FSB FINANCIAL STABILITY BOARD

Implementing the FSB Principles for Sound Compensation Practices and their Implementation Standards

Third progress report

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Implementing the FSB Principles for Sound Compensation Practices and their Implementation Standards
Third Progress Report

Executive Summary

This is the third progress report on the implementation of the FSB *Principles for Sound Compensation Practices* and their *Implementation Standards* (P&S). The report, which was prepared by the FSB Compensation Monitoring Contact Group (CMCG), reports on remaining implementation gaps and focuses on some of the key challenges and evolving practices in this area. The main findings are as follows:

1. ***Implementation of the P&S has been essentially completed, although several FSB jurisdictions continue to refine their regulatory framework or guidance on compensation practices***. The most notable development in this regard is the adoption by the European Union (EU) of the Capital Requirements Directive (CRD) IV, which includes specific requirements on compensation structures that go beyond those found in the P&S. Other jurisdictions issued additional regulation or supervisory guidance either clarifying or expanding the scope of previous regulation, or introducing requirements in addition to those of the P&S. As mentioned in the 2013 progress report, there remain a few FSB jurisdictions that have not adopted one or a few P&S due to their non-applicability or incompatibility with local laws; these jurisdictions should assess the risks posed by remaining gaps and take appropriate measures to address them.

2. ***Supervision of compensation practices continues to improve***. The assessment of compensation practices has become for many authorities an essential part of the supervisory cycle given the relevance for effective risk management and governance. Responses indicate, however, important differences in supervisory intensity across jurisdictions (including in the use of on-site inspections, horizontal reviews and ongoing dialogue with firms as instruments of active supervision) and in supervisory actions (e.g. formal/informal enforcement procedures) in response to findings on firms' compensation practices. Supervisory findings indicate a number of areas for improvement by firms – in particular, governance, identification of material risk takers (MRTs), risk alignment and ex post adjustments. Embedding good practice is an ongoing long-term process, and supervisors believe there is value in comparing approaches across the industry and jurisdictions, and continuing to provide incentives for firms to refine their practices.

3. ***Almost all authorities assess the level of implementation by significant banks in their jurisdiction as being medium or high***. No major changes to the structure of compensation for significant banks are reported; their practices are generally assessed by supervisors as aligned with the P&S. In the EU, some changes in compensation structures are expected in the future due to the implementation of CRD IV. This includes a higher number of MRTs identified by firms; a move by a number of firms to a higher proportion of fixed pay for MRTs in some business areas; and the introduction of new forms of remuneration (which are currently under scrutiny by European authorities) in response to the cap on the ratio of fixed to variable pay. Several jurisdictions outside the EU are monitoring the potential impact and competitive effects of these changes.

4. ***All authorities report that significant financial institutions have continued to improve their governance frameworks for compensation, and better practices are observed in terms of ex ante risk adjustment of compensation to reflect risk-taking***. Some challenges in the area of effective risk alignment remain, in particular the application of risk metrics to the business unit or at the specific product and activity level, as well as at the individual level; a more transparent and consistent application of policies and procedures to guide the use of discretion; and the availability of better data to support the effective alignment of compensation with prudent risk-taking behaviour. Although the majority of authorities assess disclosure by significant institutions as satisfactory and compliant with the Basel III Pillar 3 principles on disclosure of compensation practices, a few authorities have indicated scope for enhancement. In particular, comparing information across firms continues to present challenges due to uncertainties surrounding the reliability of underlying data and differences in business models and regulatory requirements. Some authorities have emphasised the need to encourage firms to use plain language and more graphs and charts to make disclosures more understandable and comparable across firms.[1]

5. ***There remain significant differences among jurisdictions in the approach to, and implications of, identifying MRTs***. Important differences remain, in particular, in terms of whether to treat MRTs only individually or as "groups of risk takers" and the extent to which staff in control functions should be included in the MRT definition. A key observation is that it is not just differences in the regulatory approach which lead to potential non-level playing field issues but also, and perhaps more critically, differences in what the implications are of being identified as an MRT. These differences make it difficult to compare the effective treatment of MRTs across firms, including in terms of the number of identified employees per firm/geography/business line.

6. ***As regards ex post performance adjustment, progress is more evident on the use of malus than clawbacks***. Some jurisdictions continue to cite legal impediments (mainly labour law and tax-related) to the adoption of clawbacks. Moreover, the effectiveness of both malus and clawback clauses depends in part on the proportion of pay that is variable, and there appears to be wide variation among jurisdictions on the extent of variable pay that is: a) required; b) subject to deferral; and c) "at risk" under a malus or clawback mechanism. Progress is apparent in the continued refinement of triggers, as institutions are using a wider range of malus triggers (i.e. not just financial) and recognise that they do not need to wait for behaviour that justifies legal termination to make appropriate ex post conduct compensation adjustments. Despite these challenges, supervisors and firms share the view that proper application of malus and clawback clauses is important for incentivising prudent risk-taking behaviour. There is also an emerging consensus on what constitutes key success factors. These include: a) increasing pay at risk and ensuring that the periods for vesting and "look backs" are long enough, going beyond three years where possible; b) ensuring that the triggers and thresholds for malus and clawback clauses are not set so high as to be unrealistic or to fail to have an impact on behaviour; c) focusing on how an institution makes decisions on the application of malus and

[1] Standardised disclosure formats have been adopted in some cases, for example in the EU with the publication of the guidelines and results for the data collection exercise on high earners and for the benchmarking exercise, in order to increase the consistency of information collected and thereby benchmark remuneration trends.

clawbacks and strengthening the governance in this area; d) encouraging institutions to revise manager employment contracts and compensation plan documentation so as to explicitly provide for malus and clawback clauses and not to waive these provisions in the event of negotiated termination settlements; and e) working with legislators and other parties to bring more legal certainty or support for clawback clauses.

The FSB, through the CMCG, will continue to monitor and report on the implementation of the P&S. As part of this work, it will organise a roundtable in early 2015 with the industry to analyse trends, exchange views on implementation progress and discuss remaining challenges to effective implementation, particularly in terms of effective alignment between compensation and risk governance frameworks.

In light of these findings, the report identifies the following next steps:

1. More intense and effective supervision of compensation practices

As noted above, there remain important differences among FSB jurisdictions in the frequency and intensity of supervision of firms' compensation practices. The responses also show that those jurisdictions that have advanced furthest in their supervisory activities in this area tend to be the ones reporting the most advancement by their firms in the implementation of the P&S. Jurisdictions that have not undertaken a horizontal review of compensation practices are therefore recommended to conduct such a review to assess the status of practices in their domestic market. Moreover, all jurisdictions should include oversight of compensation practices in their ongoing supervisory cycle, including review of the effectiveness of a firm's compensation system through appropriate quantitative and qualitative indicators, its relationship with the firm's governance framework and its impact on risk-taking behaviour.

2. Linking compensation systems and risk management/governance

The CMCG in its next progress report will focus on the link between compensation structures and firms' risk appetite and overall risk governance frameworks. The work will also consider relevant guidance issued on this topic by the FSB or other standard setters.[2] This will include an examination of the interaction between the compensation function, management, the board of directors, and the risk management and other control functions in decisions concerning variable remuneration. The annual workshop with industry participants will be used to collect and analyse information on better practices in this area.

3. Greater use of malus and clawbacks

Jurisdictions should continue to foster the use of malus and clawback mechanisms by more explicitly requiring these mechanisms and/or increasing supervision of them. Supervisors are encouraged to focus on these mechanisms in assessing compensation practices of firms in their jurisdiction, as was done for example by the UK authorities that have recently issued guidance on the expected application of malus and clawback clauses. Where gaps or deficiencies are noted, jurisdictions should consider explicitly requiring firms to apply back-testing and other means to assess the use and impact of these mechanisms.

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[2] See FSB Principles for an Effective Risk Appetite Framework, November 2013; and FSB Guidance on Supervisory Interaction with Financial Institutions on Risk Culture (A Framework for Assessing Risk Culture), April 2014.

4. Monitoring the impact of compensation-related reforms

The G20 and the FSB have emphasised the need to move from monitoring the timeliness of implementation of internationally agreed reforms to assessing their effects and effectiveness in achieving the desired outcomes. This is particularly relevant in the area of compensation practices given the lack of adequate and consistent public information on the evolution and impact of compensation practices. In order to assist with progress in this area, the FSB – through the CMCG – will build on existing findings and explore the use by supervisors, firms and third parties (e.g. consultants) of metrics and other indicators to monitor the effective risk alignment of compensation structures for significant institutions.

5. Taking stock of compensation practices for significant insurance firms

Implementation monitoring of the P&S to date has focused primarily on banking institutions, while much less information is available on compensation structures for other sectors. However, increased attention is being given at the international level to the risks stemming from significant non-bank financial institutions. The CMCG will assist in this process by organising, in collaboration with the International Association of Insurance Supervisors, a workshop in 2015 to discuss compensation practices for significant insurance firms and presenting the findings in its next progress report.

6. Follow-up work on MRTs

The identification of MRTs remains central to effective compensation regimes and is an area on which the CMCG will continue to focus. In particular, the CMCG will work to further clarify what constitutes better practice in areas such as the identification and treatment of control functions and/or senior executives as well as the issue of "groups of risk takers" or "collective risk takers". Given the important regulatory changes recently introduced in the EU, this follow-up work will be initiated from mid-2015 onwards so that it can build on the most recent findings on regulatory developments and market impact.

I. Introduction

At the 2011 G20 Summit in Cannes, the Leaders called on the FSB to "undertake an ongoing monitoring and public reporting on compensation practices focused on remaining gaps and impediments to full implementation [of the *FSB Principles for Sound Compensation Practices* and their *Implementation Standards* (P&S)] and carry out an ongoing bilateral complaint handling process to address level playing field concerns of individual firms."[3] To undertake this monitoring, the FSB established in early 2012 a Compensation Monitoring Contact Group (CMCG) comprising national experts from FSB jurisdictions with regulatory or supervisory responsibility for compensation practices. The CMCG is responsible for monitoring and reporting on national implementation of the P&S. The monitoring exercise is based primarily on responses to a questionnaire prepared and compiled by CMCG members. The FSB also established the Bilateral Complaint Handling Process (BHCP), which is a mechanism for national supervisors from FSB jurisdictions to bilaterally report, verify and, if needed, address specific compensation-related complaints by financial institutions based on level playing field concerns[4].

The FSB reported on the results of its annual monitoring exercise in progress reports published in June 2012 and in August 2013. These reports confirmed that achieving lasting change in behaviour and culture and effectively aligning compensation practices with prudent risk-taking is a long-term challenge, and recommended further actions for the FSB, supervisory authorities and firms towards consistent and effective implementation of the P&S. In particular, the 2013 progress report found that, while good progress had been made, more work was needed to embed positive risk management in firm's compensation practices and to achieve effective alignment with risk and performance. The reports also recommended that the FSB promote the sharing of experiences among supervisors and firms, particularly in areas where implementation challenges could hinder the effectiveness of the P&S in incentivising sound compensation practices and prudent risk taking behaviour.

This progress report summarises the main findings of responses to the annual monitoring questionnaire, providing information on recent actions and initiatives by FSB jurisdictions to implement the P&S since the August 2013 progress report. It also incorporates the results of a survey conducted in late 2013 regarding material risk takers (MRTs) and malus/clawbacks, and the findings of the second FSB workshop with private sector participants held in April 2014.[5] The workshop focused on three areas: the identification and treatment of MRTs; the use of malus and clawback clauses as part of the alignment of compensation with risk taking and performance; and governance frameworks, including the role of compensation structures in supporting a sound risk and compliance culture at financial institutions. The workshop

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[3] See http://www.financialstabilityboard.org/implementation_monitoring/g20_leaders_declaration_cannes_2011.pdf.

[4] To date, no BHCP complaints have been filed.

[5] Officials from FSB member organisations participating in the FSB CMCG and senior executives mainly responsible for remuneration, primarily from global systemically important banks (G-SIBs), participated in the workshop.

findings, published on the FSB website[6], are incorporated in this third progress report, which also focuses on key implementation challenges and evolving practices in the above areas.

The report is structured as follows. Section II describes the overall progress made by national authorities in implementing the P&S since the 2013 progress report as well as recent regulatory initiatives and supervisory oversight and actions. Section III outlines the status of implementation by firms, including observed trends in compensation structures and developments in alignment of compensation with ex ante risk taking, firms' disclosure and governance arrangements around compensation. The section also reports on the supervisory authorities' assessment of firms' compensation practices. Section IV reports on the findings of the stock taking analysis on identification of MRTs and use of malus and clawback clauses.

II. Implementation by national authorities

1. Adoption of the P&S in national regulation and supervisory guidance and recent regulatory initiatives

All FSB jurisdictions report that they have now fully, or almost fully, implemented the P&S through regulation or supervision (see Annex A). Argentina reports having completed the implementation process over the past year, with the Board of Directors of the Central Bank (which is also the supervisory authority) having issued a Communication that incorporates the provisions set forth in the FSB standards on risk alignment.[7] In Indonesia, even though the regulation or supervisory guidance for banks does not include provisions focusing explicitly on risk alignment (Principles 5-7 and Standards 4-14),[8] the authorities report that several major banks have aligned their remuneration with risks and have included some forms of malus and clawback clauses in compensation arrangements. In Turkey, several standards on risk alignment are not yet implemented in the regulation (7, 8, 9 and 14) and they are not compulsory for all banks. Supervisors, however, expect banks to take the principles stated in the regulation into account when designing their internal systems and procedures, and any implementation gaps are considered in the overall supervisory rating.[9]

A few implementation gaps remain for some jurisdictions due to legal and other constraints (see Annex B). In particular, some jurisdictions have not implemented one or a few selected standards on risk alignment (Standard 10: Argentina, Brazil, China, South Africa; Standard 12: India; Standard 14: Brazil, Indonesia, Turkey). Some are due to labour law issues (e.g. Standard 10 in Argentina and Brazil), while others are due to non-applicability of the relevant

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6 See http://www.financialstabilityboard.org/publications/r_140627.pdf.

7 The implemented standards are: 5 (partially), 6, 7, 8, 9, 12 and 14. Only one standard (10) has not yet been implemented, as clawback clauses are still not possible under the local legislation.

8 The 2013 Progress Report noted that the Indonesian regulation on corporate governance for banking, amended in early 2013, covers some elements of the P&S and also requires the regular submission by banks to the supervisory authority of data on remuneration structures. Moreover, a regulation issued in 2014 on corporate governance for insurance companies mentions the obligation to implement remuneration systems that encourage prudent behaviour.

9 In addition, the Capital Markets Board of Turkey issued a regulation on corporate governance in January 2014 applying to all listed companies, under which the P&S should be implemented on a comply-or-explain basis.

standard in the jurisdiction (Standard 12 in India). In Switzerland, although the regulator has not issued specific guidance on standard 14 (anti-hedging), it reports that the standard is met in substance by significant banks. The US reports that it is in the process of adopting standard 15 on disclosure and that, given other provisions, the level of bank disclosures is already very granular and much of the information required by the BCBS Pillar 3 guidance is already disclosed by major banks; however, some disclosure gaps are evident, such as on the number of MRTs by bank.

Several other FSB jurisdictions have made further changes to their regulatory framework on compensation practices over the past year. Australia changed the scope of the regulation to include superannuation trustees and executives, while Mexico extended the application of the P&S to regulated non-banks. Hong Kong introduced legislative amendments requiring locally incorporated institutions in the banking sector to report on their compliance with the disclosure requirements set out in the P&S, while the P&S are also now being incorporated in the guidance on corporate governance of authorised insurers. In Russia, new supervisory guidance is being prepared to complement the existing regulatory framework. This guidance, which includes provisions on assessing financial incentives via risk management indicators, is expected to enter into force in January 2015 and to be used to conduct annual assessments of compensation systems for credit organisations.

In Europe, in addition to developments in the European Union (EU) (see below), the UK issued guidance in October 2013 on the application of malus to variable remuneration; following consultation on the application of clawback, it has introduced a rule which will come into force from 1 January 2015; and it consulted in July 2014 on proposals to take forward the remuneration recommendations in the 2013 report of the Parliamentary Commission on Banking Standards.[10] In mid-2014, Italy issued a set of recommendations requiring all listed companies (including banks) to give more specific information on the payments made in case of early termination of a contract of a member of the management body ("golden parachutes" and other benefits); the information requirement adds to the already existing disclosure requirements for all listed companies and the Bank of Italy Pillar 3 disclosure requirements for banks.

In the US, several new regulations were issued in 2013 that include provisions on compensation generally and incentive compensation specifically, most of them as a result of the Dodd-Frank Act's statutory requirements.[11]

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[10] See: http://www.bankofengland.co.uk/pra/Documents/publications/policy/2013/appofmalusss2-13.pdf, http://www.bankofengland.co.uk/pra/Documents/publications/policy/2014/clawbackcp6-14.pdf, http://www.parliament.uk/documents/banking-commission/Banking-final-report-volume-i.pdf and http://www.parliament.uk/documents/banking-commission/Banking-final-report-vol-ii.pdf. See also http://www.bankofengland.co.uk/pra/Documents/publications/ps/2014/ps714.pdf and http://www.bankofengland.co.uk/pra/Documents/publications/cp/2014/cp1514.pdf.

[11] These are: the Volcker rule, including provisions on compensation; the Loan Originator Compensation requirement, which includes a prohibition against compensation based on the terms of transaction; and the Enhanced prudential standard for BHC and FBOs, which includes a requirement that a global risk management framework must have "processes and systems to integrate risk management and associated controls with management goals and its compensation structure for its global operations. See section 619 of the Dodd-Frank Act (the Volcker Rule) – http://www.federalreserve.gov/newsevents/press/bcreg/20131210a.htm; Loan Originator Compensation Requirements (Regulation Z) at https://www.federalregister.gov/articles/2013/02/15/2013-01503/loan-originator-compensation-requirements-under-the-truth-in-lending-act-regulation-z; (Certain amendments) http://files.consumerfinance.gov/f/201309_cfpb_titlexiv_updates.pdf; and the Enhanced Prudential Standards for Bank

As noted in the 2013 progress report, one notable regulatory development has been the adoption by the EU of CRD IV – the European directive enacting Basel III – which came into effect on 1 January 2014 and includes specific requirements on compensation structures that go beyond those found in the P&S. All FSB jurisdictions that are EU member states have enacted or are in the process of enacting the legislative provisions implementing CRD IV, while the associated Regulatory Technical Standards (RTS), prepared by the European Banking Authority (EBA) and adopted by the European Commission, are directly applicable. The package modifies the rules relating to:[12] i) the structure of the remuneration of MRTs (e.g. introduction of a limit on the ratio of variable/fixed remuneration); ii) the quantitative and qualitative criteria for the identification of MRTs;[13] iii) remuneration requirements for specific categories of staff members (e.g. control functions); and iv) the public disclosure of information on the remuneration policies adopted by banks and banking groups and their practical implementation during a given financial year. EU jurisdictions are also annually involved in the EBA data collection on compensation policies and practices, focusing on MRTs and persons remunerated with particularly high amounts (so-called high earners). The EBA has recently amended the guidelines on the basis of which the data is collected and reported, in order to achieve more granular and homogenous figures.[14]

In some FSB members that are EU member states, additional regulatory provisions governing compensation practices are also being proposed. Italy is introducing additional rules for the banking sector on top of those provided for in the CRD IV to strengthen the current banking regulation on remuneration. In the Netherlands, the Finance Minister has published a proposal for a new law that, if approved by parliament, will introduce an overall cap on variable remuneration of 20% of fixed remuneration starting from 1 January 2015. This is a significantly more stringent cap than the minimum 100-200% required under CRD IV rules. It also implies a differentiation between banks operating within the Netherlands, as the 20% cap is proposed to apply to all domestic and foreign banks but not to the Dutch branches of EU member states' banks, which will have to comply with the required cap as implemented in the national law of their home countries.

Several jurisdictions also modified the application of the proportionality principle and the definition of thresholds to identify the major institutions in scope. In one case (Italy), this change was aimed at aligning the proportionality thresholds with the one indicated by the European Central Bank (ECB) to identify significant banks (e.g. 30 billion euro of total assets).

Holding Companies and Foreign Banking Organizations (12 CFR Part 252) – http://www.federalreserve.gov/aboutthefed/boardmeetings/memo_20140218.pdf. Several disclosure regulations were also proposed or finalised (see section 4 below for additional detail on these disclosure regulations).

[12] For more information and related references, see the 2013 progress report.

[13] See http://www.eba.europa.eu/regulation-and-policy/remuneration/draft-regulatory-technical-standards-for-the-definition-of-material-risk-takers-for-remuneration-purposes. The RTS has been adopted by the European Commission by Commission Delegated Regulation (EU) No 604/2014 of 4 March 2014 (OJ L 167/30 of 6.6.2014).

[14] See http://www.eba.europa.eu/regulation-and-policy/remuneration/guidelines-on-the-remuneration-benchmarking-exercise.

2. Supervisory monitoring and action

As already observed in 2013, most FSB jurisdictions are now actively supervising compensation practices. Several jurisdictions have included the assessment of such practices within the regular supervisory cycle (Australia, Brazil, Canada, France, Germany, Hong Kong, India, Italy, Korea, Japan, Mexico, Netherlands, Saudi Arabia, Singapore, Spain, Switzerland, Turkey, UK, US). The assessment process on compensation policies is usually considered in the evaluation of firms' corporate governance.

Several authorities also carry out on-site audits and inspections dedicated to compensation issues (Argentina, Brazil, Canada, France, Germany, Italy, Mexico, Saudi Arabia, Spain, Turkey). Several authorities (Canada, Italy, Netherlands, Singapore, Switzerland, US) report that they have regular meetings with the board and senior management members or human resource directors of major firms to discuss and assess compensation practices and for insights and updates on their experience in implementing the P&S.[15] In India, the compensation structure of the Chief Executive Officers (CEOs) is formally approved by the regulator.

The objects of supervisory examinations include: evaluation of the adequacy of compensation risk adjustments; evaluation of the role and activities of the board and board level committees as well as control functions in the development and revision of compensation programs; reviews of annual disclosure to assess compensation trends; and detailed reviews of compensation structures for key personnel or lines of business, including performance objectives and deferral arrangements. In all cases, the supervisory activity extends also to local branches or subsidiaries of foreign institutions, with the aim of examining compliance with local regulation but also the implementation of group compensation policies at the local level.[16]

A number of jurisdictions (e.g. Argentina, Brazil, Germany, Hong Kong, Italy, Singapore, US) have conducted horizontal dedicated reviews of compensation practices over the past year, and are following up on the findings. These reviews are carried out to take stock of the status of implementation and compliance with local requirements or to better assess the appropriateness of compensation arrangements and practices.

Germany carried out dedicated audits of the 15 largest banking institutions, focusing on remuneration systems as part of the risk management system. Special audits also took place in foreign subsidiaries of German institutions and domestic subsidiaries of foreign institutions.

In Hong Kong, the horizontal review also covered subsidiaries of banking groups and branches of overseas-incorporated banks. It found insufficiently clear criteria to identify MRTs in a few medium-sized institutions, and a lack of deferral arrangements or non-

[15] In the case of Switzerland, this includes discussions on the proposed use of innovative instruments and reviews of their capital and liquidity implications during the bonus round.

[16] There are some exceptions: in Korea and the Netherlands, the supervisory activity does not extend to branches or foreign banks in the jurisdiction. In Switzerland, the remuneration circular applies to branches of foreign banks which are "mandatorily included in consolidations". In Singapore and Spain, the supervisory activity does not extend to branches or subsidiaries. Singapore plans to extend its supervisory activity to the subsidiaries of foreign banks with significant local presence shortly.

correspondence of ex post risk adjustments to the employees' seniority and responsibility in a small number of foreign intermediaries. Follow-up off-site monitoring will examine the remuneration structure of MRTs in the main business divisions, the role played by risk and control functions in variable remuneration allocation, and the application of malus and clawback to incentive awards.

In Italy, based on the analysis of paid "golden parachutes", a formal request was sent to those banks deemed not to be fully aligned with the rule that compensation related to such payments should: i) be linked to performance achieved and risks taken over time by the staff member to whom the golden parachute is granted; and ii) comply with the provision on deferral and ex post risk adjustment. A survey was also carried out on the pay structure of the CEO and general managers of small and medium-sized banks, with the assessment still underway.

In the Netherlands, a specific, detailed review is being conducted on the relationship between key performance indicators, variable remuneration, and liquidity risk management. Findings are expected in the third quarter of 2014.

The US conducted a horizontal line of business review focusing on middle market commercial lending and a "monitoring and validation" review of 2011 compensation arrangements. The latter required firms to conduct an analysis of the relationship between incentive compensation awards, measures of risk taken and financial performance. More sophisticated firms were encouraged to use back testing and a statistical approach. The supervisory authority expects to finalise additional supervisory expectations as a result of this exercise.

The supervisory assessment of remuneration practices is used in many cases as an input into the grading of the institutions' overall risk profile or of their management, risk governance and controls system. The inclusion within the risk governance grading is the prevalent approach (Australia, Brazil, Canada, Germany, Indonesia, Italy, Netherlands, Singapore, Spain, US), although there is typically no separate grading for the incentive compensation system.[17] Several authorities collect compensation data as part of their supervisory assessment (Canada, Saudi Arabia, Switzerland, US, EU jurisdictions). Some authorities also monitor various indicators, statistics, or aspects of firms' compensation structures in order to help complete the overall qualitative assessment of the remuneration practices of a bank (France, Singapore, Switzerland, US). However, in most cases no specific (quantitative) indicators of effectiveness have been developed by supervisors and many qualitative considerations are

[17] Some examples of the assessment process are as follows: in Italy compliance is assessed with specific reference to three macro areas: i) design approval and control process of compensation policies; ii) the compensation structure and its effectiveness in terms of alignment to risk and performance; iii) internal transparency and disclosure to the public. The Netherlands follows a similar process to derive a measurement of the impact of compensation policy and practice on the total risk profile. In Hong Kong, the supervisor of the banking sector assesses as part of the Pillar 2 review whether institutions have actively considered the operation of the remuneration systems as part of their capital planning processes and have adopted appropriate practice for making remuneration awards sensitive to risk taking. Singapore requires domestic banks to submit compensation-related indicators relating to MRTs, bonus pools and deferrals, and compensation instruments. Switzerland reviews factors such as the affordability of variable remuneration and alignment with economic performance. In the UK, all Level 1 firms (i.e. 18 firms that are considered the most significant within the scope of the remuneration code) must submit to the supervisor an annual Remuneration Policy Statement, which is reviewed to assess firms' compliance with the Remuneration Code; the supervisory authority then issues a "sign off" template that records the final assessment of compliance, which enables institutions to proceed with paying the annual bonus round.

considered helpful in assessing the remuneration systems of companies.[18] In the EU, jurisdictions also collect information annually under the EBA data collection exercise; in some cases, the EBA has required further information based on reported data and national authorities have taken actions where deficiencies have been observed.

The results of the implementation monitoring exercise show that those jurisdictions which have a proactive supervisory approach have effected real change in firms' practices. This reinforces the need and provides support for other jurisdictions to take a similar approach.

Supervisory findings also suggest that there remain a number of areas for improvement (governance, identification of MRTs, risk alignment, ex post adjustment for performance). In particular, gaps continue to be identified for smaller institutions and in some cases for foreign intermediaries operating in the jurisdiction.[19] Some jurisdictions report gaps relating to: i) the scope of application of the provisions on compensation, including the discretionary use of proportionality criteria; ii) the (lack of) identification of MRTs below the first and second level of management and directors as well as other personnel whose operative and decision making profile impose risks on the firms and the group as a whole; iii) lack of transparency in the frameworks for applying risk adjustment; iv) insufficient articulation of risk appetite statements and alignment of compensation programs with risk appetite measures, such as the lack of inclusion of all relevant risks and consistency with risk appetite framework (RAF) metrics; v) governance issues, such as the composition and expertise of the members of remuneration committees as well as excessive discretion granted to the CEO and senior management for the assessment of bonuses (including their own); and vi) disclosure of compensation practices.

Supervisory authorities have followed up on these findings by requiring remedial actions before any formal enforcement procedures are taken. In a few instances, formal supervisory actions have been launched. In Canada, for example, the supervisor issued formal recommendations to domestic systemically important banks to enhance their RAF by addressing, among other things, the alignment of compensation programs. Sanctions were imposed in Mexico following a dedicated set of inspections on a sample of banks, brokerage firms and regulated non-banks. In Saudi Arabia, supervisory action included revisions in the identification of MRTs, changes in the terms of reference of the board remuneration committee, and changes in bonus pools.

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[18] Russia uses an "indicator of staff financial motivation risk management", which contributes to the supervisory evaluation of management quality and overall economic standing. One of the indicators describing the quality of governance is based on the assessment of various aspects of the bank's compensation system, i.e. how boards of directors (supervisory councils) of banks oversee the compensation system's design and operation and ensure the adequacy of the compensation system to the bank's strategy, nature of business and range of activity; whether effective alignment of compensation policy with prudent risk taking is ensured; the organisation and operation of the bank's internal control system; and the disclosure of compensation practices.

[19] It is worth keeping in mind, however, that the P&S are meant to apply to "significant" institutions.

III. Implementation by firms: overall assessment, challenges and evolving practices

1. Overall assessment of implementation by firms

Almost all authorities assess the level of effective implementation of the P&S by "significant financial institutions" in their jurisdiction as being medium or high, and are satisfied that the implementation level is in line with the regulatory requirements.[20] This is true in particular for those authorities that have initiated the active supervision of compensation practices earlier. Most authorities, while assessing the level of implementation as high, believe that there is room for improvement in some areas, as evidenced by the supervisory findings described above. In other jurisdictions that have only recently begun implementation and may have not yet adequately communicated supervisory expectations on these issues, a few exceptions are noted in terms of alignment with the P&S. Turkey reports, for example, that deferred variable compensation is not available or is only limited to senior executives, that all variable payments are made in cash, and that clawbacks are not used. In India, one significant bank reports compensation structures generally aligned with the P&S, but identifies only 6 MRTs out of an overall employee base of more than 70,000 people.

The majority of jurisdictions reported no significant change in the level of implementation by firms since last year.[21] However, a few jurisdictions (Canada, Italy, Germany, Spain, US) report that effective implementation is higher compared to last year due to additional efforts by the relevant firms and enhanced supervisory intensity in this area. Canada reports that its domestic systemically important banks have enhanced their compensation programs and that there is generally a higher degree of awareness of the risk-reward relationship, although there remain areas for enhancement in the integration of risk appetite statements into performance plans. In Italy, the role of risk management in defining and monitoring compensation policies was observed to have been strengthened at the major firms (e.g. in terms of aligning the malus conditions to the limits identified in the firm's RAF). In the US, more employees are now subject to malus and clawback conditions, and those conditions generally cover a broader set of circumstances than in the past as they now include more non-financial performance criteria and a better assessment of actual risks taken. As a result, ex post performance adjustment is seen as working more effectively and for a larger number of employees.

No relevant changes since last year are reported on the structure of compensation (variable pay, deferrals, rate of vesting, types of instruments), which for significant financial institutions is reported in almost all cases to be aligned with the P&S. Some jurisdictions have noted that especially the major firms have moved beyond the features required by the P&S,

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[20] See the 2011 FSB peer review report (http://www.financialstabilityboard.org/publications/r_111011a.pdf) for a list of significant financial institutions covered in this section. That list has remained the same for the purpose of progress reporting, with the exception of Italy (MPS has been removed from the list) and Argentina (HSBC has been added).

[21] In particular, Australia, Brazil, Hong Kong, Indonesia, France, Korea, Netherlands, Saudi Arabia, Singapore reported no significant developments in compensation practices since last year, and no change in the level of implementation. This assessment is based on continued active supervisory monitoring. Argentina and Russia, on the other hand, report not having significant information available to assess developments in the evolution of compensation structures, in both cases because the relevant regulation has just been implemented and its effects have not yet become apparent.

for example by adopting high percentages of performance-dependent variable pay, cliff vesting for deferrals, and longer vesting periods for some of the most senior executives on long-term incentive plans.

Some changes are expected in the future as a consequence of the implementation of CRD IV and the associated RTS. These changes, which will only be possible to assess after the 2014-2015 compensation rounds, relate to: i) the number of MRTs reported by firms, which is expected to be higher in FSB jurisdictions that are EU members (in some of these jurisdictions, the number of MRTs is reported to be already high); ii) the expected move by a number of firms to a higher proportion of fixed pay for MRTs in particular in some business areas (e.g., private banking, asset management); and iii) the introduction of potentially new forms of remuneration (e.g. fixed-pay allowances based on the role and responsibilities of individual employees, without any performance conditions attached)[22] in response to the cap on the ratio of fixed-to-variable pay in CRD IV.

These anticipated changes in compensation structures represent the most relevant development, and several jurisdictions are monitoring their potential impact on compensation practices more broadly, including outside the EU. One non-EU jurisdiction with significant global banks reports that, if fixed pay is increased, its banks would be concerned about the competitiveness of the domestic banking system to attract qualified talent globally and about the increase in fixed pay costs for the industry, which would limit the ability to adjust them downwards should banks' financial performance declines; in such a case, compensation outcomes would also become less symmetric to risk and performance outcomes**.**

Apart from the developments related to the implementation of CRD IV, most jurisdictions do not expect domestic compensation structures (particularly in retail banking) to move toward a higher percentage of fixed pay or otherwise to be affected by the regulation in other countries.

2. Remaining challenges to effective implementation

The 2013 progress report recommended that the FSB continues its dialogue with the industry on challenges to the effective implementation of the P&S. The 2014 implementation monitoring exercise focused on the areas of: a) ex ante risk adjustment; b) governance; and c) disclosure. These areas were further discussed during the April 2014 FSB workshop with the industry, which confirmed improvements in the governance of compensation practices, including better integration of risk and control functions in compensation decision-making by firms. Remaining operational challenges were also highlighted in the workshop, for example: identification of metrics to assess risk-aligned performance; educating board members about compensation-related risk factors and the variety of balancing mechanisms, including robust criteria for the use of malus and clawbacks; and determining the extent of discretion that should be applied by the board and remuneration committee in implementing compensation policies across the firm and over time. Workshop participants also discussed the increasing complexity of compensation structures, partly as a result of different regulatory approaches,

[22] Since such schemes may be seen as a means of circumventing the CRD IV requirements in some circumstances, the conditions under which the EBA consider they would be compatible with EU law are addressed in an EBA report and opinion issued on 15 October 2014. See http://www.eba.europa.eu/-/eba-discloses-probe-into-eu-bankers-allowances.

as well as the need to balance regulatory requirements with shareholder pressure that pay be performance-related. The questionnaire to national authorities further examined evolving practices and implementation challenges in these three areas.

2.1. *Alignment of compensation with ex ante risk taking*

Progressively better practices are being observed among significant institutions in the area of ex-ante risk alignment, with more rigorous risk management and governance provisions, including monitoring and documentation, so as to better reflect risk taking in incentive compensation. Many authorities report increased efforts to link compensation with the firm's risk appetite frameworks, allowing a better and in some cases more granular consideration of risks in the determination and allocation of the bonus pool. One jurisdiction reports that firms used, for the ex-ante risk alignment, risk metrics that are well integrated and recognised in the culture and within current use of the organisation.[23] These better practices in risk alignment are also the result of better articulated governance processes, and improved interaction at the board level between remuneration and risk committees in determining compensation policy, setting performance objectives and informing award and payout decisions. Almost all jurisdictions report an active role for the Chief Risk Officer (CRO) function to ensure better coherence with the RAF and alignment with longer term performance and prudent risk taking. In a number of cases, the CRO function is also actively involved in the design of the compensation system, including the establishment of metrics, specific factors and types of risks to consider for determining employees' compensation.

At the same time, non-financial performance factors or dedicated "risk reviews" are increasingly used for issues such as risk awareness and management performance; conduct and compliance-related objectives and adherence to the firm's risk culture and values; and "relationship" objectives, such as managerial effectiveness and '360 degree' reviews.

Some challenges remain, such as the need for: i) a more rigorous identification and application of risk metrics at the business unit / specific product or activity / and individual level;[24] ii) a more transparent and more consistent application of policies and procedures that help guide the use of discretion; and iii) better data to support the analysis of effectiveness of compensation arrangements and alignment with prudent risk taking behaviour.

As for the use of discretion, better practices typically involve creating a robust governance framework surrounding the use of such discretion. Industry participants at the workshop noted that a judgemental overlay on top of objective approaches for risk alignment might be needed in some instances where other factors play a role (for example, in the case of legacy positions

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[23] Only Korea has expressly indicated that a firm's risk appetite does not have a significant impact on the performance compensation system. Another authority reported instead that RAF plays an important role in structuring compensation programs, as RAF metrics are used to define gate/malus conditions, contribute to the overall amount of the bonus pool, and are included in the individual scorecard of the top management.

[24] One bank on the other hand was reported to have implemented a standardised model to measure the risk-adjusted individual performance, based on NIBBT adjusted by performance relevant contributions and by allocation of contributions from the non-core operating unit. One authority also mentioned as a challenge the use of performance metrics developed based on bank's internal risk models due to the lack of accurate and comparative market-based metrics for benchmarking. One bank has been reported to have implemented a standardised model to measure the risk-adjusted performance of individuals.

reflecting non-performing instruments). A robust governance framework requires that the judgemental overlay is provided in an analytical and transparent manner by an independent function, and possibly by agreeing upfront on the factors that may justify adjustments and by having good governance processes, including for effective challenge and for disclosure to the shareholders and supervisory authority of any material waivers.

In terms of information technology, effective systems are needed in order to use data on compensation and risk within a more integrated framework for back testing and other analysis. Based on the findings of a jurisdiction that has conducted detailed analysis in this area, several challenges remain in terms of addressing existing data gaps (such as at the unit/individual level) and inconsistencies in collected data (such as incomplete performance scorecards or documentation that is not consistently filled out). Other authorities reported remaining challenges for the integration of compensation databases with planning, finance and risk management data. It was also observed that banks are now in the process of complying with the 2013 BCBS principles on risk data aggregation and reporting, which are expected to support risk alignment in incentive compensation programs.

2.2. *Disclosure*

As regards disclosure of compensation practices by significant institutions, most jurisdictions assess it as satisfactory and compliant with the Basel III standards, including the publication of the number of MRTs. All jurisdictions provided links to annual remuneration reports or other publicly disclosed information by significant institutions. The information on compensation is considered by supervisory authorities as being more detailed for CEOs and board members, and in some cases also senior executives, due to the legal requirements for listed firms.

For most jurisdictions, in compliance with the Basel III standards, the information also includes details on the number and pay structure of MRTs. The jurisdictions where the information on the number of MRTs is not publicly disclosed at present are India, Indonesia, Mexico, Turkey, Russia and the US. Mexico and Turkey have assessed their disclosure practices as non-compliant with the Basel III Pillar 3 disclosure requirements on remuneration; Mexico reports that a review on regulatory disclosure requirements will be developed according to the Basel Committee's Pillar 3 Guidance, but taking into account security concerns regarding firms' personnel. Russia has not conducted such an assessment. In Brazil and the US, the regulation implementing the FSB standard on disclosure and the Basel III Pillar 3 requirements on remuneration has not been issued. In Brazil, by effect of other regulation in place, financial institutions are already required to disclose several pieces of information regarding the remuneration of key persons, including the main aspects of Standard 15. In the US, authorities report that existing disclosure is extensive for large US-headquartered firms because they are subject to the SEC's disclosure requirements for publicly listed firms; proxy statements provide large amounts of annual information about executive remuneration, in particular with respect to "named executive officers" (which

however do not represent the full cohort of MRTs) as well as robust information on broader compensation structures, governance and risk-related issues.[25]

In the EU, the CRR goes beyond the P&S and the Basel III requirements, in particular by requiring disclosure on the ratio between fixed and variable remuneration, the number of individuals earning remuneration above 1 and 5 million euros, and based on demand from the Member State or competent authority, the total remuneration for each member of the management body or senior management. The EBA also publishes the results of a benchmarking exercise aggregating data and showing trends on the number of MRTs by business line, the detail of their remuneration, and the amount of remuneration subject to deferral, malus and clawback.[26, 27]

Several jurisdictions where the disclosure standard and the Pillar 3 guidance have been implemented also actively supervise disclosure by significant financial institutions, in some case within the annual supervisory reviews (Australia, Canada, France, Hong Kong, India, Italy, Korea, Saudi Arabia, Singapore, Spain, Switzerland). Although most authorities report that the level of informativeness, detail, and comparability of information is generally high, a few of them note that the information disclosed to the public still shows gaps and there is consequently scope for enhancement.

Authorities have identified better practice in cases where information is "available, easy to find, clear and not ambiguous". One jurisdiction indicated that an example of best practice is that of a bank including examples of performance targets by instrument of fixed and variable

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[25] According to the US authorities, extensive regulation for listed firms ensures that a large set of the information required by the Basel III's Pillar 3 standard is disclosed; additional information is also disclosed, such as for example about the relationship of the firm's compensation policies and practices to risk management, if risks arising from such policies and practices are reasonably likely to have a material adverse effect on the company. While the situations requiring disclosure will vary depending on the particular registrant and compensation policies and practices, situations that may trigger disclosure include, among others, compensation policies and practices: at a business unit of the company that carries a significant portion of the registrant's risk profile; at a business unit with compensation structured significantly differently than other units within the registrant; at a business unit that is significantly more profitable than others within the registrant; at a business unit where compensation expense is a significant percentage of the unit's revenues; and where such policies and practices vary significantly from the overall risk and reward structure of the registrant, such as when bonuses are awarded upon accomplishment of a task, while the income and risk to the registrant from the task extend over a significantly longer period of time. In addition, compensation disclosure provisions recently enacted include the adoption of exchange listing standards to address the independence of the members of a compensation committee; the committee's authority to retain compensation advisers; the committee's consideration of the independence of any compensation advisers and responsibility for the appointment, compensation, and oversight of the work of any compensation adviser. The SEC also amended proxy disclosure rules to require new disclosures about companies' use of compensation consultants and conflicts of interest and plans to issue proposals to implement the following sections of the Dodd-Frank Act: Section 953(a), requiring disclosure of the relationship between "executive compensation actually paid" and the issuer's financial performance; Section 954, calling for exchange listing standards requiring issuers to adopt and disclose clawback policies for recovering from current and former executive officers, and Section 955, requiring disclosure regarding employee and director hedging practices. Finally, the proposed SEC regulation on pay ratios would require the disclosure of the median of the annual total compensation of employees and some pay ratios between minimum and maximum remuneration and the median (see http://www.sec.gov/rules/proposed/2013/33-9452.pdf). The proposals would apply generally to public companies other than emerging growth companies, smaller reporting companies, and foreign private issuers.

[26] See details on the EBA benchmarking exercise reported in the 2013 progress report, and the EBA remuneration benchmarking report 2010 to 2012, available at http://www.eba.europa.eu/documents/10180/534414/EBA+Remuneration+benchmarking+report+2010+to+2012.pdf.

[27] One jurisdiction noted that domestic banks will be encouraged to publish more granular information on individual executive performance when compliance with the P&S among regional banks becomes more harmonised, and such disclosures do not result in significant competitive disadvantage in business retention.

remuneration per type of activity and business line. Another jurisdiction noted the issue of potentially overlapping and redundant disclosure requirements as a potential challenge to clear disclosure practices. Some authorities have emphasised the need to encourage the use of more plain language and more graphs and charts, particularly if comparable from year to year and showing historical trends, in order to make disclosures more understandable and comparable across firms. Other authorities favour the adoption of standardised information disclosure formats, in order to increase comparability at the international level.

2.3. *Governance*

Governance is assessed by both firms and supervisors as the area with most tangible improvements in recent years. All jurisdictions report that significant financial institutions in particular have continued to improve governance frameworks, with: i) a more active role for the board of directors in establishing compensation policies, overseeing their implementation, and deciding on compensation structures for senior executives and MRTs; ii) the establishment of remuneration committees composed in most cases of independent directors and supporting the board in setting up and reviewing the policies, including their effectiveness; iii) progressively greater involvement of control functions. In particular, discussions at the industry workshop indicated a more prominent role for independent risk reviews in compensation processes, and a greater awareness of the importance of working effectively with control functions in making compensation-related decisions.

Control functions are reported as generally becoming more independent and more conscious of compensation risk. Their own pay is generally reported as linked to performance indicators appropriate for their functions and independent of business results.

Almost all authorities report progressively greater interaction between remuneration and risk and other committees, sometimes with overlapping membership, to design compensation plans and the criteria for risk performance. This has contributed to the development of internal processes to review how remuneration and performance metrics support their desired risk taking behaviour, including risk appetite and risk culture. One authority reports that the remuneration committees at domestic banks discuss the risk mitigation mechanics and arrangements embedded within key incentive programs, as well as the adequacy of the bank's resources to monitor and manage the risk related to the bank's compensation programs.

Notwithstanding this, discussions with the industry have confirmed that effective risk governance that delivers compensation fully consistent with the firm's risk appetite framework still present challenges, and that it takes time for board members to acquire the experience and full understanding of risk-related aspects of compensation in order to appropriately assess the extent to which compensation packages are effectively aligned with risk and to appropriately utilise discretion.

IV. Findings on MRTs and malus and clawbacks

The FSB's Implementation Standard 6 calls on jurisdictions to identify "senior executives as well as other employees whose actions have a material impact on the risk exposure of the firm (MRTs)." As noted in the 2013 progress report, the identification of MRTs is an area where a

broad range of practice continues to exist, in part due to differences in national regulation and supervision, and in part because of differences in size, nature or complexity of institutions subject to those regulations. It is not yet clear whether such diversity of practice is leading to significantly different outcomes, or indeed which approaches are most "effective". The 2013 progress report, by recognising existing differences in approach and points of view, recommended that the FSB survey and compare the range of practice in this area across its membership, with a view to identifying good practices while recognising firms' differences and the need for proportionality. In order to address remaining challenges and make progress in assessing effectiveness, the report also recommended that the FSB continues to promote good practices among supervisors and firms, particularly in areas such as the use of malus and clawbacks. Following these recommendations, a dedicated stocktaking exercise was conducted on progress in the area of identification of MRT and on the application of malus and clawbacks. The main findings from this exercise are described below.

1. Material risk takers

The methodologies for identifying MRTs differ across jurisdictions. In most jurisdictions, identification is largely the responsibility of individual firms, albeit with guidance, oversight and monitoring from regulators/supervisors. Several jurisdictions provide detailed guidance (Australia, Brazil, France, Hong Kong, India, Italy, Japan, Netherlands, Spain, United Kingdom);[28] others use a principles-based approach (Canada, Singapore, Saudi Arabia, Switzerland, United States, Germany), while some do not provide any specific guidance.

Examples of each type of approach yield different numbers (both large and small) of MRTs across firms, implying that the substance of the requirements is more important than the approach used. It is not differences in the regulatory approach alone which leads to potentially non-level playing field issues but also, and perhaps more critically, differences on the implications of being identified as an MRT. Within an institution, typical implications include a greater level of oversight and more focus on performance assessments, as well as application of specific regulatory standards relating to variable remuneration (such as higher ratio of pay at risk, longer deferral periods, application of malus and requirements on form of payment such as shares). Some jurisdictions indicated the requirement for an annual "risk review" covering MRTs or mandatory risk-related scorecard components, while others pointed to increased documentation and governance requirements.

In terms of supervision and/or regulatory oversight, being identified as an MRT typically invokes higher levels of supervisory oversight and monitoring (including on-site assessments, requests for information and reviews of individual remuneration policies), disclosure obligations, and coverage by potential enforcement actions.

Jurisdictions cited a wide range of internal criteria used by institutions in the identification of MRTs; generally, larger firms have more complex systems to identify MRTs. Criteria included: role (e.g. level of seniority), remuneration (variable and/or fixed) and

[28] Going forward, the identification of MRTs by institutions in the EU will be subject to the EC's Delegated Regulation providing regulatory technical standards on the identification of categories of staff whose professional activities have a material impact on an institution's risk profile.

responsibilities (e.g. control function roles, material risk taking, membership in specific business units or committees, authority to design and approve products, ability to impact a firm's capital and liquidity positions including the wider business group). The majority of firms use a group-wide approach to ensure consistency across all operating jurisdictions. The most consistent focus tends to be individuals with capacity to significantly impact the risk profile of a firm. Categories of individuals most commonly identified include: i) employees at a defined organisational level and above; ii) employees who are managing a business; iii) employees based on the type of risk they are permitted to take; and iv) key employees in control functions, such as legal, internal audit, risk management and human resources. More generally, industry participants at the FSB workshop indicated that the process to identify MRTs has evolved from a "broad stroke" approach to being more refined and articulated, with better understanding by both employees and managers of the identification process, the role of risk within that process, and the implications of identification on compensation structures.

While not all jurisdictions provided information on this issue, it is clear that there are differences on whether the focus is on inherent or residual risk when identifying MRTs, i.e. whether the impact of control structures should affect the assessment of actual risk for identification purposes (some jurisdictions consider risk before the application of controls).

With regard to the output of identification methodologies, not all jurisdictions provided the total number of employees identified as MRTs. In terms of the average percentage of total employees typically identified as MRTs at "significant" firms, responses ranged from 0.01% of employees of the global consolidated organisation to more than 5%.[29] This number varied between but also within individual jurisdictions and institutions as a result of factors such as the number of institutions surveyed, institution size, and nature of business.

One key difference is whether jurisdictions consider "groups" of risk takers when identifying MRTs. Approximately one third of the jurisdictions referenced "collective risk takers" in their submissions. While similar in concept, the definition of "groups" of MRTs is not the same as the one used by, for instance, Australia and the US. Switzerland, which has no definition for collective risk taker, allows consideration of whether a cluster of risk takers shares commonalities that would merit additional oversight.

Taking into account the various definitions of "group" or "collective" risk takers, among the positions most often covered in this category were: traders (e.g. financial market, fixed income, global equity, commodity etc.); commissioned sales personnel; group treasury; revenue generators within an identified business unit; committee members (such as credit committees); mortgage originators; and commercial lenders.

Another key difference lies in the treatment of control functions, since not all jurisdictions indicated which functions were considered in their definition of "control", or provided information on the ratio of control functions to total MRTs. Where ratios were provided, they varied widely (from 0.06% to 26% of total MRTs as a percentage of employees of the global consolidated organization).

[29] However, it is not clear from the responses whether "group of material risk takers" are considered in all cases in the numbers provided, making a comparison difficult.

2. Malus and clawbacks

There is increasing acceptance by the firms of ex post adjustments as a way to influence risk behaviour and promote longer-term performance. There appears to be general consensus that malus and clawback mechanisms should exist and apply to the variable remuneration of all senior executives and other important decision-makers. However, the findings from the stocktaking exercise as well as discussion with industry suggest comparatively more progress in the use of malus adjustments than clawbacks. For example, submissions suggested that over 80% of reporting jurisdictions now require malus mechanisms. Further, even where not required, jurisdictions report an increase in the number of institutions operating in their country that have malus mechanisms in place. Progress on mechanisms to enable clawbacks, however, appears less pronounced. Less than half of the jurisdictions have mandated the adoption of clawback provisions, and only 20% report seeing an increase in use of these clauses by their institutions.

Supervisors and institutions do not report major legal obstacles related to the use of malus mechanisms, but many report local legal challenges that impede wider applicability of clawback clauses. These stem primarily from labour and tax law considerations as well from the costs involved when an employee brings a challenge to court.[30] Despite legal complications, some institutions voluntarily use clawback provisions for their "incentive effect". They do so based on the risk calculation that the cost of legal challenge is outweighed by the benefit of affecting employee conduct. Use of such mechanisms can send a strong message to employees that variable compensation will be at risk, even after vesting, if subsequent facts reveal that the original award was made under false assumptions (e.g. there was misrepresentation, misconduct etc.).

While the presence of malus adjustment clauses now appears widespread, there is still insufficient evidence to determine the extent to which these clauses are actually being triggered and consistently applied. In other words, it is not yet clear – in situations where the malus conditions have been met – whether the triggering of such clauses results in an appropriate impact on compensation. This may have to do in part with the fact that neither institutions nor supervisors may be testing sufficiently whether malus mechanisms are working as intended, and in part with the fact that more time may be needed to gather the data necessary to do appropriate back-testing and other reviews to measure adherence and impact.

Practices differ with respect to the proportion of variable remuneration at risk, and in particular on the extent of variable pay that is: a) required; b) subject to deferral; and c) at risk under a malus or clawback mechanism.[31] A number of jurisdictions believe that the effectiveness of such adjustment mechanisms could be adversely impacted by recent developments, such as the introduction of a limit on the ratio of variable to fixed remuneration for banks subject to CRD IV provisions, should such developments reduce the proportion of pay that is available to be put at risk.

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[30] In Mexico, for example, the Federal Constitution prohibits the seizing of the product of a person's labor without due judicial process, making clawback procedures unavailable.

[31] In the EU, CRD IV requires that "up to 100 % of the total variable remuneration shall be subject to malus or clawback arrangements".

One purpose of malus and clawback mechanisms is to better align remuneration outcomes with the risk cycle. Deferral and "look back" periods are important variables in the design of effective mechanisms. A lengthening by institutions in the deferral or vesting periods, often at the encouragement of supervisors, has already been observed; some institutions now have deferral periods of up to 5 years or more for some instruments. Other institutions are also now moving in the direction of increasing the "look-back" period, sometimes to five years or longer (one institution uses seven years, another ten years, another has no limit).

Some institutions are using malus mechanisms in a wider range of circumstances, and recognise that they do not need to wait for behaviour that justifies legal termination to make appropriate *ex post* conduct compensation adjustments. There is also strong consensus that the triggers or performance indicators should not be only financial in nature but should also include factors such as managerial oversight, personal conduct, compliance with relevant regulations and proper management of risk. The triggers or thresholds currently in use vary considerably in nature and degree of specificity. Some are very specific, such as "credit loss exceeding X level", "financial loss on trading", or "pre-tax loss". Others are more general and thus may allow for more discretion, such as "revenue impairment", "adverse impact on economic profit", "devaluation of corporate value", and "deficient financial performance". Some triggers set very high hurdles ("material restatement of the financials", "substantial loss", "materially adverse financial impact") that are only likely to be triggered in the most severe of circumstances.

Hurdles for clawbacks can be high ("substantial contribution to a significant financial loss", "substantial breach", "wilful and deliberate misrepresentation", acts that cause a need for "extraordinary disclosure"), although some institutions use these in combination with other triggers that may allow for wider application (e.g. "personal misconduct", "neglect or failure to use proper risk management", "omission in supervisory duties").

Supervisory responses reflect a variety of views on what contributes to effective malus and clawback mechanisms. These range from ensuring that such mechanisms are properly documented in employee contracts and compensation plans, to avoiding abuse of discretion by allowing only downward adjustments or using a special committee to review malus/clawback application which includes representatives from a control function. There is also emerging consensus that clarity of communication to employees, proper governance, consistent application, and having enough variable compensation "at risk" are key to effective ex post risk adjustment.

With regard to clarity of communication, authorities and firms underline the importance of ensuring that employees understand the reasons for the use of ex post mechanisms, and the situations under which they will apply. This includes regularly reminding employees of the existence of these mechanisms and the behaviours that will be rewarded or which could lead to a reduction in pay. It is also important to have in place a good governance process to help ensure integrity in the development and application of these mechanisms, including ensuring consistent and fair enforcement.

Annex A: Status of national implementation

The table below provides a snapshot of the status of implementation in FSB member jurisdictions. The table does not provide an assessment of the degree of compliance with the particular Principle or Standard, but is an indication of the extent to which regulatory or supervisory initiatives have been taken to implement the Principles and Standards (or elements thereof).[32] The table was developed by the FSB Secretariat based on the responses to the template by FSB jurisdictions, and national entries have been checked for accuracy by the relevant authorities. The cells highlighted in orange indicate areas where changes are reported since the 2013 progress report (in parenthesis, the status before the change).

	AR	**AU**	**BR**	**CA**	**CN**	**FR**	**DE**	**HK**	**IN**	**ID**	**IT**	**JP**	**KR**	**MX**	**NL**	**RU**	**SA**	**SG**	**ZA**	**ES**	**CH**	**TR**	**UK**	**US**
Effective governance of compensation																								
P1	R	R	R	S	S	R	R	S	R	R	R	S	S	R	R	S	R	R	R	R	R	S	R	R
P2	R	R	R	S	S	R	R	S	R	R	R	S	S	R	R	S	R	R	R	R	R	S	R	S
S1	R	R	R	S	S	R	R	S	R	R	R	S	S	R	R	S	R	R	R	R	R	S	R	R
P3	R	R	R	S	S	R	R	S	R	S	R	S	S	R	R	R	R	R	R	R	R	S	R	S
S2	R	R	R	S	S	R	R	S	R	S	R	S	S	R	R	S	R	R	R	R	R	S	R	S
Effective alignment of compensation with prudent risk taking																								
P4	R	R	R	S	S	R	R	S	R	R	R	S	S	R	R	S	R	R	R	R	R	S	R	S
S3	R	R	R	S	S	R	R	S	R	R	R	S	S	R	S	S	R	R	R	R	R	S	R	R
S4	R	R	R	S	S	R	R	S	R	IP	R	S	S	R	R	S	R	S	R	R	R	S	R	S
P5	R	R	R	S	S	R	R	S	R	IP	R	S	S	R	R	S	R	R	R	R	R	S	R	S
S5	R (partly)[33] (NA)	R	R	S	S	R	R	S	R	IP	R	S	S	R	R	S	R	S	R	R	R	S	R	S

[32] The effective implementation of the Principles and Standards can be achieved through a variety of approaches, including different mixes of regulation and supervisory oversight.

[33] Partly completed (clawbacks have not been implemented).

	AR	AU	BR	CA	CN	FR	DE	HK	IN	ID	IT	JP	KR	MX	NL	RU	SA	SG	ZA	ES	CH	TR	UK	US
P6	R	R	R	S	S	R	R	S	R	IP	R	S	S	R	R	S	R	R	R	R	R	S	R	S
S6	R (NA)	S	R	S	S	R	R	S	R	IP	R	S	S	R	R	S	R	S	R	R	R	S	R	S
S7	R (NA)	S	R	S	S	R	R	S	R	IP	R	S	S	R	R	S	R	S	R	R	R	NA	R	S
P7	R	S	R	S	IP	R	R	S	R	IP	R	S	S	R	R	S	R	R	R	R	R	S	R	S
S8	R (NA)	S	R	S	IP	R	R	S	R	IP	R	S	S	R	R	S (partly)	R	S	R	R	R	NA	R	S
S9	R (NA)	S	R	S	S	R	R	S	R	IP	R	S	S	R	R	S	R	S	R	R	R	NA	R	S
S11	R	S	R	S	S	R	R	S	R	IP	R	S	S	R	R	S	R	S	R	R	R	S	R	S
S12	R (NA)	S	R	S	S	R	R	S	NA	IP	R	S	S	R	R	S	R	S	R	R	R	S	R	S
S14	R (NA)	S	IP	S	S	R	R	S	R	IP	R	S	S	R	R	S	S	S	R	R	NA	NA	R	S

Legend: R – regulatory approach (including applicable laws, regulations, and a mix of both regulation and supervisory oversight); S – supervisory approach (including supervisory guidance and/or oversight); IP – initiatives under preparation; UC – initiatives under consideration; NA – not addressed or not relevant. (S19 not included.)

Acronyms: AR – Argentina; AU – Australia; BR – Brazil; Ca – Canada; CN – China; FR – France; DE – Germany; HK – Hong Kong; IN – India; ID – Indonesia; IT – Italy; JP – Japan; KR – Korea; MX – Mexico; NL – Netherlands; RU – Russia; SA – Saudi Arabia; SG – Singapore; ZA – South Africa; ES – Spain; CH – Switzerland; TR –Turkey; UK – United Kingdom; US – United States.

Annex B: Remaining gaps in national implementation

Country	Remaining gaps in national implementation	Principle not yet implemented	Standard not yet implemented	Reason / additional information
Argentina	Effective alignment with risk taking		5 (partly) and10	In Argentina there are legal restrictions on clawback clauses. In regard to Standard 10, it has not been legally established that supervisors can restructure compensation schemes of a banking institution. The Financial Law N° 21526 Section 35 and complementary measures establish the legal framework for the restructuring of such institutions. See http://www.bcra.gov.ar/pdfs/marco/MarcoLegalCompleto.pdf.
Brazil	Effective alignment with risk-taking		10 and 14, 15 (partly)	The implementation of Standard 14 is under preparation. After the 2012 Progress report Brazilian authorities started studies regarding the implementation of standard 14, which is still in course. To date, Standard 10 is not applicable in Brazil since the Fiscal Responsibility Law prohibits the injection of public funds in failing banks. Current regulation (Resolution CMN 4,019, September 2011) allows the Central Bank of Brazil to set limits to fixed and variable remuneration in cases of inappropriate exposure to risks, deterioration of the institution's financial situation and internal control deficiencies. As regards Standard 15, the Basel Committee's 2013 regulatory consistency assessment of Basel III risk-based capital regulations in Brazil (http://www.bis.org/bcbs/implementation/l2_br.pdf) reports that the Pillar 3 remuneration disclosures requirements have not been implemented due to security concerns. The authorities report that for listed companies, pre-existing regulation addressed several disclosure requirements on compensation of directors and senior executives.
China	Effective alignment with risk-taking	7	8	Currently, compensation is overwhelmingly paid in cash. China is considering increasing the use of long-term incentive plans with stock-linked instruments.
India	Effective alignment with risk-taking		12	Standard 12 has not been implemented as any payment of compensation to whole time directors and CEOs during and after employment requires RBI approval on a case-by-case basis. Given the above, the authority is of the view that no further measures are required to be taken.

Country	Remaining gaps in national implementation	Principle not yet implemented	Standard not yet implemented	Reason / additional information
Indonesia	Effective alignment with risk-taking	5, 6, 7	4-14	These Standards remain under consideration. The adherence by financial institutions to the standards on risk alignment is confirmed by supervisory evidence.
Russia	Effective alignment with risk-taking		8 (partly)	Legislative and market practice constraints (most institutions are non-listed companies, and remuneration with debt instruments is not allowed).
South Africa	Effective alignment with risk taking		10	South Africa is currently in the process of adopting a twin-peaks regulatory structure. Principle 10 could possibly be addressed in the above legislation, although this is an ongoing process and the implementation timelines are not yet clearly specified.
Switzerland	Effective alignment with risk-taking		14	Even though there is no formal guidance, the Standard concerning no hedging in respect of remuneration is addressed by larger institutions through internal compliance processes. The adherence by larger institutions to this Standard is confirmed by supervisory evidence.
Turkey	Effective alignment with risk-taking		7, 8, 9, 14	These standards are not implemented in the regulation or in supervisory guidance (7, 8, 9 and 14) and they are not compulsory for all banks, however supervisors expect banks to take the principles stated in the regulation into account when designing their internal systems and procedures.
US	Disclosure		15	The US is in the process of preparing a rule related to Pillar 3 compensation disclosure guidance. Much of the information required by the BCBS guidance is already disclosed by major banks.

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