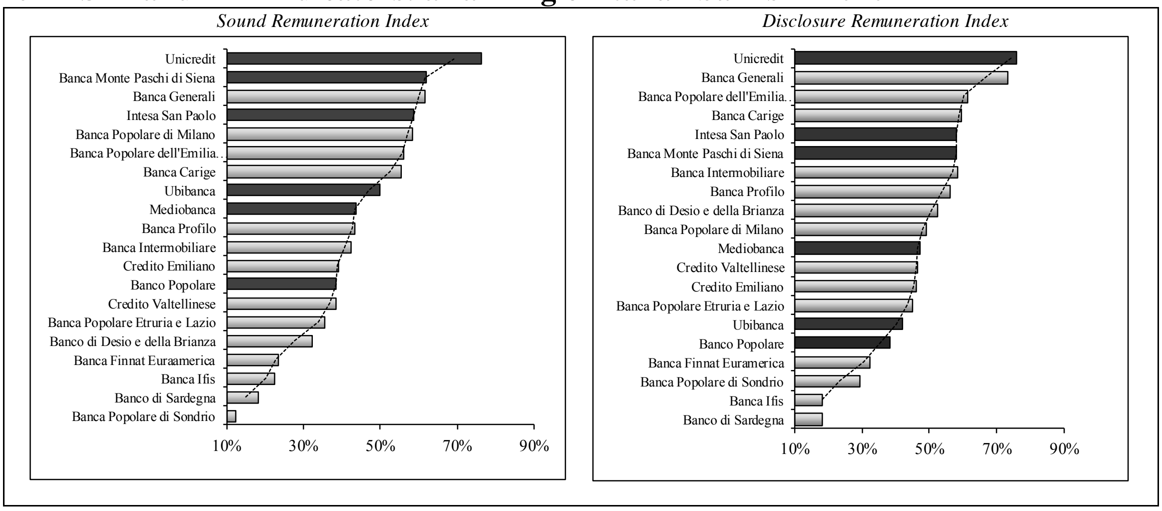
The most important criticalities are made both by a clear and high dispersion of the soundness and disclosure of remuneration policies of Italian banks (circumstance well illustrated by the broad gap between the highest SRI and DRI values, pertaining to Unicredit, and the lowest values by the Banco di Sardegna and Banca Popolare di Sondrio[11]) and the classification of 6 systemically

[10] On this point, more generally, see paragraph 4.

[11] In turn, this reveals that Italian banks have not yet reached a sufficiently uniform and compact approach to tackling the issue of remuneration packages.

important Italian banks, including Unicredit Banca, Monte dei Paschi di Siena, Intesa-Sanpaolo, Mediobanca, UBI Banca and Banco Popolare[12].
The greater attention addressed to such intermediaries by our regulatory authorities, would certainly have justified their placement at the top of the rankings. This, however, is clearly not true as shown not only by Figure 4, but also by the subsequent Table 5, which distinguishes between *Best performer banks*, i.e. those with the highest SRI and DRI, and *Worst performer banks*, relating to the intermediaries with the lowest *Sound Remuneration Index* and *Disclosure Remuneration Index*[13].
Of the 6 banks on which the Bank on Italy focuses its attention, particularly critical is the position of Banco Popolare (in last place among these banks), as well as that of Mediobanca and UBI Banca, whose SRI and DRI values are below even those of some smaller limited company banks (such as Banca Generali and Banca Carige), as well as those of 2 cooperative banks (Banca Popolare di Milano and Banca Popolare dell'Emilia Romagna). Besides, considering the 5 *SRI Best Performer banks* (Table 5, first section), among them only 3 banks are the intermediaries identified by the Bank of Italy as being of particular importance, and none of them were awarded the top position. Near the bottom of the table, however, the negative position of Banco Popolare stands out, with a DRI of just over 30%. This value, out of a total of 20 Italian banking groups, many of which are smaller, makes it the *Worst performer bank* in terms of DRI (Table 5).

Figure 4 - SRI and DRI indicators: a ranking of Italian banks in 2010



Source: our figures

Overall, leadership among our systemically important banks is held by Unicredit, the only Italian intermediary in 2010 to "beat the benchmark", i.e. to reach higher SRI and DRI values (although only by 10.21% in the first case and 6.8% in the second) than the corresponding average values achieved by the five European banks in the sample created for the comparative analysis (Table 4).

[12] In Figure 4, these banks are highlighted by a darker, more intense, color.
[13] This classification justifies the increased attention given to these banks by the Bank of Italy, revealing their correct classification as "systemically important intermediaries". In other words, it seems that our Supervisory Authority was already aware that the level of remuneration policies at these banks was deficient and, on the basis of this and of their dimensional characteristics, decided to include them in a special category of intermediaries subject to more regulatory obligations. Support for such an interpretation comes from the timeframe for publication of the regulatory provisions that identify those banks, i.e. October 2009 (see "Remuneration and incentive systems, Communication of 10/28/2009"), considering that previously (i.e. June 2009) all Italian banks had already sent some information on their remuneration practices in compliance with the "Supervisory provisions for organization and corporate governance", dated March 2008.

Table 4 – SRI and DRI indicators of the benchmark banks *(year 2010)*

	Bank name	Country Name	2010	
			SRI	DRI
1	HSBC	United Kingdom	78%	79%
2	UBS	Switzerland	65%	69%
3	Deutsche Bank	Germany	51%	59%
4	BNP Paribas	France	67%	69%
5	Banco Santander	Spain	69%	72%
	Mean		***66%***	***70%***

Source: our figures

Table 5 - SRI and DRI indicators: The Best & The Worst Italian Bank *(year 2010)*

Sound Remuneration Index

	Legal form	*Bank*	SRI	*Gap on Benchmark**
position		**The Best**		
1	Commercial bank	Unicredit	76.21%	(10.21%)
2	Commercial bank	Banca Monte Paschi di Siena	62.00%	4.00%
3	Commercial bank	Banca Generali	61.45%	4.55%
4	Commercial bank	Intesa San Paolo	58.78%	7.22%
5	Cooperative bank	Banca Popolare di Milano	58.21%	7.79%
position		**The Worst**		
16	Cooperative bank	Banco di Desio e della Brianza	32.12%	33.88%
17	Commercial bank	Banca Finnat	23.24%	42.76%
18	Commercial bank	Banca Ifis	22.32%	43.68%
19	Commercial bank	Banco di Sardegna	18.00%	48.00%
20	Cooperative bank	Banca Popolare di Sondrio	12,10%	53.9%

Disclosure Remuneration Index

	Legal form	*Bank*	DRI	*Gap on Benchmark**
position		**The Best**		
1	Commercial bank	Unicredit	76.86%	(6.89%)
2	Commercial bank	Banca Generali	73.00%	(3.00%)
3	Cooperative bank	Banca Popolare dell'Emilia Romagna	61.12%	8.88%
4	Commercial bank	Banca Carige	59.21%	10.79%
5	Commercial bank	Intesa San Paolo	58.12%	11.88%
position		**The Worst**		
16	Cooperative bank	Banco Popolare	38.23%	31.77%
17	Commercial bank	Banca Finnat	32.12%	37.88%
18	Cooperative bank	Banca Popolare di Sondrio	29.12%	40.88%
19	Commercial bank	Banca Ifis	18.12%	51.88%
20	Commercial bank	Banco di Sardegna	18.12%	51.88%

* This value is obtained by deducting from the SRI and DRI of each bank the respective average values of the benchmark. Thus, a positive value shows that the Italian bank in question has failed to reach the benchmark value for the 5 European banks, whereas of course a negative value (..) shows that the bank has surpassed the benchmark.

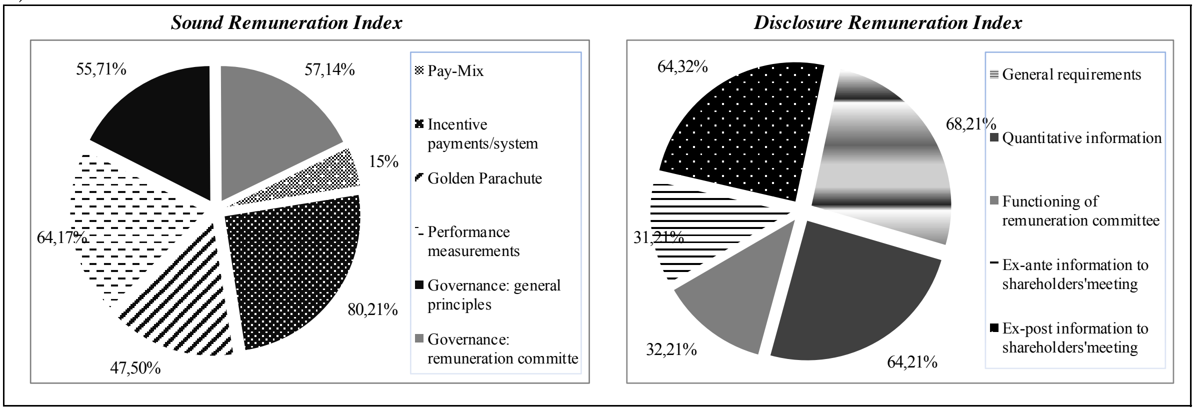
Source: our figures

3.3.1 Weaknesses and margins for improvement

Finally, to conclude this first part of the empirical analysis, further considerations come from the disaggregated analysis of the basic information used to calculate the two qualitative indicators (see Appendix).

As regards the first indicator (SRI), its breakdown into sub-categories or phenomena of analysis, shows that the smaller Italian banks' compliance with international best practices occurs mainly with regard to the incentive mechanisms where consequently there are the greatest margins for improvement (Figure 5). The level of regulatory compliance in this area, in fact, is the lowest among those analyzed, demonstrating how the articulation of equity-linked instruments issued by Italian banks is still poorly oriented to the creation of long-term value, as strongly required by the post-crisis rules on sound compensation practices. In fact, in the information given when the bank issues stock options or other similar instruments, key elements are often missing or, where present, are not at all compliant with regulatory requirements, especially the more recent ones. Among the technical aspects of a stock incentive plan with higher criticality, there is the *vesting period* whose configuration is often not perfectly in line with international guidelines that though setting out only a minimum period of three years, clearly hope that this period will be longer. Not only, it is rare to find both a *holding period*, i.e. a period of time during which the manager, after exercising his stock options, may not sell financial instruments, and the *ex-post risk adjustment mechanisms* (malus or claw-back arrangements), which is the contractual agreement whereby the staff member agrees to return ownership of an amount of remuneration to the institution under certain circumstances (for example in case of negative or inadequate performance or in the case of established fraud or misleading information)[14].

Figure 5 - SRI e DRI indicators: improvement margins for each phenomenon analyzed[15] *(year 2010)*



Source: our figures

In contrast with the more adequate structural features, however, are the areas of investigation related to the governance of remuneration policies, where there is less margin for improvement (Figure 5). This is certainly due to the presence in our country, since the early years of the new millennium, of a complex of regulations, which although not binding, aimed to encourage listed companies to address particular attention to corporate governance and remuneration policies[16].
However, as regards the second qualitative indicator (DRI), the most deficient area is related to "ex-post information", i.e. the information that all banks must produce regarding implementation of their remuneration policy during the previous year. However, the "ex-ante information" is quantitatively greater, and, as will be detailed in the following paragraphs, is essentially inherent to the main section of the Remuneration policy, being made up of the guidelines that the bank intends to address with regard to its remuneration practice. Information on the characteristics of the remuneration policy and quantitative data also appear to be unsatisfactory. Often these can be found only in parts H and I of the Notes in the balance sheet, although the new regulatory requirements will explicitly require the presence (and in a more articulated form), even a separate Remuneration policy. Consequently, all areas of the DRI are characterized by high margins for improvement

[14] For all these concepts (vesting and holding period, claw-back arrangements), see CEBS, 2010b, Annex 1.
[15] A higher percentage indicates a greater margin for improvement, resulting from lower compliance with legislative requirements.
[16] The reference is to the Corporate Governance Code issued by the Borsa Italiana, which since the first year of publication (1999) has encouraged all listed companies to set up, as part of the board, a compensation committee composed mainly of independent directors, anticipating the new provisions concerning the governance of remuneration policies in the wake of the severe sub-prime crisis. Not only, in keeping with the findings above, the greater suitability of areas related to the governance of remuneration practices is also due to the increasing availability of information. In 2010, in fact, the analysis was carried out on the new remuneration policies that all the Italian banks had drawn up in compliance with new legal instructions from the Bank of Italy. This new document, in fact, despite its several shortcomings (see paragraph 4), has greatly increased the information given by the Italian banks on their remuneration practices and, consequently, their compliance with the new regulatory requirements.

except the area of investigation relating to “ex-ante information” and the functioning of remuneration committees[17].

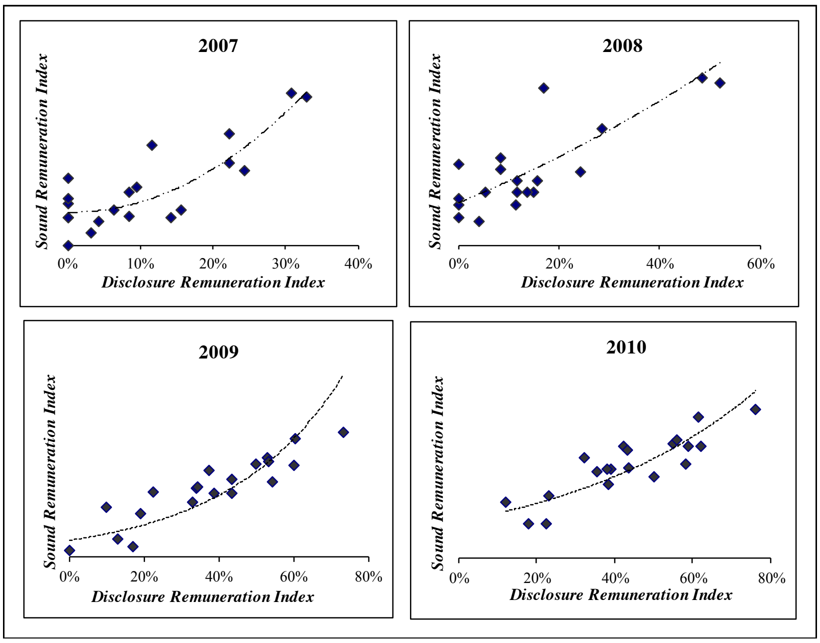
3.2 Soundness and disclosure of remuneration policies: what relationships?

After conducting the qualitative analysis, we proceeded to carry out a second analysis of a quantitative nature. This consisted in a series of correlation studies both between the two previously-mentioned qualitative indicators (SRI and DRI) and between these and some dimensional variables expressing the performance achieved by the banks. Thereafter a multiple regression analysis was carried out, which will be detailed in the next section. Here, however, we suggest the results of linear correlations carried out between the two qualitative indicators in each year of the survey (2007-2010).

The rationale of this exercise is to test empirically whether soundness and disclosure of a given management process will follow the same direction.

Figure 6 shows that there is a strong correlation between the two qualitative indicators, although the linear relationship appears more pronounced during 2009-2010. In fact, compared to 2007-2008, during the last two years of the survey, several points are at their closest to the interpolated line. In addition, there are no clear outsider values, demonstrating how the soundness and disclosure of remuneration policies move in parallel.

Figure 6 – The comparison between SRI and DRI indicator: the results of the correlation analysis



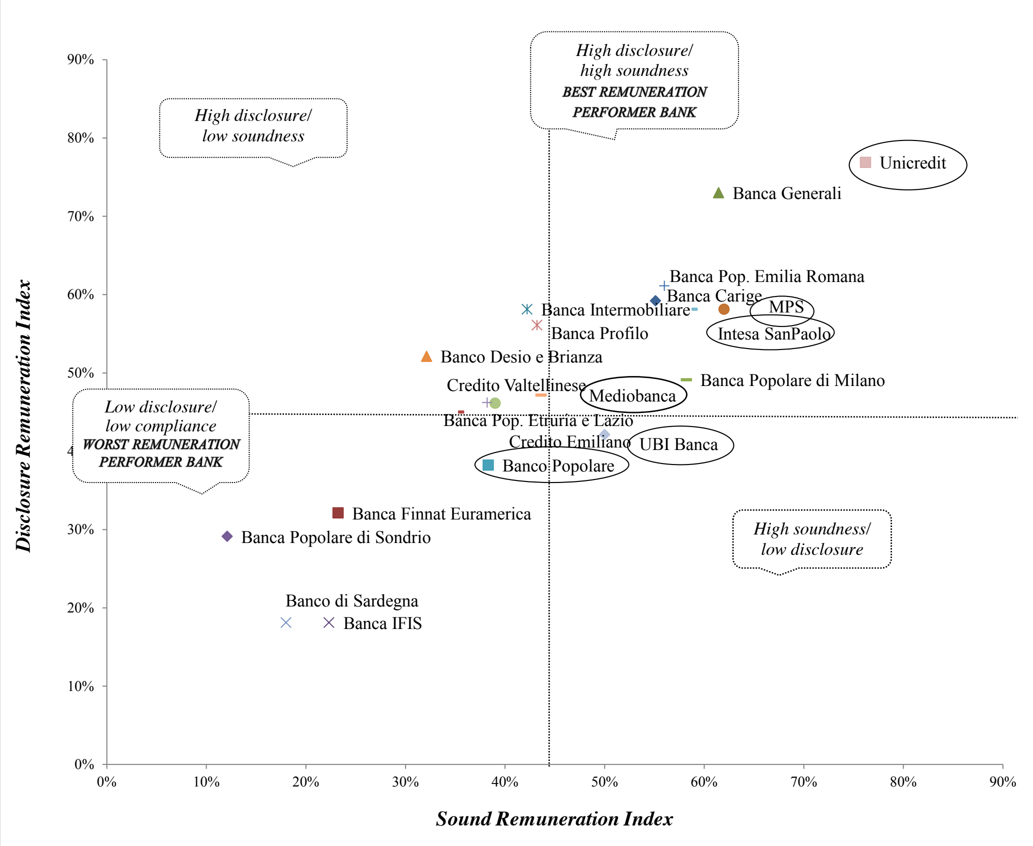
Source: our figures

This evidence suggests that if compliance of remuneration practices with best national and international practices is greater, then disclosure from banks (and vice-versa) will also be greater. In fact, when the banks are more aware that they are sufficiently compliant, we can expect them to be more transparent, with the aim of highlighting this point. By contrast, lower compliance with the legislation tends to lead to secrecy, thus minimizing the amount of information provided. The analysis, therefore, excludes that a low level of disclosure may correspond to a good level of compliance.

[17] For this committee, we can address the same considerations applied to disaggregated analysis of the first qualitative indicator (SRI).

These considerations are confirmed in Figure 7 below, in which the correlation between the two qualitative indicators (SRI and DRI) is exploded by highlighting the position of each bank investigated with regard to the last year of the survey.

Figure 7 – Ranking of Italian banks on the base of their SRI and DRI values *(year 2010)*



Source: our figure

3.3 Remuneration practice and economic performance: a preliminary analysis on the relationships between remuneration and economic value

As stated in the previous paragraph, the second step in the quantitative analysis consisted in carrying out a series of linear correlations between each of the two qualitative indicators (SRI and DRI) and some dimensional variables expressing the economic and financial performance of banks. Consequently, a multiple regression study was carried out to simultaneously verify the relationships between all variables included in previous qualitative and quantitative correlation studies.

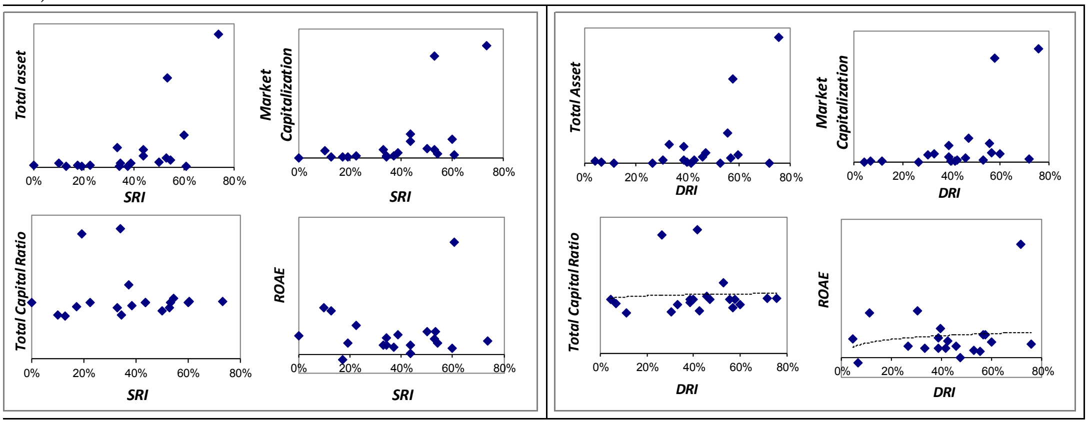
The development of these multivariate analyses aimed to determine whether greater information disclosure and soundness of remuneration practices at a bank affects, in some way, its economic performance and stimulates the process of creating economic value. In other words, we investigated, although only at a preliminary level, whether the market is actually able to attribute value to pay practices that are more compliant with international standards and whether this is reflected in a competitive advantage of such intermediaries in terms of their reputation.

The correlation analyses were conducted by relating the two indicators (SRI and DRI) with the following economic performance variables: *Market Capitalization*, *Total Capital Ratio* and *ROAE*[18]. Moreover, the regression also included some governance (often used in similar studies) and control variables.

Figure 8 presents the results of the linear correlations.

[18] The source of this quantitative information is Bankscope.

Figure 8 – Correlation analysis between SRI and DRI, total asset and performance indicators *(year 2010)*



Source: our figures

As can be seen, in no cases is there a significant relationship. On the contrary, there appears to be a sort of flattening of the different values of SRI and DRI on the same values of *Market Capitalization*, *Total Capital Ratio* and *ROAE*, apart from the existence of some cases of outsiders. Figure 8 shows that neither compliance nor soundness of remuneration practices by the banks nor greater transparency are associated with higher market performance and capitalization.
Similar results have emerged in the regression study whose econometric model consists of the following components:

$$\Delta ROE = a + \beta_1 DRI + \beta_2 SRI + \beta_3\, TotalAsset + \beta_4\, MarketCap + \beta_5\, Tier1CR + \beta_6 LegalForm + \beta_7 RemComm + \beta_8\, RemPolicy + \varepsilon$$

This was built by utilizing the following as dependent variables: a) an accounting performance indicator (ROE), b) a market performance indicator (stock returns) and c) one of the most representative ratings developed by the Fitch international agency. As independent variables, however, the econometric model includes:

a) the two qualitative indicators (β_1DRI and β_2DRI);
b) some control variables related to:
   i. the dimension of the bank (β_3TotalAsset and β_4MarketCap);
   ii. its legal status (if the Commercial or cooperative bank, β_6Legal Form);
   iii. the degree of capitalization (β_5Tier1CR);
c) some governance variables related to:
   i. the existence of a remuneration committee (β_7RemComm, dummy variable);
   ii. the elaboration of a specific Remuneration policy (β_8RemPolicy, dummy variable) in light of the presumed relationship between these aspects and the presence of remuneration practices that are more compliant with international standards[19].

Concerning the results, the regression study showed no significant relationships (Table 6). In fact, not only were the R-squared and adjusted R-squared coefficients not sufficiently high, but no p-value was within the limits of significance.

[19] The decision to use some governance variables is in line with the scientific literature that, for many years, has investigated the relationship between good corporate governance and the achievement of higher economic performance (see Brogi, 2008).

Table 6 – Regression results

Regression results	ROE		Stock Returns		Fitch Rating	
R	0,62		0,58		0,55	
R^2	0,39		0,33		0,30	
Adjusted R^2	0,20		0,13		0,09	
Errore Standard	1,62		1,71		1,81	
Number of cases	25		25		25	
Independent variables	Coefficient	*p-level*	Coefficient	*p-level*	Coefficient	*p-level*
DRI	0,18	0,19	0,09	0,96	-0,11	0,87
SRI	0,07	0,95	-0,03	1,00	-0,01	1,00
Total Asset	0,17	0,04	0,04	0,99	0,11	0,34
Market Capitalization	-0,41	0,00	-0,05	1,00	-0,20	0,15
Tier1CapitalRatio	0,13	0,11	0,04	0,96	-0,11	0,43
Legal Form	0,42	0,15	-0,17	0,95	-0,62	0,00
RemComm	0,11	0,97	-0,50	0,00	-0,05	1,00
RemPolicy	0,10	0,91	-0,14	0,77	-0,12	0,95

Source: our processing with SPSS

This absence of relationships is a stimulus to introduce corrections into the econometric model, by amplifying the number of observations (in this regression study there are only 25, of which 20 relating to Italian banking groups and 5 to foreign banks utilized as a benchmark) and using longer-term performance indicators. The issue of remuneration in the banking sector and the post-crisis regulation framework, both being quite recent, do not yet enable existing relationships with long-term performance indicators to be investigated.
A further justification for the absence of significant connections may be related to cyclical factors: at present, in fact, the financial market is not fully stabilized and is suffering the aftermath of a very important crisis; consequently, it may not be ready to attribute a value to sound remuneration practices.
Therefore, it would be appropriate not only to repeat the econometrics analysis once there is an opportunity to expand the time window, but also to differentiate the sample, making it representative of other European markets generally characterized by a more informative attitude than Italy.

4. The remuneration policies of Italian banks: analysis of the documentation and the information provided to shareholders

With a view to strengthening the minimum standards of banks' corporate organization and governance and ensure "sound and prudent management", in March 2008, the Bank of Italy published an important document delineating a new legislative framework for corporate organization and governance in the banking sector, with the aim of giving this system a central role in defining corporate strategies, risk management and control policies of banking and finance activities.
In this regard, in addition to the obligation to draw up a new and important corporate governance document consisting of the "Corporate Governance Project", which is currently an additional requirement for the exercise of banking activity, all banks were required to produce specific information at shareholder meetings regarding the compensation practices aimed at highlighting how and if these policies comply with a bank's prudent risk management policy and its long-term strategy.
More specifically, the Bank of Italy, in a clarification note (Communication of 10/28/2009 subsequent to the publication of the "Supervisory provisions of 2008" (see footnote 7), established that such new information, which essentially takes the form of a *Remuneration policy*, should have

a dual articulation and have a value that is both preventive and subsequent[20]. The Authority distinguishes, in fact, two different flows of information on remuneration policies to be produced annually: a) *ex-ante* information, and b) *ex-post* information. While the former is essentially a statement of principle - whereby banks inform their shareholders with regards to the structure of their remuneration policy, the reasons and criteria on which remuneration is based and how this enables long-term value objectives to be pursued - through *ex-post* information, the Supervisory authority encourages banks to provide shareholders with adequate information on the implementation of remuneration policies and justify the decisions taken during an accounting period highlighting their compliance with the principles set out in the *ex-ante* information.
Accordingly, since 2009, all Italian banks, during the shareholders' meetings convened in the months of March-April to discuss the financial statements, have provided this new remuneration disclosure and have required approval of their specific *Remuneration policy*[21].
The performance of the empirical analysis and the construction of the two qualitative indicators previously analyzed (SRI and DRI) provided us with the opportunity to analyze this recent reporting carried out by Italian banks in detail. In fact, as we have already said, the assessment of SRI and DRI, especially for 2010-2011, was influenced greatly just by the information included in these new *Remuneration policies*. Then, we propose a specific overview of these documents, highlighting both the strengths and the weaknesses or criticalities that the analysis made it possible to detect.
As regards the strengths, one positive aspect concerns the standardization of the structure of these new corporate documents which, in general, have similar layouts made up of three distinct parts, namely:

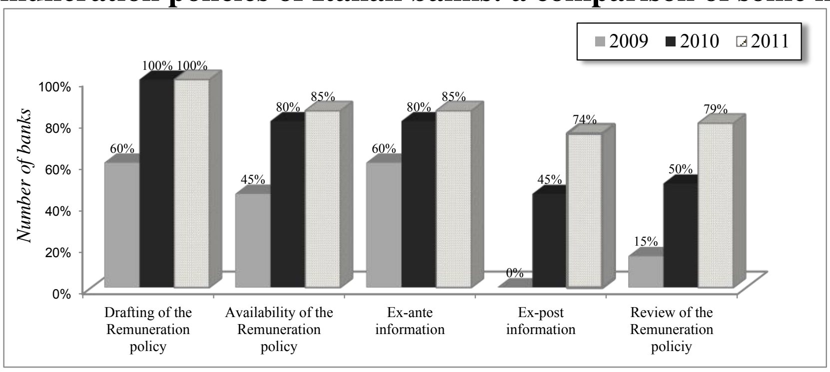
1. a first part, which aims to summarize the legislative framework, within which each bank sets out the main legislative scenario at both international and national level;
2. a second section aimed at illustrating the general principles on which it bases the compensation policy related to the following objectives:
    - sound and prudent management and stability of economic value;
    - correlation and symmetry between remuneration and risk outcomes;
    - conformity and sustainability in relation to long-term strategies and objectives;
    - connection to strategies and policies in terms of risk-taking;
    - appropriate balance of fixed and variable remuneration components.
3. a third part aimed at describing the internal process that defines the remuneration policy, including any other technical or procedural aspects.

However, apart from the similarities in their format, which partly facilitates their comparison, the new Remuneration policies developed by Italian banks do not show any other important strengths. On the contrary, they have earned considerable criticism, that it is our intention to highlight.
First, one important criticality concerns the public availability of these documents that is provided, in 2009 by only 45% of banks surveyed, a percentage that rises to 80% and 85%, respectively, in 2010 and 2011 (Figure 9). In fact, not all listed Italian banking groups currently make their Remuneration policies accessible through their websites (the main source of information for the

[20] The recent Supervisory provisions of 2011 of the Bank of Italy have reformulated this information, detailing better both *ex-ante* and *ex-post* information. See, Bank of Italy, 2011, paragraph 4.1.
[21] Since 2009 (when only some banks disclosed their *Remuneration policy*, see below) this new information immediately appeared heterogeneous in terms of content, denomination and modality of disclosure. This aspect, although it has been declining over time, is also linked to the prudential regulation that is still characterized by some weaknesses. The recent Bank of Italy guidelines, in fact, not only evidence if the ex-ante information and that ex-post must be produced simultaneously or at a different time, but they do not clarify that the information required has only internal value and therefore does not meet even the requirements for disclosure to the market with which especially larger banks must comply. On the main criticalities of the new *Remuneration policies* of Italian banks, see below.

general public and institutions), although they state (in other corporate documents) that they have prepared these reports and that they will be submitting them for the approval of shareholders[22].
Similarly, another important criticality concerns the "consultation" of these documents. When available, in fact, it has proved quite difficult to download them from the websites of each intermediary both because of the general lack of specific links on remuneration and the common choice of many banks not to call this new information "Remuneration policies of the bank", but to use other often misleading expressions, however justifiable they may be in light of the internal value that has been attributed to these corporate documents. Frequently, in fact, they do not constitute independent reporting because they are included in the minutes of the meeting, generally under the expressions: "Directors' Report," "Explanatory Report of the board" and in some cases even "Agenda".
Overall, acquiring this new information involved a real "treasure hunt", navigating within the websites of Italian banks that, while they have greatly improved their accessibility, still do not appear capable of immediately providing all the information needed by the bank's investors and, in general, its stakeholders, especially when it comes to searching for specific new information as in the case of Remuneration policies[23].
Not only, once they are downloaded, the content of the Remuneration policy has revealed strong criticalities especially with regard to the large banks and those of systemic importance.

Figure 9 - The remuneration policies of Italian banks: a comparison of some key aspects



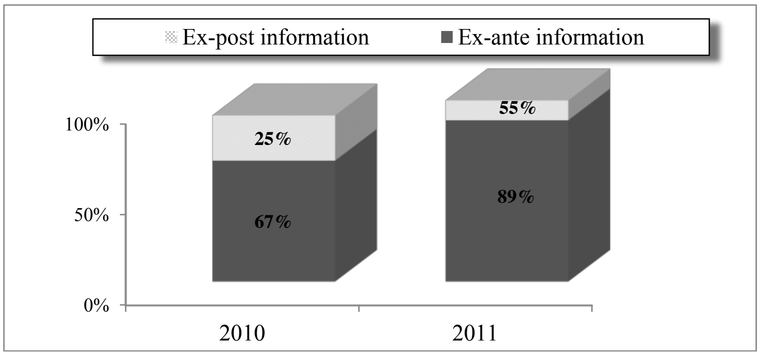
Source: our figures

Generally, in fact, the information provided through these policies did not appear at all aligned either with the requirements of the Bank of Italy nor with those of the FSB (Financial Stability Board), in both qualitative and quantitative terms. The first point was characterized by some heterogeneity, with a plethora of preliminary information superfluous to an effective understanding of the compensation dynamics adopted by the bank. Furthermore, compared to the information expressly required by the Supervisory Authority, there was a disproportionate amount of "declarations of intent", while the direct and accurate information was rather limited. Indeed, at times it seemed that the banks provided the information requested only when they could demonstrate compliance with legislative requirements; where they were unable to comply with the law, they omitted the information.
From a quantitative point of view, however, the analysis of the new Remuneration policies highlighted a lack of clarity on certain key aspects such as information on the pay-mix, the

[22] The banks that by June 2011 had not yet made available their Remuneration policy were Banca Finnat, Banca Popolare di Sondrio and Banco di Sardegna.
[23] Although it regards only a proportion of the banks surveyed (excluding, in general, the biggest intermediaries), this lack of accessibility of web-sites raises questions in view of the increasingly important role played not only by disclosure in general, but especially by the channels through which the information produced is made actually usable outside.

dynamics of the incentives, the composition of the compensation packages especially for those in senior/top positions within the organization.
In addition, concerning the articulation between *ex-ante* and the *ex-post* information, the major deficiencies were found in the latter. In fact, while in 2010-2011 *ex-ante* information is provided by all banks surveyed, *ex-post* information was produced only by 45% of the banks examined in 2010, a percentage that rose to 74% in 2011 (Figure 9). This divergence of values between 2010 and 2011 was primarily due to delays in the establishment of a formal compensation policy by various financial intermediaries, being carried out not in 2009 (as required by the Bank of Italy), but only in 2010.
Not only, when available, the *ex-post* information also appeared somewhat different from the standards required by the Bank of Italy. In fact, as can be seen from the chart below (Figure 10), the banks in this area achieved overall levels of information - given by the percentage ratio between the score awarded and the maximum achievable[24], of only 25% in 2010 and of 55% in 2011, as against much higher values for *ex-ante* information (67% in 2010 and 89% in 2011, Figure 10).

Figure 10 - Comparison between *ex-ante* and *ex-post* information of the Remuneration policies



Source: our figures

Finally, taking into consideration the requirements of the Supervisory Authority, *ex-post* information was particularly lacking at a quantitative level. The absence of this information within the *Remuneration policy* is often justified given that it can be found in other corporate documents to which they refer[25] and those of a statistical nature (Table 7). Concerning the *ex-ante* information, however, the latest information listed in Table 7 is rather lacking and, in particular, information on the impact produced by any changes to existing policies and comparative ones aimed at highlighting the positioning of banks compared to the market as a whole and other similar competitors.

[24] See Table 2 of the Appendix to verify the score attributed.
[25] This is the case, for example, for parts H and I included in the Notes to the financial statements.

Table 7 - The basic information of the *ex-ante* and *ex-post* information: a comparison of the level of information *(2010-2011)*

Type of information	Basic information	Information level 2010	Information level 2011
EX-ANTE INFORMATION	Decision-making process used for determining the *Remuneration policy*, including the information on name, composition and mandate of the remuneration committee	75%	80%
	Scope of the bank's remuneration policy	68%	78%
	Information on how the bank ensure the link between pay and performance	70%	80%
	Parameters used to define variable component of remuneration	45%	53%
	Information relating to the design and structure of remuneration processes (performance measures, risk-adjusted measures, bank's policy on deferral and vesting of variable remuneration, ex-post risk adjustment)	67%	78%
	Performance indicators utilized to assign variable remuneration (stock-option and others equity instruments)	57%	66%
	Description of the different forms of variable remuneration that the bank utilised and the rationale for using these different forms	23%	35%
	Impacts of any changes to policies already approved	10%	20%
	Comparative information concerning the remuneration practices of competitors	12%	13%
EX-POST INFORMATION	Implementation of the remuneration policy and implications of the variable components	34%	44%
	Discussion of the conformity with the guidelines and objectives defined ex-ante	12%	25%
	Statistical information on the evolution of wage dynamics, even when compared to industry trends	10%	15%
	Quantitative information:		
	Aggregate quantitative information on remuneration broken down by business area and different staff categories (directors, senior manager, risk takers, etc.)	18%	25%
	Aggregate quantitative information on remuneration broken down by different staff categories (directors, senior manager, risk takers, etc.)	18%	28%
	Amounts of remuneration split into fixed and variable components and number of beneficiaries	23%	35%
	Amounts of remuneration split into cash, equity-incentives and bonus pool linked to performance	23%	36%
	Amounts of deferred remuneration split into vested and unvested	18%	21%
	Total reductions in deferred compensation due to performance adjustment measures	10%	16%
	Number and total amount of severance payments made during the financial year	12%	21%
	The amounts of severance payments awarded during the financial year, number of beneficiaries, and highest such award to a single person	12%	21%

*Percentage of information provided compared with that required. A higher value indicates greater adherence of the information provided by banks to the analytical model which is made up of the last two sections of the "*Disclosure Remuneration Index* analysis model" included in the Appendix, Table 2).

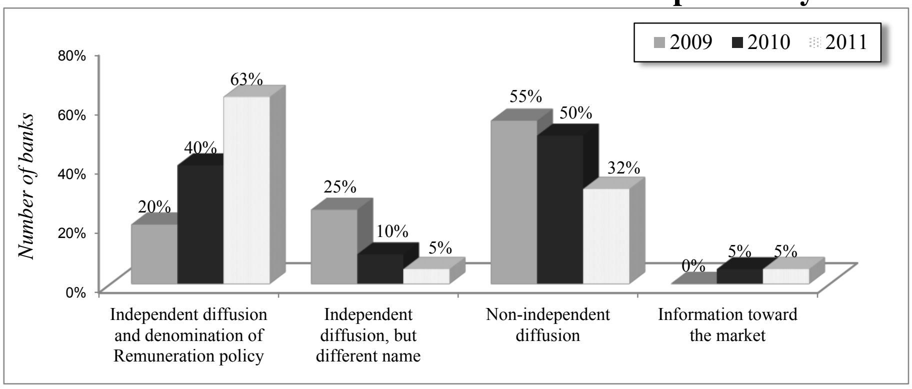
Ultimately, then, although there has been a clear improvement, especially during the years 2010-2011, the analysis of recent *Remuneration policies* drawn by Italian banks has revealed the presence of some critical aspects related to the following:

a) **Availability and accessibility of the document.** As already mentioned, at present not all banks analyzed make their *Remuneration policy* available through their website and, even when this occurs, finding it is far from immediate. According to the latest survey carried out in May-June 2011, only about the half of the banks disclose independent *Remuneration policies* by using expressions clearly evocative of the contents available therein. In contrast, 40% of these banks continue to disclose a non-independent *Remuneration policy*, including it in the minutes of the shareholders' meeting, in the general Reports of Directors, or in agenda items, etc. (Figure 11).
b) **Contents of the document**. The comparison between the minimal information required by the Bank of Italy and that reported by the *Remuneration policies* of banks highlighted discrepancies in both qualitative and quantitative terms, especially with regard to the *ex-post* information. In fact, the overall level of information of these documents reaches 89% in terms of *ex-ante* information, but drops to 55% with regard to *ex-post* information (Figure 10).
c) **Functionality of the document.** In compliance with the instructions of the Bank of Italy, banks which have drawn up their own *Remuneration policy* since 2009, did so with the intent of obtaining the approval of their shareholders, not with the objective of establishing an effective external process for disclosing their remuneration policies, for example on the basis of standards set by the FSB (Financial Stability Board, 2009). This gives the existing policies drawn up by Italian listed banks a limited functionality since they were not aimed to

create a twofold process of disclosure, towards shareholders and the market (as they should have done), but only towards the former. Finally, no less important is the incomplete compliance of these intermediaries with the new requirement (introduced by Article 3 of Italian Legislative Decree 27/2010) to publish the results of the shareholder vote. In fact, according to the latest survey (June 2011), only 15 out of 19 banks disclose independent reports highlighting the results of the shareholders votes on individual agenda items, including even those on remuneration policies.

Despite the undoubted improvements, there is still a distinct lack of transparency towards the market (currently only Unicredit, through its *Annual Report on compensation* has made a remuneration disclosure with a clear external value since 2010, see Figure 11) and there is a widespread lack of transparency to shareholders. Legislative and media attention on remuneration policies in the financial industry, at least with regard to the Italian context, is not yet offset by an effective desire on the part of banks to improve the organization of their remuneration practices and provide comprehensive disclosure. There is still a long way to go. We just have to wait for the final implementation by the Bank of Italy of the provisions of CRD III relating to the inclusion of the remuneration disclosure into the document on Pillar 3 of Basel 2 (Basel Committee on Bank Supervision, 2010c). Only in such a case will there be effective disclosure towards the market. In any case, it remains to be seen why Italian banks, especially in a matter which is the object of such intense focus on the part of the media and the regulators, have not adopted a proactive approach, independently anticipating observance of a legislative provision that could only have a positive impact on their reputation. On the contrary, they continue to reveal passive compliance with the law after their binding introduction, highlighting the absence of an effective predisposition towards truly transparent conduct.

Figure 11 -Disclosure mode for the document on remuneration policies by banks *(2009-2011)*



Source: our figures

6. Conclusions and future research lines

This paper aimed to analyze and explore the issue of remuneration policies at financial intermediaries, with specific reference to Top management, i.e. board and staff members with strategic responsibilities within the bank and whose professional activities can influence the institution’s risk profile.

The choice of this issue is part of the recent and renewed interest addressed by academics and regulators to the remuneration policies of senior management and risk-takers. In fact, banking compensation is experiencing a new phase as a result of its crucial role in the recent financial crisis and highlighted in several situations by scholars (Mieli, 2010; Conti, 2009) and especially by the most important regulatory authorities (European Commission 2009a, 2009b; CEBS 2010a; Bank of Italy 2009, 2011; European Parliament, 2010; Basel Committee of Bank Supervision, 2010a, 2010b).

At a methodological level, empirical study has used the "content analysis approach" (Neuendorf, 2002; Krippendorf, 2004; Beattie and Thomson, 2007) on the basis of which we developed two distinct models aiming to calculate both for Italian banks and the top five European banks by market capitalization (used as a benchmark) two qualitative indicators which we called the *Sound Remuneration Index* (SRI) and the *Disclosure Remuneration Index* (DRI) We then proceeded to investigate the relationship between these two indicators and the economic performance of banks, through the use of quantitative approaches (correlation and regression study).
On the whole, the results showed that the remuneration practices carried out by the Italian listed banks have not yet achieved standards of disclosure and soundness adequate and appropriate to the current economic situation, from both a qualitative and a quantitative point of view. In 2010, in fact, the average of the SRI and DRI indicators was only, respectively, 43.27% and 48.17%. Those values are affected especially by the dynamics of stock-incentive and pay-mix, whose articulation and disclosure do not yet appear fully consistent with the regulations. Not only, the most critical aspect concerns the position of the main Italian banking groups to which our Supervisory authority addressed special attention (Unicredit, Banca Intesa, Banca Monte dei Paschi di Siena, Banca, Banco Popolare and Mediobanca). Among them, only Unicredit and partly also Banca Monte dei Paschi di Siena, are more in line with regulatory requirements and international best practices; however, all other banks are rather deficient in both profiles of investigation (i.e. soundness and information disclosure), which certainly does not shed good light on our banking system, especially in an international comparison.
Further criticalities concern the structure and the availability of the Remuneration policy that the banks have submitted to the shareholders' meetings since 2009, in accordance with the new provisions imposed by the Bank of Italy. The documentation, in fact, is not sufficiently compliant with the legislation because it is inadequate, especially with regard to the implementation of the remuneration policy (*ex-post* information). At the same time, we do not understand the choice of our banks to disclose this information only to shareholders, limited exclusively to compliance with a legal provision without exploiting this opportunity to substantially increase their disclosure on an issue that is such a focus of media attention, an increase which would have had a positive impact on their reputation. In fact, where available, the Remuneration policies are often simple documents attached to the minutes of the meeting, sometimes also given misleading names, such as the "Report to the meeting", "Item on the agenda", etc.
More limited indications, however, come from the regression. In this case, the results reveal no significant relationships between performance and remuneration practices. This can be explained by the limited number of observations available (25 banks, including 20 Italian and 5 European ones used as a benchmark), but probably also by the tendency of the market not yet to attribute a value to good remuneration practices given the current phase of uncertainty and instability.
Finally, with regard to the further lines of research, on the basis of the new national and international regulations and the theoretical assumptions of the doctrine, they consist, especially, in:

a) studying the relationship between performance and remuneration practices, especially the profound ties with non-financial metrics. In the same way, it would be interesting to propose management models for the correct evaluation of non-financial performance in order to verify whether and how managerial remuneration differs from the creation of value from a stakeholders' (and not just a shareholders') perspective;
b) understanding the effective *modus operandi* of remuneration committees and making proposals to help strengthen the role attributed to these organisms;
c) analyzing the issue of relations between the remuneration committee and pay consultants, both with regard to the contribution made by this new figure and the compensation payable to it (Conyon *et al*., 2009, 2011);
d) investigating the importance of shareholder activism in defining and implementing remuneration policies in the banking industry, both by recognizing the effects of the say-on-

pay motions (Morgan *et al*., 2006; Ferri and Maber, 2009) presented by institutional investors and making proposals in order to enhance the impact of this phenomenon;

e) studying the remuneration of risk-takers and persons responsible for internal controls (for example heads of internal audit, compliance and risk management functions) in order to verify the existence of any relationship with the bonus paid to directors of the bank.

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Appendix

Table 1 – The *Sound Remuneration Index* analysis model

A	PAY STRUCTURE AND RISK ALIGNMENT	SCORE
Appropriate balance between fixed and variable components		
1	Maximum ratio between fixed and variable remuneration	1 if the item is present 0 if absent
2	Diversification of this ratio for the various staff categories	1 if the item is present 0 if absent
Incentive payments/system		
3	Maximum limit to cash bonus	1 if the item is present 0 if absent
4	Pay-out (up-front payment in share or share-linked instruments)	2 if ≥ 50% 1 if between 30 and 50% 0 if < 30%
5	Malus and clawback arrangements	1 if the item is present 0 if absent
6	Duration of the vesting period	2 if ≥ 5 years 1 if between 3-5 years 0 if < 3 years
7	Duration of the holding period or share retention policy	2 if ≥ 3 years 1 if 1-2 years 0 if < 1 year
8	Deferral period	2 if ≥ 5 years 1 if between 3-5 years 0 if < 3 years
9	Portion of variable compensation payable under deferral arrangements	2 if the item is between 40-60% 1 if between 20-40% 0 if between 0-20%
10	Performance-based conditions for awarding equity instruments	0: absence of conditions 1: only accounting conditions 2: market and accounting performance measures
11	Guaranteed bonus	0 if the item is absent -1 if present (penalty)
12	Correlation between variable and deferred remuneration and level of seniority and/or responsibility of management	1 if the item is present 0 if absent
Severance payments		
13	Limits to "golden parachute"	1 if the item is present -1 if absent (penalty)
14	Golden parachute in the case of dismissal or negative management performance	1 if the item is absent -1 if present (penalty)
Perfomance measurement		
15	Long-term performance indicators (at least from 3 to 5 years)	1 if the item is present 0 if absent
16	Risk-adjusted performance indicators	1 if the item is present 0 if absent
17	Cost of capital (required to support the risks taken)	1 if the item is present 0 if absent
18	Liquidity risk	1 if the item is present 0 if absent
19	Non-financial or qualitative criteria (achievement of strategic targets, customer satisfaction, adherence to risk management policy, compliance with internal and external rules *and* ESG *performance*)	1 if the item is present 0 if absent
20	Assessment of *performance* at different levels (individual, business unit, firm-wide)	1 if the item is present 0 if absent
B	GOVERNANCE	SCORE
General principles		
21	Draft of *Compensation/Remuneration policy*	1 if the item is present 0 if absent
22	Periodical supervision of remuneration policy by board	1 if the item is present 0 if absent
23	Control measures to prevent conflict of interest	1 if the item is present 0 if absent
24	Reliability of the risk and compliance function	1 if the item is present 0 if absent
25	Annual review of the remuneration policy by control function	1 if the item is present

		0 if absent
26	Independent and *ex-ante* review of the compliance function	1 if the item is present 0 if absent
27	Independent external review by consultants	1 if the item is present 0 if absent
Remuneration committee		
28	Institution	1 if the item is present 0 if absent
29	Composition (% of outside and independent directors)	2 if all members are independent directors (ID's) 1 if ID's make up < 50%; 0 if ID's absent or ≤ 25%
30	Adoption of an "internal charter" (or "Term of reference" by the committee)	1 if the item is present 0 if absent
31	Frequency of meetings	2 if > 4 annual meetings 1 if 2-4 annual meetings 0 if 1 annual meeting
32	Cooperation with other corporate functions (risk management, human resources, etc.)	1 if the item is present 0 if absent
33	Minutes of the meeting	1 if the item is present 0 if absent
34	Publication of the decisions taken	1 if the item is present 0 if absent
35	Collaboration with an independent professional advisor	1 if the item is present 0 if absent
36	Assignment of budget	1 if the item is present 0 if absent
37	Attendance of chair (or member) of board of auditors	1 if the item is present 0 if absent
38	Secretary	1 if the item is present 0 if absent

Table 2 – The *Disclosure Remuneration Index*[26] analysis model

GENERAL REQUIREMENTS	
1	Draft/publication of the *Remuneration policy*
2	Publication of the *Annual Report on compensation*
3	Adoption of other disclosure tools (info/link on web-site)
4	Information concerning the decision-making process used to determine remuneration policy
5	Information on link between pay and performance
6	Information on criteria used for performance measurement and risk adjustment
7	Information on key risks taken into account when implementing remuneration measures
8	Information on criteria used to assessment performance
9	Information concerning conformity of performance criteria with long-term horizons
10	Information on methodologies used to verify whether performance criteria have been met
11	Information on main parameters and rationale for any variable component scheme and any other non-cash benefits
12	Information on *deferral policy*
13	Information on *vesting criteria*
14	Information on *holding policy*
15	Role of main corporate function involved in defining remuneration policy
16	Types of employees considered as material risk takers and criteria used to define them
17	Actions taken to remedy deficiencies
18	Aggregate quantitative information on remuneration, broken down by business area (*investment banking*, *retail banking*, etc.) and different staff categories (directors, senior manager, risk takers, etc.)
QUANTITATIVE INFORMATION	
19	**Quantitative information on *Top and senior management***
1	- total remuneration for the financial year, split into fixed and variable compensation
2	- number of beneficiaries
3	- amounts and form of variable compensation, split into cash, shares and share-linked instruments and other
4	- total outstanding deferred compensation, split into vested and unvested
5	- total deferred compensation awarded during the financial year
6	- new sign-on and severance payments made during the financial year, and number of beneficiaries of such payments
7	- total severance payments awarded during the financial year, number of beneficiaries, and highest such award to a single person
20	**Quantitative information on *other staff categories* (*risk takers*)**
1	- total remuneration for the financial year, split into fixed and variable compensation
2	- number of beneficiaries
3	- amounts and form of variable compensation, split into cash, shares and share-linked instruments and other
4	- total outstanding deferred compensation, split into vested and unvested
5	- total deferred compensation awarded during the financial year
6	- new sign-on and severance payments made during the financial year, and number of beneficiaries of such payments
7	- total severance payments awarded during the financial year, number of beneficiaries, and highest such award to a single person
21	**Qualitative and quantitative information on financial and risk control staff**
FUNCTIONING OF REMUNERATION COMMITTEE	
22	Institution
23	Mandate
24	Frequency of meetings
25	Time/duration of meetings
26	Member attendance
27	Decisions/actions taken
28	Publication of member résumés

[26] In this case, for all the basic information, the score is 1 if the item is present, 0 if it is absent.

29	Information on budget/financial resources assigned
DISCLOSURE TO SHAREHOLDERS' MEETING: *EX-ANTE* INFORMATION	
30	Decision-making process for determining the *Remuneration policy,* including information on name, composition and mandate of the remuneration committee
31	Scope of the bank's remuneration policy
32	Information on how the bank ensures link between pay and performance
33	Parameters used to define variable component of remuneration
34	Information relating to the design and structure of remuneration processes (performance measures, risk-adjusted measures, bank's policy on deferral and vesting of variable remuneration, ex-post risk adjustment)
35	Performance indicators utilized to assign variable remuneration (stock-options and other equity instruments)
36	Description of various forms of variable remuneration used by the bank, and rationale for using various forms
37	Impacts of any changes to previously approved policies
38	Comparative information concerning remuneration practices of competitors
DISCLOSURE TO SHAREHOLDERS' MEETING: *EX-POST* INFORMATION	
39	Implementation of remuneration policy and implications of variable components
40	Discussion of conformity with guidelines and objectives defined *ex-ante*
41	Statistical information on evolution of wage dynamics, even when compared to industry trends
	Quantitative information:
42	Aggregate quantitative information on remuneration broken down by business area and different staff categories (directors, senior manager, risk takers, etc.)
43	Aggregate quantitative information on remuneration broken down by different staff categories (directors, senior manager, risk takers, etc.)
44	Total remuneration split into fixed and variable components and number of beneficiaries
45	Total remuneration split into cash, equity-incentives and performance-linked bonus pool
46	Total deferred remuneration split into vested and unvested
47	Total reductions in deferred compensation due to performance adjustment measures
48	Number and total amount of severance payments made during the financial year
49	Total severance payments awarded during the financial year, number of beneficiaries, and highest such award to a single person