****

# CASE STUDY

Compliance Index

### FIXED AND VARIABLE REMUNERATION IN BANKING AND INSURANCE SECTORS

Julien Abalhassane, , David Amar, Anissa Belgacem, Charlotte Caplanne

Majeure Stratégie juridique et fiscale internationale March 2021

## INTRODUCTION

To build the compliance index, we focused on banking and insurance sectors in France and more precisely on the five largest companies per sector by gross global revenue. Banking sector remuneration is very regulated in France so there were more regulatory frameworks in this field. For the study, data have been collected for three years which are : 2017, 2018, and 2019 since for some companies, information for 2020 could not be found.

## REGULATORY FRAMEWORK

1. **Hard law**

There are common rules for all sectors in the French Commercial Code which regulate remuneration when we focus on French *sociétés anonymes.* The largest companies by gross global revenue are often listed. Listed companies are subject to particularly strict regulations in terms of both the setting of remuneration and most of all the transparency of this remuneration to shareholders and the public. Therefore, we have included in our analysis certain provisions of the French Commercial Code, in particular Articles L. 225-37-2 et seq. of the French Commercial Code.

In particular concerning the banking sector, there are rules on compensation contained in the article L. 511-71 et seq. of the French Monetary and Financial Code[[1]](#footnote-0). Notably, these rules provide that the Board of Directors must adopt an regularly review the compensation policy with the support of the Compensation Committee, that the shareholders must be consulted every year and vote on the global amount of remuneration given to Directors and Executives according to the say-on-pay procedure, or also that the compensation policy must clearly make the distinction between fixed and variable remuneration. However, it must be noted that in this analysis, hard law related only to Banking sector have been mainly excluded[[2]](#footnote-1) since there were already enough variables and since we were looking for uniformity in variables to apply them to both sectors[[3]](#footnote-2).

1. **Soft law**

In the 1990s, a soft law, i.e. non-binding rules, emerged with respect to listed companies. In this respect, it is particularly important to note the development of the Corporate Governance Code and, in the foreground, the Afep-Medef Code[[4]](#footnote-3), which today constitutes a real standard for French listed companies. The Afep-Medef Code sets out recommendations, or rather advice, and the companies then specify which recommendation they decide to apply. If they decide not to apply a recommendation, they must however explain it. This is an illustration of the governance mechanism known as "Comply or explain".

In connection with our analysis, the Afep-Medef Code provides a certain number of recommendations concerning the fixed or variable remuneration of top management and directors of listed companies. Therefore, it seemed appropriate to include these recommendations in the construction of our index.

Furthermore, there is also another source of soft law that is used as a reference for listed companies and that has an influence on the remuneration of executives and these are the proxy voting guidelines that are voting recommendations in general meetings for company shareholders. There are several proxy voting agencies that produce such guidelines, such as ISS, Proxinvest or Glass Lewis. We have therefore included in the soft law, the recommendations produced by Glass Lewis which provides a detailed overview of the key policies that apply on the French market. Considering that the recommendations by Glass Lewis are sometimes a repetition from those in the Afep-Medef Code, we have included only those relevant which were not set in the Afep-Medef Code.

## DATA COLLECTIONS SOURCES AND METHODOLOGY

1. **Choice of companies**

The five companies that have been chosen for the **banking** sector are:

* BNP Paribas SA: listed on the first market of Euronext Paris and also included in the French CAC 40 index
* Group BPCE[[5]](#footnote-4) SA
* Crédit Agricole Group
* La Banque Postale
* Société Générale

It can be noted that the banking sector is particularly concentrated. Indeed, in spite of the fact that France can number around 350 French banks that are licensed and active, these major groups together represent more that 83% of French Banking assets[[6]](#footnote-5).

The five companies that have been chosen for the **insurance** sector are:

* Axa
* Scor
* CNP Assurance
* Crédit agricole (CAG) Assurance
* Covéa

Being a subsidiary of Crédit Agricole Group, CAG Assurance is a non-listed company. Even so, it is the French insurance company which has the highest market share in France (10,71%)[[7]](#footnote-6). CAG Assurance is closely followed by Axa (10,02%) and CNP Assurance (9,39%) which are 2 of the 3 listed companies that we have studied. Scor is also a listed insurance company but more precisely it is the 5th global reinsurance company[[8]](#footnote-7).

1. **Data collection sources**

The sources that we mainly, if not exclusively, use are the reference documents[[9]](#footnote-8) of listed companies. The reference documents are documents that set out in full the remuneration policy of the company groups with regard to top management and directors, but also provide information on the resolutions submitted to the general meeting of shareholders. These reference documents provided access to the necessary data to build the compliance index.

For banking sectors companies, it could also be found special reports on compensation which provides for very useful information on the Compensation Committee and also amounts of compensation allocated to executive directors and board members.

1. **Methodology of index building**
2. The selection of most relevant sub-variables

As part of our analysis, we decided to make a clear distinction between the remuneration of directors and that of top management. Indeed, the terms and conditions of remuneration, as well as the rules governing the latter, are different depending on the functions that are remunerated.

1. The normalization of sub-variables

Building our index, we realized that most of sub-variables could be answered by yes or no which made it easier to normalize.

We have decided to normalize the data using the scale from 0 to 100 because we thought it would be more precise if some data collected could be divided in a few different categories.

For instance, for the sub-variable 1.1.2, the Afep-Medef Code provides that at least 50% of the directors of the Compensation Committee must be independent. Hence, we normalized it as: less than 50% of the directors are independent = 0 because the company does not respect the rule; 50% or more of the directors are independent = 100 because the company fully respects the rule.

As a second example, for the sub-variable 2.3.2, the Afep-Medef Code provides that a significant part of the remuneration for Board members must be a variable remuneration. We considered that a significant part was above 60%. Hence, if 60% or more of the remuneration of the Board members is variable, the company fully respects the rules and is attributed a result of 100 for this sub-variable. If the variable remuneration represents 30 to 59% of their total remuneration, we considered that the company was not fully respecting the rule but was making some efforts. Hence, it would be attributed a result of 50. Below 29%, it would be attributed a result of 0 because it does not respect the rule and does not even try.

1. The data collection process

Considering that 4 out of 5 banking companies and 3 out of 5 insurance companies are listed on the French market and subject to the obligation to release a reference document, the collection of data was time consuming but at least we nearly had all the data we needed. However, a few difficulties arose.

For the attendance fees, a difficulty could be observed. Indeed, for certain groups such as Crédit Agricole, fixed and variable compensation was provided for directors and this compensation could vary depending on whether the remunerated person was a member of the Supervisory Board or a Vice-Chairman of the Board[[10]](#footnote-9). Thus, we had to perform an average in order to include it in our excel table and be able to take it into account in our study. For example, for 2017, the Vice-Chairmen were allocated fixed annual directors' fees of 80,000 euros and directors' fees paid for each meeting attended, up to a maximum of nine meetings per fiscal year. Based on the assumption, most often observed in practice, that there is 100% attendance at each meeting, we computed the following average to get the *prorata* of variable remuneration over fixed remuneration:

In the insurance sector, we had the same issue for Scor because the variable remuneration was depending on the type of committee and the number of meetings per year. Hence, we determined the prorata of variable remuneration over fixed remuneration based on the average variable compensation on the assumption that each member had attended 100% of the several annual meetings (which was the case most of the time).

Crédit Agricole Group is a listed company and hence is subject to the obligation to publish every year a reference document. However, even if CAG Assurance is not a listed company, considering it is a subsidiary of Crédit Agricole Group, it does release this document. Through the analysis of this document for our study, we noticed that CAG Assurance follows the exact same rules than the Crédit Agricole Group. As a consequence, the results in our study for the Crédit Agricole Group, as a banking listed company, are the same as those for the CAG Assurance, as an insurance non-listed company.

Finally, since Covéa is a non-listed insurance company, there was no reference document available. Hence, for the years 2018 and 2019, we based our study on their annual reports which were comprehensive enough. However, for the year 2017, it was more complicated. As a consequence, we used several documents to be able to get access to all the information needed, such as their: Financial report, Activity report, Solvency and financial situation report, and online Annual report which was not comprehensive at all[[11]](#footnote-10).

1. The weight of each sub-sub-variable

In order to calculate the average, we chose to assign a weight to the sub-sub-variable that we felt was important in determining compensation. When a certain sub- sub-variable was not applicable (see N/A), we assigned a value of 0 to facilitate the calculation of the average.

For the sub-sub-variable 1.1.1 relating to the presence of a Compensation Committee, we assigned a weighting of 30%, while the other seven sub-variables each have a weighting of 10%. In other words, the presence of a Compensation Committee is 3 times more important than the other sub-sub-variables (proportion of independent directors, independence of the committee chairman, etc.). Indeed, the presence of a Compensation Committee is fundamental, as it ensures that the compensation and its evolution are consistent with the interests of shareholders and the performance of the company (cf. art. 18.3 of the AFEP-MEDEF Code).

Concerning sub-variable 2.1. relating to the rules for the allocation of compensation in the corporate governance report, we have assigned a weighting of 50% to the sub-sub-variable 2.1.1 since we consider that it is an obligation that is indispensable from our point of view to have remuneration of Directors (also called members of the Board) to be linked with their effective participation to meetings, then we thought that sub-sub-variable 2.1.2 was less important than 2.1.3 which reveals how transparent the company is towards remuneration, so we respectively weighted them 10% and 40%. Indeed, the corporate governance report ensures compliance with and transparency of compensation rules. Logically, we can note that it is respected by almost all the companies concerned in the table, except Covéa.

Regarding sub-variable 2.2 relating to the exceptional compensation of Directors, we assigned an 80% weighting to the sub-sub-variable 2.2.1 which determines whether such compensation is allocated, and a 20% weighting to the sub-sub-variable 2.2.2 which indicates whether the potential adoption of such compensation was carried out according to the regulated agreements procedure (*procédure des conventions réglementées*). We consider that the existence of such exceptional compensation is a feature significantly more important than the way this compensation is allocated, hence the disparity in weighting of the sub-sub-variables. CAG Assurance is actually the only insurance company that allocates such compensation to its Directors.

Also, we assigned a weight of 60% to sub-sub-variable 2.3.1 relating to annual variable compensation, while and 40% for sub-sub-variable 2.3.2. Here again, we have assessed that annual variable compensation is more important, in determining the average, rather than the other sub-sub-variable, because it is a complement that provides an incentive for the company's performance.

As for sub-sub-variables 3.1.1 and 3.1.2, we considered that they were both equally important regarding the transparency objective of the Code Afep-Medef. On the contrary, the sub-sub-variable 3.1.3 about the communication of the percentage increase over previous years is really not important, especially because the readers can compute this percentage themselves. Hence, we assigned it a weight of 10%.

Knowing if an Executive receives a variable remuneration is so important in terms of transparency that we have decided to assign a weight of 2/3 to the sub-sub-variable 3.2.1. The three other sub-sub-variables being equal are sharing the weight of 1/3. In other words, the knowledge of a variable compensation for an Executive is 6 times more important than the other sub-sub-variables.

Again, each of the sub-sub-variable of sub-variable 3.3 being equally important, each has been assigned a weight of 1/3.

Finally, all formulas are based on the matrix normalization we have pre-defined.

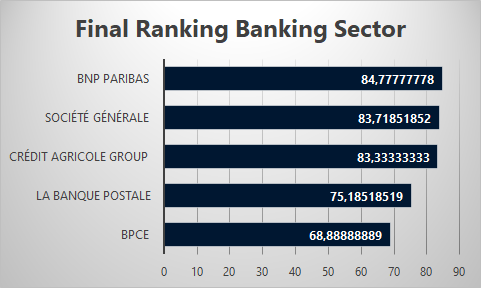
1. **Results and synthesis**

We can notice that rules about the Compensation Committee are very well respected, especially in the banking sector with results between 90% and 100%. On the contrary, two of the insurance companies are not as good: Covéa has a result of only 50% and CNP Assurance of 70%. Each company with a result below 100%, 6 in total, does not have a Compensation Committee which includes enough independent Directors.

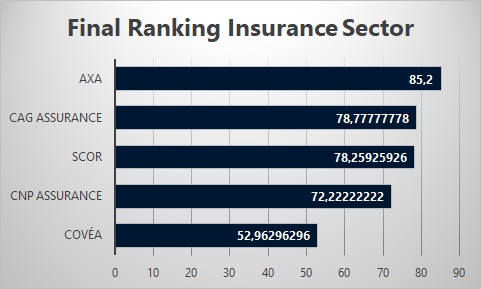
About the compensation of Directors (V2), the companies in the insurance sector (64% average) are more respectful than in the banking sectors (55% average). CAG Assurance and BNP Paribas are those which succeed the most with both a percentage of success of 67%, closely followed by Axa and CNP Assurance with 63%. Like the others, they do not pay exceptional compensation to their directors. However, their success is mainly due to the fact that 100% of the Directors’ compensation is variable.

Regarding the compensation of Executives (V3), once again the banking companies (87%) respect the rules more than the insurance companies (78%). However, Axa is the best one with 96%, closely followed by Société Générale (94%) and CNP Assurance (90%). The four other banking companies have a very concentrated result (between 83% and 88%), while in the insurance sectors, the results are more diversified, Covéa having the lowest result of 52%. This low result is due to the fact that Covéa communicates very few about these data. On the contrary, the most successful companies strictly follow the recommendations on the most important matters which allow the readers to have transparent information about the level of compensation of the Executives, as well as the way this compensation is fixed.

Ranking results give us the following figures :



For banking sector, we can notice that the best company is **BNP Paribas**.



For insurance sector, we can notice that the best company is **AXA**.

Although the banking and insurance sectors are distinct sectors, it should be noted that overall, and even though Axa is the company among all that is doing best, the companies in the banking sector are the ones that seem to comply best and most with the regulations (hard and soft law).

1. <https://www.lexology.com/library/detail.aspx?g=0894728a-192f-4612-b65c-96c149594153> [↑](#footnote-ref-0)
2. Except for one sub-variable stated in the Article L. 511-74 of the French Monetary and Financial Code [↑](#footnote-ref-1)
3. Note however that in the data collection sources, special reports related to French Monetary and Financial Code have been used. [↑](#footnote-ref-2)
4. <https://afep.com/wp-content/uploads/2020/01/Code-Afep_Medef-r%C3%A9vision-janvier-2020_-002.pdf> [↑](#footnote-ref-3)
5. We had thought about including Natixis in our review because it is a major banking company but Natixis is actually a subsidiary of BPCE so we decided to remove Natixis from our list. [↑](#footnote-ref-4)
6. <https://www.globallegalinsights.com/practice-areas/banking-and-finance-laws-and-regulations/france> [↑](#footnote-ref-5)
7. <https://www.argusdelassurance.com/classements/classements-assureurs/comptes-2019-les-tops-20-france-resultats-2018.157599> [↑](#footnote-ref-6)
8. <https://www.atlas-mag.net/article/classement-top-10-des-reassureurs-mondiaux-selon-le-chiffre-d-affaires-2018> [↑](#footnote-ref-7)
9. It should be noted that since 2020, the reference document is called « universal registration document ». [↑](#footnote-ref-8)
10. Knowing that these terms and conditions did not apply to the Chairman of the Board. [↑](#footnote-ref-9)
11. https://www.covea-finance.com/rapport-annuel-digital/2017/#page=1 [↑](#footnote-ref-10)