

The European Banking Authority

---

Cenkos Securities plc  
6.7.8 Tokenhouse Yard  
London EC2R 7AS

T 020 7397 8900

F 020 7397 8901

---

1 June 2015

Dear Sirs

**Consultation on Guidelines on sound remuneration policies (EBA/CP/2015/03)**

I write on behalf of Cenkos Securities plc (Cenkos) in response to the above consultation document. To appreciate the utmost seriousness of our position it is necessary to understand what we do in helping SMEs raise capital and the way in which our Company has grown.

**Cenkos: Background**

Cenkos commenced its business in April 2005 with 8 employees and the Company was subsequently floated on the Alternative Investment Market (AIM) in 2006.

Since its inception, the Company has been profitable in every financial year; it has grown consistently and considerably so that staff numbers are currently 120; Cenkos has paid dividends to its shareholders totalling some £69 million and it has distributed a further £17 million to its shareholders by way of share buy-backs. Over this 10-year period, the Company has raised approximately £13 billion for its clients, principally SMEs. Accordingly, the Company has assumed a leadership role in terms of capital raised for companies quoted on AIM.

In short, Cenkos has been remarkably successful from the viewpoint of all stakeholders; its staff, shareholders and clients. The reasons underlying this success are manifold. However, a central factor has been the Company's remuneration policy, which is designed to align the interests of staff, shareholders and clients. Cenkos' remuneration policy is centred on a relatively low fixed cost base (i.e. low basic salaries) while total remuneration is closely linked to the success of the business. The Company's principal revenue stream, namely the fees derived from the placing of the shares of our corporate clients with institutional investors, is consistent with the European Commission's stated aim of encouraging the access of SMEs to the capital markets as set out in its green paper "Building a Capital Markets Union" and the various recitals to MIFID II.

### **Cenkos: Today**

Cenkos Securities plc is an independent Company specialising in equity securities providing corporate finance services, primarily to SME corporate clients, and sales, research and market making services to institutional investors. We have developed excellent relationships with the major life assurers and fund management houses such as Legal & General, Schroders, Aviva, Henderson, Blackrock and M&G, all of whom with many others recognise the need to provide permanent capital to SMEs to grow their businesses in the wider economy.

We do NOT provide services to retail clients (other than small corporates).

We do NOT take deposits or make loans.

We do NOT offer or advise on structured products or derivatives.

We do NOT offer foreign exchange currency services.

We do NOT contribute to the setting of any benchmark(s).

Cenkos does NOT carry material risk on its balance sheet and does NOT create or contribute to any financial risks which are of systemic importance. From a regulatory and economic risk perspective the Company is completely distinct from a deposit taking institution or investment bank.

Cenkos and similar businesses, however, are a key part of the EU financial landscape that intermediates between the major savings institutions enabling capital to be allocated, distributed and invested efficiently and productively to deserving companies.

The majority of brokers and Nominated Advisers (Nomads) supporting growth companies on the Alternative Investment Market of the London Stock Exchange are themselves SMEs with a majority, or significant minority, of shares held by the Directors and employees. The shareholding structure of Cenkos is consistent with this with no less than 55% of the Company's shares owned by the directors and employees. Specifically, the interests of the employees are firmly aligned with the long-term interests of the Company and its shareholders.

In our view the EBA proposals do not take significant consideration of this fact. Furthermore, the EBA proposals fail to recognise that some of the directors of Cenkos are unable to receive any further remuneration by way of shares since this would increase their holdings above 10% and hence require regulatory approval for them as potential "controllers".

### **Cenkos: Impact of a change in remuneration policy**

As stated above, Cenkos' current remuneration policy involves the payment of relatively low basic salaries. The policy was deliberately designed so that, in periods of low activity, the probability of the Company remaining profitable would be maximised whilst, in periods of high activity and therefore high profits, employees would be appropriately rewarded for their success. Since remuneration is by far our largest cost, raising fixed salaries would have a disproportionate impact.

---

The empirical evidence clearly supports the view that this policy has been a resounding success. The Company has been consistently profitable over the past 10 years and, in particularly successful years, the variable element of pay for those who have produced an outstanding performance has been a significant multiple of basic pay, far exceeding the two times multiple proposed in the consultation document. Indeed, by dint of this remuneration policy, shareholders and staff have shared in the prosperity of the Company in a balanced fashion. A change of this nature would fundamentally undermine the relationship between stakeholders.

A change in the remuneration structure at Cenkos, such as that proposed in the consultation document, would have potentially devastating consequences for the firm's stability and, in extremis, its existence. If the current proposal were to become effective, fixed salaries at Cenkos would have to be raised significantly in order to retain staff. For our best performing staff, fixed salaries may have to rise by a factor of five or, in a small number of cases, significantly more. The implied increase in fixed costs would be so great that, in a period of low activity (an inevitable occurrence in the course of a business cycle), the probability of the Firm incurring losses would be greatly increased, with obvious implications for levels of employment within the firm. Indeed, depending upon the quantum of losses, the existence of the firm could be imperilled.

Additionally and in clarification because of the already significant ownership of shares by staff further payment to senior staff by way of shares will materially reduce liquidity in our shares and further concentrate holdings. Deferring into other instruments will result in a disproportionate expense given our relatively small size. Large financial conglomerates with wholly different risk characteristics, where the EBA proposals we believe are aimed, are in practice able to flex their fixed cost remuneration more easily to counter changes in market behaviour. In a highly competitive market for skilled and talented staff we face significant pressure from these organisations as they position themselves sympathetically with the proposals with devastating consequences for our stakeholders.

Presently, in a year where there is low level of corporate activity, the Cenkos model is such that our corporate finance retainers and fee income will largely cover our fixed costs. This protection would be completely removed if fixed costs were significantly forced upwards, as they would inevitably be under the current proposal.

Even in years of high corporate activity, the current proposal would have highly detrimental effects. As an example, let us assume that bonus pots are "full", i.e. employees have accrued a bonus entitlement of 100% (or 200% with shareholder approval) of fixed pay. In such circumstances, employees will be wholly disincentivised to undertake further capital raisings since there would be no prospect of an enhancement in total remuneration. This would not only impose a cap on the firm's potential profitability but would be to the detriment of those potential SMEs to which we would have otherwise provided our services. Hence, high levels of variable pay are not simply desirable but rather a necessity to enable small firms such as Cenkos to remain viable during all stages of the economic cycle.

In short, the consultative document proposal would lead to the following:

- (i) The likelihood of the firm incurring losses in periods of low activity would be greatly increased, potentially threatening the firm's existence;

- 
- (ii) Even in periods of high activity, the firm's profitability would be effectively capped, thereby curtailing the provision of our services to SMEs; and
  - (iii) Due to the negative impact upon profitability in all circumstances, the provision of capital to Cenkos itself would be inhibited, thereby curtailing our own ability to grow.

Hence, if the goal of the proposals is to promote greater stability in the financial system and to promote the access of SMEs to capital markets, the converse will be true.

Frankly, the proposals as constituted currently, are wholly impracticable and counterproductive; promoting instability and restricting the access of SMEs to capital markets.

The analysis above is a straight forward exposition of the truth. To impose these proposals upon Cenkos, a company which has become a leading provider of capital to SMEs, which has been a beacon of stability and prosperity throughout the period of the financial crisis and which shares none of the characteristics of those institutions which arguably exacerbated that crisis, would be grossly reckless and would even run the risk of being an act of economic and corporate vandalism.

### **Proportionality**

We support the contention that sound remuneration policies should reflect the risk profile of the organisation. The consultation paper, in its discussion on proportionality, recognises this point. In particular it states, in paragraph 70 that "... the proportionality principle aims to match remuneration policies and practices consistently with the individual risk profile, risk appetites and strategy of an institution...". However, that paragraph goes on to state that the obligation "... applies to all institutions... regardless of the institutions different characteristics". This second statement is at odds with the first and it is our strongly held view that the proportionality principle should properly recognise the different risk characteristics of an institution.

As a matter of law we consider that CRD IV (in a similar way to CRD III) permits the "neutralisation" of certain remuneration provisions (or at the least their disapplication on grounds of proportionality). This interpretation is based on the provisions contained within Recital 66, Article 92(2) and Article 94(1) of Directive 2013/36/EU can be given a different interpretation to that provided by the EBA in its CP/2015/03. Specifically, Article 92(2) provides the following:

Recital 66 explains that the intention is that the "provisions of this Directive on remuneration should reflect differences between different types of institutions in a proportionate manner, taking into account their size, internal organisation and the nature, scope and complexity of their activities. In particular, it would not be proportionate to require certain types of investment firms to comply with all those principles".

Article 92(2) additionally states "Competent authorities shall ensure that, when establishing and applying the total remuneration policies, inclusive of salaries and discretionary pension benefits, for categories of staff including senior management, risk takers, staff engaged in control functions and any employee receiving total remuneration that takes them into the same remuneration bracket as senior management and risk takers, whose professional activities have a material impact on their risk profile, institutions comply with the following principles in a manner and to the extent that is appropriate to their size, internal organisation and the nature, scope and complexity of their activities."

Therefore the wording of article 92(2), in particular, the use of the word "extent" clearly envisages a spectrum upon which on one end the rules are disapplied/neutralised (because they are inappropriate and disproportionate) to where all the rules are applied (because, for example, the entity is carrying out balance sheet risk or activities that may transmit such risk across the financial system).

Article 94(1) which applies the provisions to variable remuneration is explicitly stated to be on the same terms as Article 92(2) i.e. that it applies to "the extent that is appropriate to internal organisation and the nature, scope and complexity of their activities".

**It is clear therefore from the above that it is envisaged that there will be cases where the remuneration provisions can be dis-applied on grounds of proportionality.**

In this regard, this view appears to be supported (by the now long established) legal interpretation adopted by the Committee of European Banking Supervisors (CEBS) Guidelines (December 2010) (under CRD III) and the European Securities and Markets Authority (ESMA) in relation to the retail (UCITS) and the alternative investment fund industries (with adjustments assumed by the fund investors and not the manager's creditors and shareholders).

The former CEBS Guidelines on Remuneration Policies and Practices allowed for the so-called neutralisation of some of the provisions for small and less complex institutions. Although the terms of the CRD do not explicitly grant for such a right however (as noted above) the drafting of the relevant articles indicates that this was the intention. On this basis we submit that the EBA has adopted an incorrect interpretation of the rules or that the relevant CRD rules should be clarified. It is illogical to have a principal of proportionality that has no practical meaning.

We also consider the EBA proposals inappropriate on public policy grounds. In particular, we consider it to be disproportionate, for the risk profile of Cenkos, to specify a minimum deferral of 40% over 3 years and a pay-out of 50% of variable remuneration in instruments. Our bonus process takes risk into account. As a general policy of conduct our underlying business and our income derived from it has a much lower tail risk than the businesses that are typically undertaken involving lending.

Finally we remain supportive of any European wide initiative to encourage access of SMEs to the capital markets and, if it would be helpful, we would be most willing to discuss this direct with the EBA, ESMA or the European Commission. However, we strongly believe that applying remuneration structures to independent securities companies, such as Cenkos, in the same manner as for global universal banks is contrary to the commission's stated objective of assisting SMEs to access capital effectively and furthermore endangers the distribution of permanent capital which is so vital the growth of companies and the European economy as a whole.

The proposals if enacted would have devastating consequences for our Company. Not only would the carefully constructed balance between stakeholders be destroyed but also our ability to intermediate between the major savings institutions and companies seeking to expand their activities by seeking permanent capital would be severely impacted and potentially could cease.

Yours faithfully



G P Aherne  
Non-Executive Chairman