FSB FINANCIAL STABILITY BOARD

Recommendations for consistent national reporting of data on the use of compensation tools to address misconduct risk

Consultative Document

7 May 2018

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The Financial Stability Board (FSB) is seeking comments on its consultative document on *Recommendations for consistent national reporting[1] of data on the use of compensation tools to address misconduct risk.*[2]

The FSB agreed a workplan in May 2015 to address misconduct risk through a combination of measures, focusing on (i) examining whether reforms to incentives, for instance to governance and compensation structures, are having sufficient effect on reducing misconduct risk and whether additional measures are needed; (ii) examining whether steps are needed to improve global standards of conduct in the fixed income, commodities and currency (FICC) markets; and (iii) coordinating reforms to major financial benchmarks.[3] The work comprises measures for effective governance and compensation frameworks. In the area of compensation, in particular,[4] the FSB issued *Supplementary Guidance to the FSB Principles and Standards on Sound Compensation Practices* ("Supplementary Guidance to P&S") regarding the use of compensation tools to address misconduct risk in significant financial institutions (i.e. financial institutions that national supervisory authorities consider significant for the purposes of the P&S).[5]

The FSB work on addressing misconduct risk also supports efforts to improve supervisory consideration of compensation practices. In this vein, this document represents the view of the FSB on recommendations ("Recommendations") for consistent reporting of data to national (or jurisdictional)[6] supervisory authorities, within the scope of applicable legislative and regulatory frameworks, on the use of compensation tools to address

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[1] Use of the term "reporting" in this document refers broadly to supervisory information flows (or to information made available by firms to the supervisors) in the context of supervisory dialogue with firms and not to public disclosure requirements. The data gathered by national supervisory authorities would remain with them and would be considered in established processes for monitoring the use of compensation tools.

[2] For the purposes of this document, misconduct is defined as "conduct that falls short of expected standards, including legal, professional, internal conduct and ethical standards" (please see also footnote 9).

[3] The most recent FSB progress report on the misconduct workplan was published in July 2017 (http://www.fsb.org/wp-content/uploads/Misconduct-progress-report-July-2017.pdf).

[4] See *FSF Principles for Sound Compensation Practices*, April 2009 ("P&S") and *FSB Principles for Sound Compensation Practices - Implementation standards*, September 2009 ("Implementation Standards for P&S") (http://www.fsb.org/what-we-do/policy-development/building-resilience-of-financial-institutions/compensation/). FSB, *Supplementary Guidance to the FSB Principles and Standards on Sound Compensation Practices*, 2018 (http://www.fsb.org/2018/03/supplementary-guidance-to-the-fsb-principles-and-standards-on-sound-compensation-practices-2/). The guidance does not establish additional principles or standards beyond those already set out in the P&S. The guidance has been developed in the form of recommendations on better practices at financial institutions considered significant for the purposes of the P&S.

[5] The P&S also note that "The FSF Principles for Sound Compensation Practices are intended to apply to significant financial institutions, but they are especially critical for large, systemically important firms".

[6] Throughout the document the terms regulator, supervisor, supervisory authority, national supervisory authority and jurisdictional supervisory authority, in singular or plural, are used interchangeably, and therefore they should be understood as referring to the competent authority, as the context may require. This would apply in cases where the competent authority is not the national authority, for example in the case of the European Central Bank that, in cooperation with national competent authorities (NCAs), through the Single Supervisory Mechanism (SSM), is responsible for supervising Significant Institutions established in the participating EU Member States, as defined by Articles 4 and 6 (4) of the SSM Regulation of the European Central Bank (ECB); while Less Significant Institutions are under the direct supervision of the NCAs and the ECB is responsible for exercising oversight over the functioning of the system.

misconduct risk in significant financial institutions. Currently, the gathering and analysis of compensation data vary significantly across jurisdictions and firms. Similarly, in terms of the information available to national supervisory authorities, a variety of approaches exists. Firms and supervisors have expressed interest in further development of data gathering and data analysis and reporting practices.[7]

The draft Recommendations for consultation are directed to the relevant national supervisory authorities for firms in all financial sectors. They build on existing international efforts and national supervisory work, and, in particular for the banking sector, take into consideration the Basel Committee on Banking Supervision (BCBS) Pillar 3 disclosures framework, which includes disclosures on compensation.[8]

The consultation seeks input from various stakeholders in order to benefit from the collective perspective, experience and range of practice currently employed.

The FSB invites comments on the consultative document and the following specific questions:

1. Is the proposed "Data Set" sufficient to help (a) supervisors and (b) firms to monitor the effectiveness of the use of compensation tools to address misconduct?
2. If not, which additional data/information should be collected?
3. Are there any impediments to (a) firms and (b) supervisors in (i) gathering or (ii) using the Data Set?
4. Are there any elements in the "Data Set" that may not be relevant to a particular financial sector?
5. Are there any additional elements that should instead be considered for a particular financial sector?
6. What elements of the Data Set are not already utilised by firms in their own monitoring of compensation and misconduct risk management practices?
7. What types of information have been most useful to firms in their monitoring and assessments of potential misconduct, and when assessing the effectiveness of compensation tools?

[7] Several jurisdictions collect information routinely as part of the supervisory process, covering for example, risk-taking, risk outcomes, compensation structures, use of compensation tools and misconduct. Other jurisdictions gather information only on an ad hoc basis, if at all. In addition, in some jurisdictions there are substantial public disclosure requirements related to compensation. Pillar 3 standards from the BCBS cover information on the use of compensation tools. At the firm level, data gathering processes differ across individual firms, financial sectors and jurisdictions. Whereas some firms have developed sophisticated monitoring and reporting mechanisms, other firms are only at the beginning of this process. (See FSB, *Stocktake of efforts to strengthen governance frameworks to mitigate misconduct risks*, May 2017 (www.fsb.org/wp-content/uploads/WGGF-Phase-1-report-and-recommendations-for-Phase-2.pdf).

[8] See BCBS, Pillar 3 disclosure requirements (part 13), March 2017 (https://www.bis.org/bcbs/publ/d400.htm). The requirements provide for banks and banking organisations to disclose qualitative and quantitative information on their remuneration policies. Quantitative disclosure templates are meant to provide information on a bank's fixed and variable remuneration awarded during the financial year, details of any special payments made, and information on a bank's total outstanding deferred and retained remuneration, respectively. The disclosure requirements should be published annually, with the first disclosures due in a bank's Pillar 3 report at its financial year-end 2017.

8. What are the most important changes that have occurred in firms' management of compensation and conduct risk in recent years? Do the current Recommendations focus enough on these developments that may help to better achieve alignment of risk and reward?
9. How do firms monitor and validate the use of compensation tools when misconduct occurs to ensure an appropriate balance between risk and reward? What analytics support firms' judgments in these areas?

Responses to this consultative document should be sent to fsb@fsb.org by Friday 6 July 2018. Responses will be published on the FSB's website unless respondents expressly request otherwise.

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Recommendations for consistent national reporting of data on the use of compensation tools to address misconduct risk

1. Introduction

Collecting appropriate data and evaluating it on a regular basis can provide both firms and supervisors with important insights into the effectiveness of compensation programmes and potential areas of weakness. The Recommendations are directed to national supervisory authorities from all financial sectors for further consideration as part of their oversight of compensation practices in significant financial institutions, within the scope of a jurisdiction's laws and regulations. They draw on the experience of supervisors who are members of the FSB and are designed to support more effective engagement with firms and informed assessments of the role played by compensation in supporting prudent risk-taking behaviours and business practices. The Recommendations are meant to represent better practices for data gathering and reporting and to assist national supervisory authorities from all sectors by enhancing their capacity to consider and monitor the effectiveness of compensation tools and other mechanisms in promoting good conduct and addressing misconduct risk, in a manner consistent with the scope of applicable legislative and regulatory frameworks.[9] Where guidance on public disclosure exists, as for banks,[10] the Recommendations lever on such guidance to avoid overlaps and recognise the synergies in information production, while recognising that information collected for supervisory purposes on the link between compensation and conduct might be more detailed or specific than that prepared for public disclosure.

The Recommendations are aimed at the supervision of significant financial institutions[11] and are not intended to be prescriptive, but instead suggest certain categories of data that may be useful for supervisors when interacting with firms[12] on misconduct risk. The Recommendations draw on the expertise of the FSB to identify the types of data that should be helpful to better understand the conduct risk management framework and use of compensation tools to prevent and remediate misconduct risk. The FSB believes the Recommendations will be useful in furthering a number of important FSB objectives, including development of comparative baselines, supporting accountability for adverse outcomes and identifying areas of weakness or emerging risks that could usefully be addressed through compensation and performance management processes. The use of compensation and performance management mechanisms

[9] Throughout this document, the term "misconduct risk" is kept for consistency with the terminology used in the FSB work on measures to address "misconduct risk" (see http://www.fsb.org/2017/07/reducing-misconduct-risks-in-the-financial-sector-progress-report-to-g20-leaders/). It is however noted that many firms prefer the use of the term "conduct risk" as conduct programmes extend well beyond efforts to address misconduct, and increasingly exhibit, for example, measures aimed at promoting positive conduct as well as remediating inappropriate conduct.

[10] See footnote 8.

[11] The P&S note: "The FSF Principles for Sound Compensation Practices are intended to apply to significant financial institutions, but they are especially critical for large, systemically important firms". The Supplementary Guidance to P&S note: "Significant financial institutions" are those that national supervisory authorities consider significant for the purposes of the P&S.

[12] The P&S use the term "financial institutions" and "firms" interchangeably. Both terms are used in these Recommendations interchangeably and they should be understood, as the context may require, as referring to different types of institutions or firms in the broad financial sector.

should not only address misconduct - preventatively and when it occurs - but should also help to promote good conduct.

Supervisory reviews that take into account the effectiveness of compensation and wider performance management practices in promoting appropriate standards of conduct can help support firms' efforts to prevent misconduct, help ensure products are suitable for clients, and help safeguard both market and firm integrity. These supervisory reviews should lever on existing firm-driven analyses and internal monitoring and testing. For this reason, the FSB encourages both firms and supervisors to develop a structured approach to data gathering, reporting and analysis.

The proposed data set ("Data Set") is designed to help firms and supervisors answer a number of important questions. These include whether governance and risk management processes surrounding compensation:

- appropriately include conduct considerations in the design of their compensation and incentive systems, including the setting of individual goals, ex ante performance measurement mechanisms and ex post compensation adjustments;
- support the effective use of compensation tools - in combination with other performance management tools such as training, promotion and disciplinary systems - to help promote good conduct or to remediate individual conduct that is not in line with the firm's expectations, including holding individuals accountable for any misconduct that occurs;
- promote wider risk management goals, including for conduct issues, consistent with the firm's strategy and risk tolerance; and
- support the effective identification of emerging misconduct risks and where appropriate, review use of incentive systems and compensation decisions in response to conduct incidents to ensure alignment of incentives, risk and reward.

The Recommendations do not establish new principles or standards beyond those already established in the P&S, nor are they designed to be "one size fits all". The Recommendations must be viewed in light of existing national laws and in a manner consistent with the supervisory powers individual regulators have been granted. Decisions on the scope of data gathering, the types of data and the appropriate data gathering cycle and frequency are solely for national supervisory authorities to make, taking into account the types of supervisory work conducted, the relevant legislative and regulatory framework, the extent to which data is already collected, whether the firm is a significant financial institution and the specific risk profile or financial activities engaged in by the firm.

2. Misconduct and Compensation

In recent years, supervisors and firms have directed significant attention to improving compensation and risk adjustment practices. They have focused more intensively on the impact

compensation and related performance management mechanisms can have on incentives, the risks they may create, and their implications for the long-term health of financial institutions.[13]

The current focus on compensation and broader performance management mechanisms as tools to help manage the risk and consequences of misconduct stems from a belief that these tools can play an important role in addressing misconduct by providing both ex ante incentives for good conduct and ex post adjustment mechanisms that support appropriate accountability when misconduct occurs.[14]

Identification and collection of data are critical to supporting supervisory analyses of incentive compensation awards and pay-outs and whether adjustments to compensation appropriately consider risk. Gathering and appropriately assessing information are also key steps in evaluating the effectiveness of compensation related reforms.

As set out in the P&S,[15] firms should regularly review whether the design and implementation of incentive compensation programmes deliver appropriate risk-taking incentives, and they should correct any identified deficiencies. Well-targeted data gathering and analysis supports a number of processes used by firms to identify, prevent, mitigate and remediate misconduct, including internal monitoring and back-testing of incentive compensation awards and pay-outs.[16]

While the Recommendations provide a tool for possible use by national supervisory authorities, firms are expected to develop supporting processes, including internal structured approaches to data gathering. The data gathered for firms' internal use may extend beyond the set of data recommended for supervisory reporting.

The FSB acknowledges the challenges inherent in gathering data, including, among others, those related to: coordination between group activities and local entities; integration of data from various sources (such as legal, finance, audit and human resources databases which may be retained on separate systems), and aggregating them in meaningful pools; data privacy issues; and data integrity issues. Indeed, a major challenge within firms is how to meaningfully integrate and ensure the exchange of information on a horizontal level between the different control and support functions (human resources, compliance, legal, risk), and also among different group entities. Further, these processes are often multi-year in nature and this will influence the cycle and timing of related data gathering and data analysis. For this reason, it is important for firms to engage in a regular review of their data collection and aggregation processes and related management information system issues. Work already undertaken by some firms in this area is encouraging and provides a path to better practices. At a workshop held by the FSB with industry participants in December 2017 it was discussed by participants and one bank noted that "the collection and use of data to support analysis of the link between

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[13] See for example: FSB, *Implementing the FSB Principles for Sound Compensation Practices and their Implementation Standards: Fifth progress report,* July 2017 (www.fsb.org/wp-content/uploads/P040717-6.pdf).

[14] FSB, *Measures to reduce misconduct risk: Second Progress Report*, (September 2016) (www.fsb.org/wp-content/uploads/Measures-to-reduce-misconduct-risk-Second-Progress-Report.pdf)

[15] See P&S, Principle 2 and related commentary.

[16] As noted in the FSB's fifth progress report on the implementation of the P&S, although firms have made progress in these areas, significant work remains to be done. (See: http://www.fsb.org/wp-content/uploads/P040717-6.pdf)

compensation and misconduct risk is key to reducing the opportunities for misconduct while strengthening the ability to contain the associated risks".[17]

These Recommendations are intended to support supervisors in their dialogue with firms and are aimed at fostering the development of better practice. The information outlined for data gathering and reporting to supervisors is also intended to better support implementation of the P&S as well as the Supplementary Guidance to P&S. Relevant references to the P&S and the Supplementary Guidance to P&S are noted for context in footnotes to the Data Set.

3. Objectives of the Recommendations

The goal of the Recommendations is to propose a supervisory framework for data gathering and reporting as a tool for supervisors for monitoring and analysing the effectiveness of compensation frameworks in addressing misconduct risk.

To achieve this goal, it is recommended that, consistent with legal and regulatory frameworks, supervisors collect a set of descriptive information, both qualitative and quantitative, on the firm's compensation system and its use as part of the misconduct risk management framework. Broadly, the information collected should help supervisors to understand and review:

3.1 The importance of individual conduct within the firm's incentive compensation framework and the role of compensation policy in establishing a sound risk and conduct culture. Data recommendations in this respect include information on the:

- incentive system's main characteristics and functioning (e.g. setting individual targets/performance criteria, assessing performance and determining compensation). Data gathering and reporting should help supervisors, for example, to review whether non-financial performance measures are appropriately designed and incorporated in performance plans and effectively impact compensation awards, pay-outs and adjustments. The specific reporting on the use of conduct and misconduct indicators in compensation frameworks should help supervisors to review progress made by firms in integrating effective conduct standards into their risk and control frameworks.
- procedures in place to manage misconduct risk. For a comprehensive analysis and understanding of the risks that compensation adjustments should reflect, supervisors should have access to information on the firm's conduct management framework and the role played by compensation and performance management practices within that framework. This should include information on how misconduct is identified, as well as on the governance and decision-making processes used to assess individual and collective responsibility when misconduct occurs and to decide the impact on compensation. For example, information on events that have occurred would also support supervisors' consideration of how compensation adjustments are being used and under which circumstances.

[17] FSB, *FSB Workshop on the Link between Compensation and Conduct Data collection and analysis*, May 2018 (www.fsb.org/2018/05/fsb-workshop-on-the-link-between-compensation-and-conduct-data-collection-and-analysis/)

- metrics used to identify and measure misconduct risk for compensation purposes. The development of such metrics, especially forward-looking metrics, remains a challenge. Some observed practices across firms show that indicators are often limited to compliance with laws and regulations, rather than also incorporating values and standards of conduct including fair treatment of customers.

3.2 The use of compensation tools in practice and their role in ensuring accountability when misconduct occurs. Data gathering in this area that may be helpful includes information on:

- compensation adjustments made during the previous year (e.g. at bonus pool and individual levels, as in-year adjustment, or as ex post adjustment in terms of malus or clawback) and the rationale for making such decisions.
- the relevance attached to compensation measures vis-a-vis other tools available for ensuring accountability when misconduct occurs.[18] This includes information on investigation of significant misconduct and actions taken in response, so as to understand the circumstances under which compensation adjustments are made or whether other tools were considered more appropriate. The recommendations include information on: incident identification; reporting and risk management when significant control disruptions or other failures occur; or when adverse outcomes result in significant consumer harm or reputational damage; the root cause of such events and the ways in which firms utilise related lessons learned to identify and prevent similar failures in other areas of operations; [19] the roles and responsibilities of those involved in decision-making; and internal management information reports.

On the part of firms, an internal structured data collection of such information may strengthen their ability to establish, implement and monitor risk prevention and mitigation strategies, and assist a more effective use of compensation as an incentive device within a firm's risk governance and risk management frameworks. Internal data should be sufficiently granular to support rigorous internal monitoring and analysis.[20] A structured data collection by firms should also assist back-testing and thereby support refinements to compensation policies and misconduct risk management systems. Internal data collection should also support more effective disclosure as required by the P&S (e.g. to shareholders, regulators and other stakeholders).

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[18] Compensation is just one of the available tools to address misconduct risk. In certain instances the incentivising/deterrent effect of compensation might not be sufficient, and it may be necessary to resort to other measures such as disciplinary sanctions, dismissal, deferment in career progression, mandatory training, depending on the severity of the misconduct. Further, it may be that in a financial year a firm is unable to leverage on its compensation system due, for instance, to subdued economic performance.

[19] Root cause analysis and application of lessons learned can provide information critical to better design and monitoring of compensation arrangements and support more effective prevention of misconduct.

[20] Sufficient data and strong analytical capacity should be in place within the firm to adequately monitor, with involvement of control functions, the effectiveness of incentive compensation arrangements, carry out robust misconduct root cause and pattern analysis, including identification of outliers and key trends, and determine the firm's overall exposure to misconduct risk and the effectiveness of the management of this risk.

4. Scope

The Recommendations are aimed at supervision of significant financial institutions. The application of the Recommendations by national supervisory authorities, within their scope of competence, should be risk-based and take into account the cost of implementation balanced with supervisory objectives within applicable law. Authorities should in any case establish clear expectations on data gathering and reporting on the use of compensation tools to address misconduct risk.

As regards the population in scope, the occurrence of conduct issues can extend well beyond the population of identified material risk takers (MRTs), and cover for example junior employees or employees not strictly in financial business units. For this reason the Recommendations adopt an open approach by providing for the supervisory data gathering and reporting to cover those individuals considered in scope by the firm's compensation framework as conduct considerations are applied.

5. Recommendations

The data on the use of compensation tools to address misconduct risk is conceptually the intersection set between the firm's compensation and performance measurement systems and the firm's misconduct management system.

The Data Set covers the firms' frameworks as well as their actual implementation. It is therefore comprised of elements derived from the firm's compensation and performance measurement systems and the firm's misconduct management system, and in particular:

Part A: Compensation frameworks to address misconduct risk and their governance

Part B: Compensation actions taken in the event of misconduct

The Recommendations identify a core set of data ("Core Data") for the effective supervision of compensation practices. The Core Data are considered particularly important for the supervision and monitoring of misconduct incidents and when considering trends and the related responses by firms. This represents the minimum set of information that should ideally be available to supervisors.

The FSB recommends that the Core Data be reviewed periodically through ongoing supervisory activity and integrated into supervisory frameworks, within the scope of a jurisdiction's applicable laws and regulatory frameworks.

To complement the Core Data, the Recommendations also identify additional information that can provide further insight on compensation and misconduct risk, and support more in-depth analysis. Supervisors may consider, if not already collected through other frameworks, whether these additional reporting data could be useful when considering misconduct related risks and compensation outcomes.

Recommendations for consistent national reporting of data on the use of compensation to address misconduct risk

DATA SET

The following box describes the Core Data and additional information for the purpose of the Recommendations.

The Core Data are highlighted in bold, whereas the additional information (not bolded) could provide supervisors with additional context and may be useful in particular in case of supervisory deep dives or horizontal reviews on compensation and misconduct risk.

It is recommended that supervisors carry out an initial, comprehensive data gathering of the Core Data indicated in parts A and B for significant financial institutions,[21] and then receive updates no less frequently than on a yearly basis.[22] Since frameworks, policies and procedures do not change frequently, at least not in a material way, the updates on the information in part A related to the firms' policies and procedures generally should include only material changes or new elements that became relevant.

On the other hand, the information in part B on concrete compensation actions taken in response to misconduct generally should be updated annually.

A. COMPENSATION FRAMEWORKS TO ADDRESS MISCONDUCT RISK AND THEIR GOVERNANCE

A.1. Population in scope for the application of compensation tools to mitigate/address misconduct risk and, if available, a description of the criteria/methods used to identify material risk takers (MRTs) in relation to misconduct risk;[23]

A.2. Processes for determining, monitoring and reviewing the firm's use of compensation in supporting effective risk management including of misconduct risk. This should include a description of the role of key bodies, processes and functions involved in misconduct risk management, such as:[24]

- **A description of the internal definition of misconduct categories used for compensation purposes, including whether misconduct categories are used consistently among different business units or legal entities; and**
- **A description of the firm's policies and decision-making procedures for assessing and deciding on the use of compensation tools in case of misconduct, specifically the policies and decision-making procedures for**

[21] See footnote 11.

[22] Footnote 8 notes that for banking organisations some of these data, and in particular the additional information to the Core Data set A might already be collected by firms for the purposes of Pillar 3 disclosure. National supervisory authorities should assess the extent of any potential synergies among the two exercises.

[23] Firms should consider whether the current population identified through their MRT process should be reviewed to reflect the incidence and potential for misconduct in other areas of their workforce.

[24] Supplementary Guidance to P&S (recommendations 1-4).

assessing and determining individual responsibility and appropriate impact on compensation in case of misconduct incidents, including information on bodies and functions involved and information gathered in support of the process.

A.3. Design of performance arrangements and performance measurement, such as:

- **Information on the design of compensation arrangements for MRTs and how that design takes into account conduct-related considerations;**[25]
- **A description of the key financial and non-financial metrics (where applicable performance score cards and dashboards) used to link compensation and conduct for both MRTs and other employees,**[26] **the data used and its sources, the triggers and their respective weighting if any;**
- **Details of the financial and non-financial measures that are used to set the bonus pool; and**
- **The incorporation of misconduct considerations in the compensation adjustment process, i.e. the extent to which misconduct can impact compensation (the percentage of compensation at risk for misconduct issues).**[27]

A.4. Compensation adjustment tools available:

- **The breakdown of compensation adjustments by compensation tool (in-year adjustments; and ex post adjustments through malus or clawback). The reporting should include the wording of the malus and clawback clauses.**

Additional information on the firm's compensation policies and procedures

Compensation Governance[28]

A.1.1. Documentation supporting review of the compensation policy, including action items, responsible parties and progress against those items, to address any gaps raised (e.g. outputs of monitoring and back-testing processes)

Description of the firm's compensation system: [29]

A.1.2. Most important design characteristics of the compensation system, including:[30]

- the key risks taken into account in the compensation process;

[25] P&S (Principles 1-2); and Supplementary Guidance to P&S (recommendations 1 and 5).

[26] P&S (Principle 4); and Supplementary Guidance to P&S (recommendations 1, 5 and 7).

[27] P&S (Principles 5-6); Supplementary Guidance to P&S (recommendations 5, 6 and 7).

[28] P&S (Principles 1-2).

[29] See, for example, information covered under the BCBS standards on Pillar 3 disclosure requirements (part 13), March 2017 (https://www.bis.org/bcbs/publ/d400.htm).

[30] Supplementary Guidance to P&S (recommendations 5, 6 and 7).

- the ways in which the firm links compensation with performance and adjusts compensation for key risks during a performance measurement period (performance and risk metrics used to adjust compensation where appropriate through in-year adjustment, malus or clawback);
- the deferral and retention policy[31] and vesting criteria; and
- balance between cash and non-cash instruments such as shares.

Additional information on the firm's misconduct risk management framework

A.2.1 A description of how conduct objectives feed into the firm's Risk Appetite Framework and are cascaded down to legal entities/business units.

A.2.2 A description of the types of measures and policies for dealing with misconduct events.

A.2.3 A description of internal processes and supporting information for assessing and determining individual responsibility in case of misconduct. The additional reporting could include: aggravating and mitigating circumstances considered in the decision; disclosure within the firm of the incident and of the outcome of the procedure; information sources (e.g. whistleblowing/alert systems; customer complaints; legal disputes; internal audits; self-denunciation; other); internal reporting mechanisms and escalating procedures.

A.2.4 A description of how compensation is used in combination with other tools within the performance management framework in relation to misconduct (e.g. hiring, performance review, promotion, succession planning and talent development strategies).

A.2.5 The firm's code of conduct and other relevant internal guidelines in place to specify expected good conduct.

A2.6 General information on positive incentives and policies utilized by the firm to promote good conduct.

B. COMPENSATION ACTIONS TAKEN IN THE EVENT OF MISCONDUCT[32]

B.1. Data on misconduct incidents under examination by the firm (including outstanding cases and new cases that have occurred in the current year) and relevant measures taken, including compensation adjustments as applicable.[33] This includes:

- **category/type of misconduct incident and year of its first manifestation;**

[31] For instance, information on percentage of deferral, total time horizon, time horizon of vesting, persons in scope.

[32] Supplementary Guidance to P&S (recommendation 8).

[33] Misconduct cases may take some time before they come to the light, and the inquiry by the firms into the events and the follow up actions may also take some time to be decided. The data gathering should take this timing issue into account.

- **severity assessment of the misconduct event (from significant event to lower level infractions);**
- **number of employees and category of staff involved by rank and function;**[34]
- **root cause of the misconduct event and remedial actions taken; and**
- **details on the size of compensation adjustments relative to total variable remuneration.**

B.2. A listing of all compensation adjustments (in-year, malus, clawback) with the rationale for the adjustments, including separate evidence of compensation adjustment or other appropriate remediation (termination, disciplinary actions, promotion considerations, warnings, training etc.) for misconduct (as refers to cases outlined in point B.1).

Additional information

B.1.1 A record of major incidents and near misses, and their potential estimated or actual impact in terms of financial losses or capital implications. A description of what is considered a major incident that is internally escalated.

B.1.2 Data on misconduct incidents for which no compensation adjustment or performance management measures were made (for which there was a determination in the previous financial year that misconduct occurred), including a rationale for not taking any action.

B.1.3 Management information reported to (a) senior management and (b) the board on misconduct.

B.1.4 A copy of relevant independent investigation reports and thematic conduct reviews or audits.

B.1.5 Internal analysis conducted by the firm in mapping misconduct, identifying patterns of misconduct and determining the root causes of misconduct.

[34] Supplementary Guidance to P&S (recommendations 5 and 6).