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Conclusion
In our view, both shareholders and regulators should welcome the Credit Suisse plan, as it potentially removes risky assets from the balance sheet and preserves capital, while introducing this risk directly into executive pay over the long term. Furthermore, the long-term perspective should have the opportunity to gain some upside in the event that the toxic assets return to value. Both the UBS and Credit Suisse remuneration structures have laid the bar in terms of challenging remuneration committees to meet the needs and objectives of shareholders and regulators. However, while we welcome these two remuneration plans, we are concerned by the potential lack of incentives for independent banks to adopt similar policies.

Banking Trends
- Stronger financial regulation is high on the world agenda. As shown in Chart 2, banks have been significantly impacted by the crisis in some cases, losses have approached their required Tier 1 capital levels. Thus, world and EU leaders utilised the G20 summit to support tighter rules. Nevertheless, should the current regulation efforts fail to shift banks’ models towards an approach favours stable economic growth, the ultimate threat is a Glass-Steagall-type of reform. Bank performances should now be primarily assessed in relation to risk profiles and be more focused on the long term.
- Retail Banks. The crisis has increased concentration and market share for retail banks, which are highly exposed to economic cycles. However, the crisis context has also led to reduced pressure from the European Commission’s (EC) antitrust rules and consumer protection laws. Players such as telecom companies, media groups and retailers are showing renewed interest in providing financial services.

Banking Overview
- The European Banking sector consists of 6,600 banks, with total assets of more than €23 trillion. The top 300 listed banks represent nearly 80% of the sector and account for about 15% of the world’s largest economies that mandatory bonus limits are intended to reduce the potential lack of incentives for independent banks to adopt similar policies.
- Four major bank business profiles have been identified: Retail Banks (RB) refer to banking institutions that handle transactions directly with consumers, rather than with corporations or other banks. This is a very mature business in Europe, and contributes to over 50% of European banks’ profits. Key drivers in this sector are loyalty and mobility.
- Commercial Banks (CB) carry out traditional corporate lending activities and credit facilitation through a wide range of products. This is a competitive business segment that is highly exposed to economic cycles where access to capital and geographical representation are key issues.
- Investment Banks (IB) carry out all financial market-related activities notably trading in securities, managing corporate mergers and acquisitions, originating, underwriting and syndicating both equity and debt, and insuring bonds (e.g. selling credit default swaps).
- Wealth Management (WM) is an investment advisory discipline that incorporates financial planning, investment portfolio management and a number of aggregated financial services.

CASE STUDY: REMUNERATION IN THE BANKING SECTOR

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The financial crisis exposed the inherent weaknesses of the remuneration system used by banks. This system rewarded executives for behaviour that encouraged excessive risk-taking in order to earn bonuses that were dependent on an assessment of short-term performance which failed to account for long term risks. However, given the EU’s failure to adopt a coordinated approach to the issue of remuneration, the best path to reform may in fact be market-based, with shareholder and government involvement where necessary. In our view, UBS and Credit Suisse’s recent implementation of remuneration policies designed to encourage long-term performance supports this argument.

UBS’s new model tackles head-on the primary issue for any reform of bank’s remuneration policies, namely the payment of bonuses based on performance that is neither transparent nor sustainable over the long term. The new plan introduces a bonus/malus system under which a maximum of one-third of the bonus can be paid out in cash.

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The crisis has revealed the importance of the systemic responsibilities held by retail, commercial, and investment banks. A major sustainable objective is to prevent these risks from spreading from a specific bank to the entire sector and to the rest of the economy. In terms of ESG research, it calls for specific screening of systemic vs. specific risks.

Risk management and transparency (CB II & IB) is essential to ensure financial market stability and in order to ensure that the appropriate level of expertise is in place to manage State-driven funding and risk control. Furthermore, the movement towards increased EU-level regulation and supervision of hedge funds and tax havens is evidence of the shift towards more transparency.

Customer protection issues (RB II & VI) include pricing, transparency, cost of products, banking mobility, advertising and marketing of credit products, pre-contractual information to be provided as well as ways to assess product suitability, borrower creditworthiness, advice standards, reasonable borrowing and lending relating to the framework for credit intermediaries (e.g., discussion, regulation, licensing and supervision).

The Lamfalussy Process is an approach to the development of financial service industry regulations used by the European Union. It is composed of four "levels," each focusing on a specific stage of the development of financial services products. The EU’s Lamfalussy approach and its extension to banking is a key element in achieving the dynamic global economy anticipated in the Lisbon treaty.

Emissions and Scopes

Scope 3 emissions include all indirect emissions. The latter stem from sources that are not owned or controlled by a company, but which occur as a result of its overall activity.

The systemic risk of product responsibility (RB, CB II & IB) is illustrated via sales practices that may push lenders to hand out money without properly assessing borrowers’ ability to pay it back, as well as the companies’ function in the financial system as a whole.

The commitment to transparency (AII) requires providing stakeholders with consistent and relevant disclosure and being receptive to their needs for specialized information. Commercial confidentiality should not be used as an excuse to deny stakeholders access to information.

Specific ESG Issue Social Impact

The Banks’ licence to operate lies with their social responsibilities in facilitating the flow of money through lending to retail and corporate banks. It also has indirect consequences on the environment.

Access to credit and credit database transparency (Retail).

These are key performance indicators of a bank’s contribution to qualitative economic growth. Some banks may allow people in low-income brackets access to financial services. However, facilitating cross-border access to credit databases may improve access to finance for some categories of borrowers. However, these databases do not necessarily result in a more responsible credit and financial market.

Restructuring and relocation of jobs (AII). EU banks have shifted rapidly from being large recruiters to a slightly negative trend, with substantial labour-related consequences in the second half of 2009 (a cut of about 5% in total banking headcount) as well as the Netherlands and Spain.

State aid counterparties (AII). The conditions that accompany any state aid measures are explicit in credit cycle history, albeit to a lesser extent in Europe. Constrained capital bases and deleveraging are likely to tighten credit terms. However, banks are set to receive further support from national regulators to improve access to credit locally. For example, credit to local businesses is to be excluded from the calculation of leverage ratios.

The indirect environmental impact of banks’ activities is far greater than the direct impact. For example, scope 3 (CO2) emissions from the banking sector (client-funded) could be reclassified as a larger proportion of the direct and indirect carbon footprint of all other sectors.

Environmental impact of business (CB II & IB) can be mitigated by considering transparency via risk screening and by pricing their fair price in transactions. The Equator Principles, the Principles for Responsible Investments (PRI) and the more recent Climate Principles represent advanced indicators for measuring the implementation of a consistent approach. This may lead to best-in-class and inclusion policies being created on the basis of these principles.

The commitment to ‘do no harm’ (CB II & IB) means preventing and minimising the detrimental environmental and/or social impact of portfolios and operations. Solutions in this respect require the creation of policies, procedures and standards based on the precautionary principle, in order to minimise environmental and social harm, improve social and environmental conditions where banks and their clients observe social involvement in transactions that understate sustainability.

Human capital attraction and retention (AII). Banks’ ability to attract, retain and motivate employees can be measured through:

- Remuneration policies
- Employee productivity
- Culture

Managing ageing (Retail). Managing the mature age pyramid in the sector is a challenge that can be tackled by ensuring the long-term employability of staff (including trained), as well as transmitting experience to the new generation of employees.

Systemic ESG Issues Risk Control and Transparency

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Supervisory rules. A post-G20 summit rolling programme of regulatory processes should establish a more consistent set of supervisory rules. The Financial Stability Board (FSB) is to become the G20 arm for enhancing and enforcing prudential and governance rules. In addition, in May 2009, the EC issued an implementation outline suggesting a proposal for stronger European financial supervision.

Capital requirements. EU legislative proposals to address liquidity risk and excessive leverage (Autumn 2009) will lead to further constrained capital bases and ongoing deregulation. Leveraging ratios will be more limited in the future to prevent systemic risk—so a sustainable limit may be within the 20-25% range. Capital requirements for trading activities will be dramatically increased.

Trading activities. Capital used for trading activities rather than credit businesses may be subject to further control and requirements and ultimately, the EU may see some sort of Tobin tax to pay for the systemic risk embedded in these activities.

Systemic ESG Issues Responsible Lending & Financial Product Distribution

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Banks’ tighter credit standards, despite government intervention, have contributed to the substantial macroeconomic slowdown and an increase in corporate defaults. The credit situation, however, is likely to stabilise.

Credit cycle: this is one of the most significant downturns in credit cycle history, albeit to a lesser extent in Europe. Constrained capital bases and deleveraging are likely to tighten credit terms. However, banks are set to receive support from national regulators to improve access to credit locally. For example, credit to local businesses is to be excluded from the calculation of leverage ratios.

Specific ESG Issue Stakeholder Satisfaction

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- White CSR performance in this sector is seldom taken into account by clients as a factor determining their choice of retail bank. Pricing and the quality of service remain key in terms of appeal for customers.

However, implementing CSR measures may be a tangible means of retaining customers over time.

Systemic & Specific ESG Issue Environment Management

Systemic & Specific ESG Issue Environment Management

- Staff costs (CB II & IB & VI) are being scrutinised as there is potential room for improvement after years of salary stagnation. However, the favourable ageing pyramid could offset both the negative economic environment and the cost of restructuring.

Microfinance only represents a fraction of European banks’ activities and, although some banks are active in this field, this segment cannot, at this stage, be a substitute for the traditional credit model with regards to improving access to credit.

Systemic & Specific ESG Issue Environment Management

There will most likely be pressure on operating costs while visibility on earnings and balance sheets is improving. Operating expenses are likely to be kept under tight control during the downturn in the credit cycle, limiting both job opportunities and skill development.

Specific ESG Issue Human Capital management

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- Liabilities of 'to pay for the systemic risk embedded in these activities.'
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Remuneration Example – Credit Suisse

Credit Suisse’s (CS) plan does not include a malus/bonus system but uses debt rather than capital to remunerate employees. Under CS’s scheme, employees of the Investment Banking business will receive the majority of their deferred bonuses in the form of partner facility awards (PFA). The PFA awards are indexed to a specified pool of illiquid assets based on the most illiquid loans and bonds on Credit Suisse’s balance sheet. PFA holders will realise potential gains if assets in the pool are liquidated at prices above the initial fair market value. However, PFA holders cannot receive any payments for at least five years after the awards are granted, at which point participants will receive an annual cash payment.

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Chart 1: Top 20 European Banks – Market cap vs total assets (2008)

Chart 2: Cost of the Crisis

The above chart uses a 10% default since selecting one is as important as selecting two. http://wwwзорзертюрие/опис/чартист/чартист/