

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

**Fourth progress report**

10 November 2015

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

## **Fourth Progress Report**

### **Executive Summary**

This is the fourth progress report on the implementation of the FSB *Principles for Sound Compensation Practices* and their *Implementation Standards* (P&S), which aim to reduce incentives for excessive risk taking that may arise from the structure of compensation schemes in significant financial institutions. The report, which was prepared by the FSB Compensation Monitoring Contact Group (CMCG), focuses on remaining implementation gaps, key challenges and evolving practices. This year's report also examines compensation practices in relation to conduct risk and in the insurance sector. The main findings are:

1. **Almost all FSB jurisdictions have now fully implemented the P&S for banks.** Two jurisdictions are still completing their regulatory processes to fully align the existing rules to the P&S (Indonesia and Turkey), while a few others have not adopted a few P&S due to their non-applicability or incompatibility with local laws (see Annex C). Several jurisdictions continue to refine their regulatory framework or guidance on compensation practices. Implementation in the insurance sector is less advanced, with fewer jurisdictions having adopted dedicated regulation or supervisory guidance.
2. **The oversight of compensation practices has now been fully embedded in bank supervisory frameworks in most jurisdictions.** More than half of the jurisdictions assess the level of implementation by significant banks as “high” in the three areas of governance, risk alignment and stakeholder engagement covered by the P&S. The supervisory focus is now on further improving the governance framework and the risk alignment of compensation, including by ensuring a better link between compensation frameworks and risk governance frameworks. Further work is needed by banks, in particular, in setting clear and measurable objectives at the level of individuals that include elements related to conduct; in the identification of risk metrics that are granular enough to affect business lines and individuals; and in ensuring appropriate amounts are at risk of forfeiture through malus and clawback.
3. **The risk alignment of compensation structures, at least for senior executives, shows improvements in various respects.** Some of the key trends are as follows:
  - increase in the number of jurisdictions using deferrals, and in the length of deferral periods, although with significant variation between institutions and across categories of staff in the percentage of variable remuneration that is deferred;
  - in those jurisdictions (about two-thirds) where malus and clawbacks conditions are mandated or applied, the deferred portion of variable remuneration is considered to be fully (100%) at risk of forfeiture;
  - however, the use of provisions to adjust for adverse risk outcomes, including for cases of misconduct, remains limited and in the case of clawbacks largely untested.

4. **An increase in the fixed portion of remuneration in 2014 compared to 2011 is observed by several jurisdictions, both EU and non-EU members.** Several FSB jurisdictions including non EU members noted also recently an increase in the proportion of fixed remuneration paid by banks (particularly those headquartered in the EU), with some expressing concern about this limiting the scope to affect risk taking through compensation incentives, about the competitive impact in their domestic market and about the implications of the increase in the fixed component of pay for banks' ability to adjust to a downturn. Some also expressed concern that competition for talent is also increasingly coming from a diverse set of firms, including firms in other sectors that have different compensation structures and/or regulatory frameworks.
5. **Compensation and risk governance frameworks are increasingly linked.** All jurisdictions indicate that significant banks have strengthened risk management processes and governance structures, including a more prominent and formalised role for the risk function in decisions regarding the alignment of compensation with both *ex ante* risk and *ex post* performance. There remains however room for improvement in developing quantitative and qualitative measures to assess changes in risk-taking behaviour
6. **Existing compensation provisions, if appropriately calibrated and applied rigorously, should enable firms to more effectively prevent or deter misconduct.** Deferrals that are aligned with the time horizon of risks as well as adjustments to variable pay can be effective in demonstrating a firm's intent to take action in the event of misconduct. However, the effectiveness of these mechanisms remains largely untested and more analysis is needed by firms and supervisors to assess whether tools such as malus and clawbacks are sufficiently developed (and effectively used) to deter misconduct risks. Establishing a more direct, transparent and immediate link between conduct issues and the award of variable remuneration could help to reduce the incidence of misconduct. More generally, compensation is seen by both firms and supervisors as an important but not the only tool to address misconduct; improving risk culture, awareness and individual responsibility at firms are seen as key. The synergies between governance, compensation and culture merit further investigation.
7. **There are important differences in the implementation of the P&S in the insurance sector across jurisdictions** In the majority of cases, there is no dedicated regulation or guidance on compensation issues, although according to the IAIS standard on remuneration in its Insurance Core Principles, the supervisor requires the insurers' boards to adopt and oversee the effective implementation of a remuneration policy for the insurer.<sup>1</sup> In some jurisdictions, in particular those with integrated authorities, compensation practices in the insurance sector are regularly monitored by the supervisors. Notwithstanding these differences across regulatory regimes, compensation practices of internationally active insurers seem fairly aligned across regions, with a prominent role played by the risk function in identifying material risks and risk-takers. A number of these

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<sup>1</sup> The IAIS is currently revising its Insurance Core Principle on Corporate Governance, which includes standards on remuneration in line with the FSB P&S and following up on a Self-Assessment and Peer Review of the IAIS members' implementation of the Core Principle. The IAIS will also be addressing remuneration issues in the further enhancement of the proposed standards to apply to Internationally Active Insurance Groups as of 2019.

insurers indicate that the longer-term business and risk horizon result in a lower number of material risk-takers (MRTs) and reduce the need for *ex post* risk alignment.

In light of these findings, the report identifies the following actions:

- 1. Several recommendations of the third progress report remain relevant for action by national authorities.** In particular, the recommendations on more intensive and effective supervision of compensation practices, and for authorities that have not yet undertaken a horizontal review of practices in their domestic market to conduct such a review, are still applicable. The monitoring findings confirm that supervisory attention to compensation issues is a key determinant of firms' progress and convergence to best practices.
- 2. More work on monitoring and assessing the effectiveness of reforms is needed.** While the findings of the latest monitoring exercise indicate a strong link between compensation and risk governance and management functions, both supervisors and firms could benefit from further development of indicators – qualitative or quantitative – to track the evolution of pay practices, compare progress across firms and through time, and assess the effectiveness of compensation policies and practices in shaping risk-taking behaviour and conduct more broadly. Supervisory authorities will coordinate via the CMCG to explore the use of indicators based on common definitions to monitor the effective risk alignment of compensation structures for significant institutions across jurisdictions.
- 3. Taking stock of compensation practices in other financial sectors.** The FSB, in collaboration with the relevant standard setting bodies, will continue to take stock of compensation structures (in terms of regulatory treatment and firm practices) in other financial sectors and how they can affect risk taking incentives, while recognizing that financial firms differ in goals and that approaches used in one aspect of the financial sector may not be applicable in others. The CMCG will assist in this process by discussing, together with IOSCO, compensation practices in the securities sector (including by jointly organizing an industry workshop in 2016) to elicit further information about current practices, and present the findings in its next progress report.
- 4. Compensation and conduct.** While the CMCG's work has revealed that supervisors believe the tools are in place to address conduct issues through compensation mechanisms, the effective use of such mechanisms by firms – and therefore their influence on potential misconduct – is unclear. In order to further examine the need or desirability of new disincentives to misconduct, the CMCG will continue to collect information and examine the case for strengthening disincentives to misconduct through compensation-related tools and if appropriate will make proposals. In particular, the CMCG will continue its current study of malus and clawback practices and the use of different instruments as an element of deferred compensation and if appropriate will make recommendations in the next progress report on better practices for significant firms, while recognising that individual jurisdictions may want to consider application to a broader range of firms.
- 5. Follow-up work on MRTs.** As indicated in the 2014 progress report, the identification of MRTs remains central to effective compensation regimes and is an area on which the CMCG will continue to focus. One of the 2014 action points noted that the CMCG would work from mid-2015 onwards 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”. The CMCG will re-examine the issue of MRTs in 2016-2017.

Going forward, progress reports on the implementation of the P&S will be prepared every two years. The FSB, through the CMCG, will continue its ongoing monitoring, including via industry workshops, and will also prepare streamlined annual updates on implementation progress for G20 reporting, which will be included in the implementation annual reports.

## I. Introduction

The November 2011 G20 Summit in Cannes 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)]<sup>2</sup> and carry out an ongoing bilateral complaint handling process to address level playing field concerns of individual firms”.<sup>3</sup> 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, which aim to reduce incentives for excessive risk taking that may arise from the structure of compensation schemes in financial institutions that are significant for the purposes of the P&S. The P&S are not intended to prescribe particular designs or levels of individual compensation and recognise that “one size does not fit all – financial firms differ in goals, activities and culture, as do jobs within a firm.”

This progress report summarises the responses provided by CMCG members to a questionnaire concerning actions and initiatives by FSB jurisdictions to implement the P&S since the November 2014 progress report.<sup>4</sup> It also incorporates the findings of the third workshop on compensation practices<sup>5</sup> attended by senior executives from global systemically important banks in April 2015, and of an FSB-IAIS (International Association of Insurance Supervisors) workshop<sup>6</sup> attended by senior executives from internationally active insurance groups in May 2015. As in past years, the report and its conclusions focus mainly on compensation practices at significant banks, although this year a new section on compensation practices in the insurance sector is also included.<sup>7</sup>

The report is structured as follows. Section II describes the overall progress made by national authorities in implementing the P&S since the 2014 progress report as well as recent regulatory initiatives and supervisory oversight and actions. Section III outlines the status of

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<sup>2</sup> See <http://www.financialstabilityboard.org/what-we-do/policy-development/building-resilience-of-financial-institutions/compensation/>.

<sup>3</sup> See [http://www.financialstabilityboard.org/implementation\\_monitoring/g20\\_leaders\\_declaration\\_cannes\\_2011.pdf](http://www.financialstabilityboard.org/implementation_monitoring/g20_leaders_declaration_cannes_2011.pdf).

<sup>4</sup> See <http://www.financialstabilityboard.org/2014/11/third-progress-report-on-compensation-practices/>.

<sup>5</sup> <http://www.financialstabilityboard.org/2015/06/third-fsb-workshop-on-compensation-practices/>.

<sup>6</sup> <http://www.financialstabilityboard.org/2015/08/fsb-iais-workshop-on-compensation-practices-in-the-insurance-sector/>.

<sup>7</sup> This report, however, does not focus or necessarily reflect other sectors’ practices.

implementation by firms and reports on the supervisory authorities' assessment of firms' compensation practices. Section IV discusses compensation and conduct issues and Section V reports of compensation policies and practices in the insurance sector. Annex A provides an overview of the evolution of compensation in the banking industry in recent years. The analysis in this Annex was prepared by the FSB Secretariat on the basis of public information sources, and the underlying data and analysis should not be interpreted as vetted or necessarily endorsed by the CMCG. While not directly focussed on the link between compensation structures and risk alignment, which is the main focus of the CMCG, the analysis is meant to provide background information on the evolution of compensation costs and structures for the banking sector and offer some context to the trends highlighted by the responses to the national authorities questionnaires, commented in the main text of the report. Annex B and C provide more detail on the status of implementation of the P&S in the banking sector. Annex D provides the list of banks that were surveyed by the respective supervisors in the FSB jurisdictions for the purposes of this report.<sup>8</sup> Annex E illustrates the main changes and remaining banks' implementation challenges in the three areas of the P&S. As a background to the analysis in the text of the report, Annex F includes examples of conduct-related triggers for malus and clawbacks clauses. Finally, Annex G provides the list of CMCG members.

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<sup>8</sup> All these firms are considered by the respective authorities as significant for the purposes of the P&S.

## II. Implementation by national authorities

### 1. New regulatory and supervisory initiatives, activities and findings

All FSB jurisdictions report that they have now fully, or almost fully, implemented the P&S for the banking sector<sup>9</sup> through regulation or as a result of supervisory guidance (see Annex B). However, the implementation gaps identified in 2014 still remain. In particular, Indonesia and Turkey have not implemented several provisions on risk alignment.<sup>10</sup> Both jurisdictions continue to work on draft regulations to fully align existing rules to the P&S. In Turkey, current guidance requires banks to pay the variable remuneration in instalments by taking account of the time dimension of the risks and to take back any unvested portion of variable remuneration of employees who are responsible for a serious financial downturn (standards 7 and 9). There are also regulatory initiatives under preparation to fully align the domestic regulation with the other standards on risk alignment (S7, S8, S9, S14).

A number of other implementation gaps remain for some jurisdictions, mostly due to legal and other constraints (see Annex C and the 2014 Progress Report). In Russia, where significant provisions of the P&S had not been implemented, the previous regulation has been significantly amended and complemented by additional rules and supervisory guidance, and banks are expected to modify their compensation systems this year in accordance with new provisions. In particular, new supervisory guidance entered into force from January 2015 aims at bringing compensation systems of credit institutions into compliance with P&S.<sup>11</sup>

Other jurisdictions have refined their regulatory framework or guidance on compensation practices by expanding the scope of previous regulation, clarifying rules and guidance, or introducing requirements that complement those of the P&S. Table 1 classifies jurisdictions according to whether changes have been made to the regulatory and supervisory guidance on compensation practices.

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<sup>9</sup> For the implementation of the P&S in the insurance sector, see Section IV. Other sectors have not been covered by this implementation monitoring exercise.

<sup>10</sup> As described in the 2014 report, 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), 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 are covered by supervisory guidance, in that supervisors expect banks to take the principles into account when designing their internal systems and procedures, and gaps are considered in the supervisory rating.

<sup>11</sup> The Bank of Russia Instructions establish requirements aimed at aligning compensation systems with the nature and scope of operations of credit institutions, their financial results, level and combination of risks assumed, and sets special requirements for compensation systems of significant credit institutions. Instructions № 154-I of 17 June 2014 “On the Procedure of Conducting Assessments of a Compensation System of a Credit Institution and the Procedure of Submission to a Credit Institution an Order to Eliminate Violations in its Compensation System”.

Table 1

Regulatory framework and/or supervisory guidance	
No changes	Recent changes
Argentina Australia Brazil Canada China Germany <sup>12</sup> Indonesia ( <i>draft regulation for commercial banks to align existing rules to the P&amp;S. No new supervisory initiative</i> ) Japan Korea Saudi Arabia South Africa ( <i>Financial Sector Regulation Bill and Special resolution Bill in preparation</i> ) Switzerland Turkey ( <i>regulatory initiative under preparation to align existing rules to the P&amp;S. No new supervisory initiative</i> )	France, Italy, Spain ( <i>Regulation implementing the European directive enacting Basel III - CRD IV</i> ) Hong Kong ( <i>issued revised remuneration guideline for banks to formally incorporate the Pillar 3 disclosure requirements for remuneration</i> ) India ( <i>Reserve Bank of India guidelines for private sector banks on the compensation to Non-Executive Directors</i> ) Mexico ( <i>enhancing disclosure standards</i> ) Netherlands ( <i>CRD IV and additional, more stringent provisions for cap on variable compensation, clawback, severance pay, retention bonuses, transparency, state support</i> ) Russia ( <i>new legislation and new Bank of Russia guidance stipulating requirements for credit institutions aimed at aligning compensation systems with the nature and scope of operations of credit institutions, their financial results, level and combination of risks assumed.</i> ) Singapore ( <i>introduction of a Balanced Scorecard framework for financial advisers</i> ) UK ( <i>Rules on clawback requiring variable remuneration to be subject to malus and clawback for an overall period of seven years from the date of an award made on or after 1 January 2015, new deferral requirements and new guidance on supervisory expectations</i> ) US ( <i>Office of the Comptroller of the Currency (OCC) Heightened standards for Board of Directors; Securities and Exchange Commission (SEC) proposed rules on pay versus performance disclosure; SEC proposed rules directing national securities exchanges and associations to establish listing standards requiring clawback; SEC adopted rules requiring disclosure of the ratio of the compensation of its chief executive officer to the median compensation of its employees</i> )

In 2015 the Netherlands published a new law on remuneration with entry into force on 7 February 2015, which applies to all financial institutions and changed the scope of application of the cap on variable compensation and the cap itself. The new law provides for a 20% cap (i.e. the variable compensation can be at the maximum 20% of the fixed compensation) for all staff of all financial institutions in the Netherlands (there are some exceptions). The new law

<sup>12</sup> In Germany, the regulatory implementing the “European directive enacting Basel III - CRD IV” came already into force on 1 January 2014 and was covered by the Third FSB progress report on compensation.

also includes some specific requirements regarding claw back, severance pay, retention bonuses, transparency and state support.<sup>13</sup> The Regulation on sound remuneration policies is also being amended, for expected publication in late 2015.

The UK introduced in July 2014 new rules on clawback requiring variable remuneration to be subject to malus and clawback for an overall period of seven years from the date of an award (made on or after 1 January 2015). This has been supplemented by further rules introduced in June 2015 that introduced new and more stringent deferral requirements and extended the clawback period for senior managers for up to a further 3 years at the end of the existing 7-yr period, if regulatory or internal investigations were outstanding. These rules also included new requirements on risk adjustment and the remuneration of non-executive directors. An existing rule on discretionary payments in the case of bailed-out banks was also strengthened.<sup>14</sup> New supervisory guidance was also published on the UK Prudential regulation Authority expectations on how firms should comply with the rules.<sup>15</sup>

In the US, in September 2014 the OCC published its final regulations on Heightened Standards for Certain Large Insured National Banks, Insured Federal Savings Associations and Insured Federal Branches. Among other requirements, the regulation prohibits any incentive based payment arrangement, or any feature of any such arrangement, that encourages inappropriate risks by providing excessive compensation or that could lead to material financial loss.<sup>16</sup> The Securities and Exchange Commission (Commission) proposed or adopted additional rules to implement certain sections of the Dodd-Frank Act (DFA). In February 2015 the Commission proposed rules regarding hedging disclosure to implement DFA Section 955. In April 2015 the Commission proposed rules regarding pay versus performance disclosure to implement DFA Section 953(a). In July, the Commission proposed rules directing national securities exchanges and associations to establish listing standards requiring listed companies to adopt policies that require executive officers to pay back incentive-based compensation that they were awarded erroneously, to implement Section 954 (clawback). In August the Commission adopted rules to implement Section 953(b) requiring disclosure of the median of the annual total compensation of all employees of a registrant (excluding the chief executive officer), the annual total compensation of that registrant's chief executive officer, and the ratio of the median of the annual total compensation of all employees to the annual total compensation of the chief executive officer.<sup>17</sup>

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<sup>13</sup> For subsidiaries of Dutch institutions based within the EU the cap is 100% and subsidiaries based outside the EU the maximum variable compensation is 200% of the fixed compensation. For existing contracts these caps will in most cases only apply from 1-1-2016 onwards. See <https://zoek.officielebekendmakingen.nl/stb-2015-45.html>.

<sup>14</sup> See <http://www.bankofengland.co.uk/pr/Pages/publications/ps/2014/ps714.aspx>. The new deferral requirements are 7 years for senior managers as defined under the Senior Managers Regime; 5 years for risk managers as defined under the European Banking Authority (EBA) regulatory technical standard (RTS) on identification of MRTs; and 3 to 5 years as per the Capital Requirements Directive (CRD) minimum for all other MRTs). See <http://www.bankofengland.co.uk/pr/Pages/publications/ps/2015/ps1215.aspx>.

<sup>15</sup> See <http://www.bankofengland.co.uk/pr/Pages/publications/ss/2015/ss2715.aspx>.

<sup>16</sup> This regulation establishes minimum standards for the design and implementation of a covered bank's risk governance framework and sets minimum standards for the covered bank's board of directors when providing oversight to the risk governance framework's design and implementation. See: <http://www.gpo.gov/fdsys/pkg/CFR-2015-title12-vol1/pdf/CFR-2015-title12-vol1-part30-appD.pdf>.

<sup>17</sup> See <http://www.sec.gov/rules/proposed/2015/33-9723.pdf>, <http://www.sec.gov/rules/proposed/2015/34-74835.pdf>, <http://www.sec.gov/rules/proposed/2015/33-9861.pdf>, and <http://www.sec.gov/rules/final/2015/33-9877.pdf>.

## 2. Supervisory action

As noted in previous progress reports, supervisory activities in most jurisdictions now routinely include the analysis of compensation structures, practices and outcomes, mostly as part of a broader governance-based assessment.

Several jurisdictions have conducted ad-hoc supervisory activities focussed on compensation structures. Argentina and Mexico reviewed the supervisory approach on compensation.<sup>18</sup> Several jurisdictions have conducted ad hoc horizontal reviews of banks' compensation practices.<sup>19</sup> Italy, for example, conducted in 2014 an on-site horizontal review, focused on the remuneration policy and practices of primary Italian banking groups (broadly 60% of the Italian banking system, in terms of total asset). The initiative was meant to monitor the actions undertaken by the banks to implement the Bank of Italy's new regulation transposing the CRDIV package and to complement the off-site analysis on the compliance with regulation of both the systems approved by the shareholders meeting in 2014, and the variable remunerations awarded in 2014. In the Netherlands, topics that received special supervisory attention were allowances (based on the EBA opinion – see Box 1), as well as malus and claw back, and severance payments, and an horizontal review of Key Performance Indicator setting in liquidity risk.

### Box 1: Allowances

European jurisdictions have collaborated with the EBA on the topic of “role-based allowances” to prevent circumvention of the requirements on the limits to variable remuneration set out in CRD IV. Role-based allowances have been identified as posing a level playing field issue between institutions and jurisdictions. These works have led to an [EBA Opinion on Allowances](#) which fed into the revision of [EBA Guidelines on sound remuneration practices](#), on which a consultation was launched in March 2015. The draft Guidelines set out the governance process for implementing sound remuneration policies across the EU, as well as the specific criteria for mapping all remuneration components into either fixed or variable pay. Guidance is also provided on the application of deferral arrangements and the pay-out instruments ensuring that variable remuneration is aligned with an institution's long-term risks and that any excess risk adjustments can be applied as appropriate. Specific guidance is provided on how the ratio between the variable and the fixed components of remuneration should be calculated, taking into account specific remuneration elements, such as allowances, sign-on bonus, retention bonus and severance pay.

The EBA Guidelines will apply to competent authorities across the EU, as well as to institutions on a solo and consolidated basis, including subsidiaries within the prudential scope of consolidation.

Other jurisdictions conduct on going dedicated supervisory activities. Switzerland for example conducts consultations with banks during bonus rounds and in case of any prospective changes to remuneration plans and instruments. In cases where the firm proposes

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<sup>18</sup> Argentina introduced verification of compensation policies at an individual and a consolidated level; assessment of the impact of compensation schemes in business plans; analysis of disclosures; appraisal of compensation policies within the framework of the integral risk schemes analysis. Mexico adapted the supervisory practices to include verification of the compliance with the new requirements on disclosure of qualitative and quantitative aspects of their remuneration system.

<sup>19</sup> China has reviewed self-evaluation of performance assessment systems by the largest banks. France, Italy and the Netherlands have conducted ad hoc reviews, including for the purposes of assessing guidance provided by EBA on the use of role-based allowances. Japan has focussed on corporate governance, including the review of compensation practices of senior executives for three mega-banks. Singapore has examined on the decision-making process over the compensation of sales representatives. Hong Kong has reviewed the risk appetite frameworks of local retail banks including their links to remuneration systems.

non-traditional instruments in their compensation structures, the review includes taking into account any capital, liquidity or other implications. Other jurisdictions continue on-going horizontal reviews. The US for example gathers detailed information on compensation arrangements for senior executives and on compensation programs more generally; the UK conducts a full assessment of the largest firms' bonus pools, including how they have been adjusted to take account of any risk failures during the year as well as the application of malus at a firm-wide, business unit or individual level.

Supervisory authorities have followed up on the findings of their supervisory activity by requiring remedial actions before any formal enforcement procedures are taken. In a few instances, formal recommendations have been issued. In Switzerland, the supervisor asked a bank to review individuals' misconduct and involvement in a foreign exchange-related misconduct case and imposed an enforcement measure to limit, for a period of two years, the variable remuneration to a factor of two times base salary for foreign exchange and precious metals employees globally. A special review and approval process will be introduced for other high earners of the Investment Bank in Switzerland who receive variable compensation that exceeds 200% of the basic salary.<sup>20</sup>

It is worth noting that no specific supervisory activity has been conducted or planned in Turkey and Indonesia, jurisdictions that still present implementation gaps. The Bank of Russia, which only recently completed the implementation of the P&S, conducted a survey on compensation practices in major Russian banks in August – September 2015. The main finding of the survey is that new Bank of Russia regulation stipulating requirements to compensation systems of credit institutions provides stimulus for modification of compensation systems in terms of risks adjustment. In particular, banks identify and extend categories of senior and other executives to which compensation requirements aligned with prudent risk taking apply, and change compensation structures accordingly.

A few jurisdictions have already planned reviews for 2015-2016. In 2015, the Canadian supervisors will conduct an assessment of compensation practices at the six Domestic Systemically Important Banks (D-SIBs). The assessment will focus on the ongoing alignment of the banks' compensation policies and practices with the FSB P&S and on the performance objectives and compensation programs for senior management, and a selection of MRTs, to understand and assess their alignment with the bank's Risk Appetite Statement. Brazil also has a review planned as part of the 2015-2016 periodic horizontal reviews to evaluate the adequacy of risk-adjusted compensation policies and of board remuneration committee activities.

In the euro area, since the establishment of the Single Supervisory Mechanism (SSM) the European Central Bank (ECB) is responsible for the supervision of significant banks. Supervisory activity is planned and undertaken jointly by the ECB and the national competent authorities through Joint Supervisory Teams. The SSM is currently developing a supervisory framework that implements several CRD IV requirements with regard to compensation, which will require a greater emphasis on compensation policy evaluation in the annual Supervisory Review and Evaluation Process (SREP). To that end the ECB is providing details

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<sup>20</sup> <https://www.finma.ch/en/news/2014/11/mm-ubs-devisenhandel-20141112/>.

on how it undertakes the identification process for risk-takers, setting out the requirement for remuneration policies to be consistent with a sound capital base, and the approval of variable to fixed remuneration ratios over 100%.

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

The high-level objectives of the P&S cover three specific areas: governance of compensation, risk alignment, and external stakeholder engagement.

- In terms of governance, the P&S require that significant firms have a dedicated committee of the board that actively oversees the design and operation of the compensation system; that staff engaged in financial and risk control functions be independent, have appropriate authority and have an appropriate role in the performance assessment process, including input on effective risk-adjustment of compensation; that compensation systems be subject to robust controls and periodic reviews to ensure their integrity; and that compensation and risk outcomes should be regularly reviewed for consistency with intentions.
- The alignment of remuneration with prudent risk taking is intended to be achieved via provisions to ensure that compensation is adjusted for all types of risk; that firms use an appropriate mix of quantitative and qualitative methods in making ex-ante risk adjustments; that compensation outcomes are appropriately sensitive to risk outcomes including the time horizon of risks; that subdued or negative financial performance of the firm and inappropriate risk-taking leads to a contraction of the firm’s total variable compensation, taking into account both current compensation and reductions in payouts of amounts previously earned, including through malus or clawback arrangements; that compensation is delivered in the form of instruments that create incentives aligned with long-term value creation and the time horizons of risk including cash, equity and other forms of compensation; and that firms identify material risk takers for compensation purposes.
- For effective stakeholders’ engagement, the P&S indicate that firms should disclose clear, comprehensive and timely information on their compensation practices to facilitate constructive engagement of all stakeholders.

The paragraphs below describe the status of implementation by firms in the different areas, as assessed by the national supervisors, and highlights remaining implementation challenges.

#### **1. Overall assessment of implementation by firms**

Supervisors assess the level of implementation by banks reviewed for this report <sup>21</sup> mostly as “high”, confirming the findings of previous reports. In particular, governance is the area with the largest number of “high” grades (22 jurisdictions), followed by risk alignment and

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<sup>21</sup> Jurisdictions have surveyed for the purposes of this report 77 banks. All these firms are considered by the respective supervisors as significant for the purposes of the P&S (see Annex D).

stakeholder engagement (17 and 15 jurisdictions respectively assess the level of implementation as “high”).

Supervisory evidence on compensation practices indicates that significant firms have effectively implemented the provisions of the P&S on governance and risk alignment (see section III.2). There is also evidence of greater external stakeholder engagement with greater “say on pay” at annual shareholder meetings and improved public disclosures – although room for improvement remains concerning the level of detail, comprehensiveness and granularity of the disclosures.

Supervisors have identified implementation challenges and areas for improvement in both governance and risk alignment. On governance, some supervisors have expressed concerns about the role of unbounded discretion in compensation decisions, the composition and role of board remuneration committees, the involvement of control functions to ensure that individualised and measurable objectives are being identified for all MRTs, and the lack of adequate internal review processes performed by the audit function.

On risk alignment, supervisory findings indicate that further work is needed in setting clear and measurable objectives at the individual level that include elements related to conduct (see also section V), in the choice of malus conditions, and in defining performance indicators for control functions. Supervisors are also focussed on the identification of risk metrics that are granular enough to affect incentives at the line of business and individual level, on better documentation of risk adjustment process and decisions; on a more widespread use of effective performance indicators; and on ensuring appropriate amounts are at risk of forfeiture through malus and clawback. Annex E provides more detail on the main changes in effective implementation of the P&S by firms in the period 2011-2014 and on the remaining challenges.

In order to better analyse compensation structure features related to risk alignment, the 2015 questionnaire collected from national authorities granular information on compensation structures of senior executives of significant banks.<sup>22,23</sup>

Responses to the questionnaires indicate that, in terms of the length of deferrals, there has generally been an increase in both the number of jurisdictions utilising deferral, as well as in the length of deferral periods. The average deferral is now between three and four years, and the maximum observed length is up to eight years (United States). In two jurisdictions there

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<sup>22</sup> The questionnaire asked for information on the CEO and “C-Suite” (for example: CRO, CFO, CIO, Internal Auditor) as well as the first management level below the “C-Suite”, generally including at a minimum, heads of major business lines, heads of major geographic regions, heads of risk and control functions, and any firm-wide executive or operating committee that is one level below the Executive Board. Limiting the stock-take to senior executive as opposed to the entire population of MRTs was meant to ensure better comparability of the information provided.

<sup>23</sup> The information collected through the questionnaire covered: the definition of senior executive adopted, the percentage of fixed and variable remuneration, the percentage of variable remuneration deferred, the length of deferrals, the design of variable remuneration (e.g. use of cash and non-cash instruments) the definition of malus and clawback in employee contracts, the proportion of deferred variable remuneration that is subject to malus and clawback, and the amount of exercised malus and clawback as a proportion of deferred variable remuneration. Given some inconsistencies and gaps in the data and the fact that the information is not always homogeneous or necessarily directly comparable across jurisdictions, due to the lack of harmonised definitions for the various elements of remuneration, the text includes a qualitative description only of the most significant trends, and selected examples across jurisdictions.

was no deferral policy in place in 2014 (Russia and Turkey), although in the case of Russia the supervisor reports that banks applied deferrals to compensations.<sup>24</sup>

The percentage of variable remuneration deferred varies significantly between institutions and across categories of staff. For the surveyed population of senior executives, the percentage of deferred variable remuneration remained fairly stable between 2011 and 2014, with an average figure of around 50%.<sup>25</sup> These numbers are only partly indicative of an overall trend, given the large variability across firms in each jurisdiction (from 10-100% in both years). In the majority of cases, 100% of deferred variable compensation is “at risk”, i.e. subject to malus (17 jurisdictions) and in a few cases is also subject to clawbacks. It should be noted that one of the findings of the dedicated stocktaking exercise conducted in 2014 on the use of malus and clawback clauses indicated that less than half of the jurisdictions have mandated the adoption of clawback provisions. Some jurisdictions cite legal impediments to the effective adoption of the clauses (mainly labour law and tax related). As mentioned in section II, the UK introduced specific provision on clawbacks in 2014-2015.<sup>26</sup>

Malus was exercised within the senior executive population in only in 6 jurisdictions in 2011 and in 8 jurisdictions in 2014. The impact on deferred variable remuneration ranged from less than 1% to 100% in both years.<sup>27</sup> The number and amounts of malus exercised by significant banks on the population of MRTs as a whole is however likely larger. In the UK, for example, in 2014 the major banks disclosed malus adjustments of £290 million, around £100 million more than in 2011. In the US, for example, in response to the CIO incident, JP Morgan Chase recovered more than \$100 million of compensation through the firm’s clawback mechanisms. No jurisdiction reported clawbacks actually exercised against senior bank executives in either 2011 or 2014.

The proportion of fixed remuneration of senior executives increased on average (from 40 in 2011 to 44% in 2014), not only for FSB jurisdictions that are members of the EU, but also for several other FSB jurisdictions. In the case of Mexico for example, even though fixed remuneration increased on average, the range of observed fixed pay is actually wider, with some firms reducing and other increasing the percentage of pay that is fixed. In other jurisdictions the fixed portion of pay increased significantly, by 10% or more (Germany,

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<sup>24</sup> A survey conducted by the Bank of Russia in August 2015 on major Russian banks indicates that in 2011-2014 most banks did not apply deferrals for senior executives’ remuneration. In general, there were no practices of applying malus/clawbacks. Starting from 2015, compensation systems of major banks include provisions for deferrals and malus. Deferral periods are usually three years. Banks do not intend to apply clawback clauses to paid-up remuneration. In most cases the share of variable remuneration deferred is 40% (max – 67%). In several banks malus clauses will be applicable to 100% of deferred variable remuneration.

<sup>25</sup> In seven jurisdictions (including Australia, France, Germany, Singapore, South Africa) the average has increased since 2011, while in most other cases it has remained stable.

<sup>26</sup> In July 2014, the UK introduced new rules on clawback requiring variable remuneration to be subject to malus and clawback for an overall period of seven years from the date of an award (made on or after 1 January 2015). This has been supplemented by further rules introduced in June 2015 which introduced new deferral requirements and extended the clawback period for senior managers for up to a further three years at the end of the existing seven years period for all MRTs, if regulatory or internal investigations are outstanding. The introduction of the rule on clawback in the UK extends to the subsidiaries of UK banks abroad, and to the subsidiaries of continental European and US banks in the UK.

<sup>27</sup> One jurisdiction mentioned that the non-application of malus and clawback clauses may be also due to the fact that the banks had not awarded any variable remuneration at all given that the targets prescribed by the “gate conditions” (based on financial and/or capital indicators) had not been reached.

Hong Kong, India, Spain, and UK); in others, the increase was more limited (France, Mexico, Singapore, US). In the UK for example, for all “code staff” (MRTs) at significant banks, the proportion of fixed remuneration increased from 29% in 2011 to 54% in 2014 on average; in Spain, for senior executives, from 31 to 40%.

The potential increase in the proportion of fixed pay was anticipated in last year’s report mainly as a development in response to the cap on the ratio of fixed to variable pay introduced in the EU with the implementation of CRD IV (see 2014 Progress Report, which discussed both the rationale and concerns related to the use of a variable pay cap).<sup>28</sup> Several authorities have highlighted in their response an increase in the fixed portion of remuneration as a recent observed trend (France, Germany, Hong Kong, India, Italy, Mexico, Netherlands, Singapore, Spain, UK, US).

A number of authorities also noted that firms expressed concerns regarding the influence of compensation rules by foreign authorities on compensation practices in their jurisdiction. These reported concerns are mainly related to the increase in fixed pay by foreign banks operating in the domestic market in response to the introduction of CRD IV in the EU and the competitive reaction of both domestic and third country banks (non EU jurisdictions that have reported concerns of their domestic banks in this respect are for example Brazil, Canada, Hong Kong, Mexico, Singapore, US).<sup>29</sup>

A few authorities have also indicated concerns on the part of some banks in their jurisdictions regarding their ability to compete on compensation with other financial sectors, in particular the private equity/asset management sector, due to the different regulation and practices affecting employees (including in different entities of the same banking group). This issue has not been explored at this stage by the implementation monitoring exercise.

Some supervisors indicated that the impact on compensation resulting from inconsistent regulatory frameworks is most notable at the highest talent and experience levels. As also mentioned by the firms at the workshop with industry representatives, the longer term supervisory concern is that this dynamic will create a “brain drain” on the traditional financial services sector, with top talent migrating over time to opportunities that offer a better outlook for performance-based rewards and career satisfaction.

Regarding the type of instruments used for variable remuneration, in most jurisdictions both cash and equity instruments are used, with a decline in the use of stock options. One interesting development in this respect is the use of debt instruments as an element of deferred compensation for the two significant banks in Switzerland (see Box 2).

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<sup>28</sup> It should be noted that the European Banking Authority is still processing data on benchmarking remuneration practices in 2014, the first year of applicability of the variable pay cap. The report on 2014 data is expected to be published later this year.

<sup>29</sup> In Hong Kong, a few EU-headquartered banks reported that they have increased fixed pay for MRTs to rebalance the fixed and variable components of their total remuneration. Also banks in Brazil and Mexico mentioned that a way of handling regulatory restriction on variable compensation is to offer an increase in fixed compensation. Singaporean banks have expressed concerns that such global regulatory development could potentially impact their competitiveness to attract suitably qualified talent globally, and drive up fixed costs in the industry.

**Box 2: Capital instruments as an element of deferred compensation within Swiss G-SIBs**

For the last couple of years, the Swiss banks have paid a share of deferred compensation in the form of contingent capital instruments with a Common Equity Tier 1 capital trigger of 7% or higher, depending on the role of the beneficiary. Employees are awarded notional bonds with an annual interest payment. One firm linked the yearly interest payment to the profitability of the bank. The award cliff vests in 5 years, subject to forfeiture if a capital ratio trigger or viability event occurs. As per the end of 2014, the two banks had raised roughly CHF 1.8 billion of regulatory capital with this type of instruments.

Under the focus of regulatory capital, the challenge with compensation instruments is the fact that compensation is normally expensed over time, whereas the capital definition requires fully paid in amounts. This gap can be bridged by either expensing at an accelerated speed or by building up the capital in line with the deferred compensation expenses.

Initially, the instruments were constructed in a form that meets tier 2 quality and as such were subject to amortisation rules during the last five years before maturity. In the meantime, both firms have started to structure their compensation instruments to fulfil additional tier 1 capital conditions requiring, amongst other, approval at the time of pay-out to the beneficiary from the Swiss Financial Market Supervisory Authority.

## 2. Linking compensation and risk governance frameworks

The 2014 progress report noted 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. A section of the 2015 stock take was dedicated to further examining the effective link between compensation and risk governance frameworks.

All authorities note that progress has been made in terms of an increased interaction between the compensation and risk management and other control functions and more active oversight by the board of directors on decisions concerning compensation policies and outcomes. All jurisdictions indicate that significant banks have strengthened risk management processes and governance structures, including a more prominent and increasingly formalised role for the risk function in decisions regarding the alignment of compensation with both ex-ante risk and ex-post performance. The use of structured, formal processes supports the objective of effective alignment of compensation and risk and creates stronger linkages between the risk governance framework including the risk appetite framework and the design and operation of incentive compensation programs.

In particular, while remuneration committees and the board of directors remain responsible for the oversight of compensation policies, the risk management function plays a key role in designing metrics for risk adjustment, in ensuring that the risk adjustments are aligned with the risk appetite frameworks and statements. Firms with more advanced frameworks have put in place processes to actively monitor compensation risks, for example via stress testing or back testing procedures of compensation outcomes. For example, in the US, all firms involved in the FED's horizontal review are also required to back-test or validate the effectiveness of the arrangements in aligning risk and rewards, and of compensation programs in preventing imprudent risk.

This topic was also the focus of the April workshop with the banking industry, which noted continuing progress in aligning compensation with risk, the central role played by control

functions in the design and operation of incentive compensation and efforts to build out frameworks to help validate the effectiveness of risk adjustment mechanisms. Discussions at the workshop highlighted that indicators for risk alignment have improved, that risk objectives and regular “risk reviews” are now commonplace and that there is more awareness among bank staff of the role played by risk management and other control functions including compliance in determining compensation.

Some examples of better practice are:

- The Compensation Committee receives regular input and guidance from members of senior management, including the CRO, on matters such as firm financial performance and strategic execution, incentive plan design and malus and clawback adjustments;
- There is significant interaction between the Compensation Committee and Risk Committees of the board;
- Independent control functions collaborate on proposals for the design, operation and monitoring of incentive compensation programs and take part in formalised reviews that identify and evaluate events that may merit forfeiture or clawback;
- Internal Audit performs risk-based incentive compensation audits of compliance with policies and procedures on the use of discretion, clawback and forfeiture policies and procedures, and monitoring and validation of compensation decisions for material risk-takers among other areas.

In addition, a few authorities (Australia, Canada, Netherlands, Switzerland) noted that firms are increasingly considering variable remuneration in the context of the goals and limits derived from the agreed risk appetite as managed through the Risk Appetite Framework (RAF), for example by applying risk discount factors to the total amount of variable compensation in case certain RAF limits are exceeded. In Italy for example, in banks that represent a best practice, risk metrics used for compensation are the same used in the RAF framework. In Singapore, banks have in place comprehensive processes, through the use of a Balanced Scorecard Approach, to ensure that remuneration and performance frameworks support and drive behaviours which are aligned to the risk appetite. Risk management objectives may also be reflected in the non-financial performance indicators: in the US, one firm has developed a “risk excellence” performance objective which encourages consistent demonstration of risk accountability in the conduct of business, continuous improvement in managing the risk and control environment, and delivery of critical regulatory and control remediation efforts.

One example of how firms adopt risk metrics for risk adjustment that enable a more effective link between compensation and risk governance frameworks is the following, from a analysis conducted by risk specialists at the UK supervisory authority (see Box 3).

**Box 3: Example of risk metrics and process for risk adjustments**

UK firms' approach to risk adjustment can broadly be classified into three main categories:

**Formulaic**

Where the size of the bonus pool is explicitly linked to revenue and risk. This type of approach, if based on an Economic Profit (EP) type measure, demonstrates the strongest link between variable incentives and risk but

does not account for risks that are not easily quantifiable or other quantitative considerations e.g. strategic objectives.

#### **Balanced Scorecard**

Where incentive awards are linked to a firm's performance measured against a set of pre-defined revenue and risk targets/limits. While this approach determines awards based on specific risk measures, the link between risk and award is somewhat weaker than an EP-type formula since it is sometimes difficult to ascertain whether or not the balance between risk and return targets is adequate.

#### **Discretionary**

Where incentive awards are based on the discretion of the Remuneration committee based on a firms' performance as measured by a set of qualitative and quantitative measures. This approach is the least transparent of the three and does not demonstrate a strong link between risk and reward.

However, some firms recognise the inability of a purely formulaic/ balanced scorecard approach to fully capture future risks or risks that are difficult to quantify. These firms thus use combinations of a formulaic/ balanced scorecard and discretionary approaches to determine their variable incentive awards.

While almost all authorities confirm that stronger governance and risk management processes enable more effective risk alignment, there is less direct evidence on whether such developments have changed incentives and led to more prudent risk-taking. The FSB workshop noted that the ultimate challenge remains impacting the behaviour and approaches of line of business managers, since they are key drivers of firms' performance. Improvements in this respect have been observed when managers are more closely involved in the formulation of risk management objectives.<sup>30</sup> The workshop with the industry also noted that notwithstanding progress, more work is needed to ensure the effective alignment of compensation and risk in terms of influencing staff behaviour throughout the firm. Workshop participants discussed types of indicators that could effectively show whether compensation and risk are well aligned. These may include: the dispersion of bonuses paid out around a mean; the percentage of variable compensation and the amount of compensation at risk, including through discretionary components; and the balance between forms of compensation that align with the interests of shareholders versus those that are more aligned with creditors of the firm. A few participants noted that there could be a greater role for a combination of instruments in order to structure a system that effectively aligns incentives with different stakeholders.

The potential of developing specific quantitative or qualitative measures to better measure concrete effects in terms of changes in risk taking behaviour will be an area of further analysis by the CMCG.

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<sup>30</sup> In order to enhance awareness and influence behaviour at the business line management level, one bank has incorporated remuneration as one of the factors in its business strategy stress testing programme, while another bank has increased training programmes and introduced a self-assessment for managers on performance reviews. Several participants underlined the importance of having "360-degree reviews" that involve all relevant units and control functions in the process and consider culture, compliance and risk in an integrated manner for both compensation and promotion decisions.

## IV. Compensation and conduct issues

The FSB Chair has reported to the G20 that the scale of misconduct in some markets has risen to a level that has the potential to create systemic risks and undermine trust in financial institutions and markets.<sup>31</sup> The implications of such misconduct can be far-reaching, and have the potential to create systemic risk. The FSB therefore agreed a workplan to address misconduct risks, including to examine whether the reforms to incentives, for instance to risk governance and compensation structures, are having sufficient effect on reducing misconduct and whether additional measures are needed to strengthen disincentives to misconduct.<sup>32</sup>

Various bodies have recently focussed on the issue of properly addressing misconduct risk, including via compensation structures. The revised corporate governance principles for banks issued by the Basel Committee on Banking Supervision (BCBS) highlighted the responsibility of the Board and senior management of banks in overseeing conduct risk.<sup>33</sup> The UK Fair and Effective Market Review (FEMR) and the G30 have also focussed on conduct issues and have recommended that specific actions be taken in relation to compensation programmes in order to better address misconduct risk.<sup>34</sup> In particular, the UK FEMR recommended that the FSB examines further ways to improve the alignment between remuneration and conduct risk at a global level, by a) attaching to malus and clawback clauses more explicit conduct-based triggers that are clearly linked to measures such as conduct costs, balanced scorecards and client satisfaction with standards of professional conduct; and b) revisiting the structure and the qualitative components of both fixed and variable remuneration, to ensure that an appropriate proportion of remuneration is variable, and to promote the use of a wider range of instruments and payout structures.<sup>35</sup>

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<sup>31</sup> See February 2015 FSB Chair letter to G20 Finance Ministers and Central Bank Governors, at <http://www.financialstabilityboard.org/2015/02/fsb-chairs-letter-to-g20-on-financial-reforms-finishing-the-post-crisis-agenda-and-moving-forward/>.

<sup>32</sup> See April 2015 FSB Chair letter to G20 Finance Ministers and Central Bank Governors, at <http://www.financialstabilityboard.org/2015/04/fsb-chairs-letter-to-g20-on-financial-reforms-progress-on-the-work-plan-for-the-antalya-summit/>.

<sup>33</sup> For a perspective on the relevant scope of “conduct risk”, see the [Basel Committee for Banking Supervision, Corporate Governance Principles for Banks issued July 2015](#), para. 14:

Among their other responsibilities, board members and senior management are expected to define conduct risk based on the context of the bank’s business. Cases of misconduct have been identified as stemming from:

- the mis-selling of financial products to retail and business clients;
- the violation of national and international rules (tax rules, anti-money laundering rules, anti-terrorism rules, economic sanctions, etc.); and
- the manipulation of financial markets – for instance, the manipulation of Libor rates and foreign exchange rates.

The board should set the “tone at the top” and oversee management’s role in fostering and maintaining a sound corporate and risk culture. Management should develop a written code of ethics or a code of conduct. Either code is intended to foster a culture of honesty and accountability to protect the interest of its customers and shareholders.

<sup>34</sup> See <http://www.bankofengland.co.uk/markets/Pages/fmreview.aspx> and <http://group30.org/images/PDF/BankingConductandCulture.pdf>.

<sup>35</sup> The report noted: “To underpin Standard 6 – that recommends that a “substantial proportion of MRTs compensation should be variable – the FSB could consider clarifying expectations around levels of variability in remuneration.” In also suggested to apply a more variable combination of equity and debt instruments as part of variable pay, including debt like structures such as “performance bonds”.

In light of these developments, the 2015 questionnaire focussed on the link between compensation and conduct issues. These issues were also discussed at the FSB workshop with the banking industry on compensation.<sup>36</sup>

Authorities comment that generally banks have made progress identifying and escalating instances of misconduct.<sup>37</sup> Several participants at the FSB workshop commented for instance on the development of “early warning indicators” to help identify potential conduct problems. These include assessing disproportionately high profits in specific business lines or “seats”; tracking unusual revenue patterns and erratic margin calls; monitoring of phone and e-mail communications for consistency with ethics and risk guidelines; operational risk indicators; 360-degree reviews; and monitoring of conduct-related events at other firms to ensure similar vulnerabilities do not occur within the institution. One authority observed over the past year a much greater impact from behavioural incidents on risk-adjusted compensation. In almost all jurisdictions the employees’ annual objective-setting and performance-assessment processes take into account the individual’s compliance with regulation and firms’ internal guidance on conduct issues.

In a few instances, for example in Australia, “misconduct” is defined by regulation<sup>38</sup>; in others, for example Hong Kong and Singapore, banks have internal guidelines that set out the principles and standards of behaviour that are expected of employees and guidelines on the type of misconduct that warrant disciplinary action, although the supervisors indicate that the scope and clarity of such guidelines may vary from one firm to another. In other cases, banks’ internal policies have specific provisions regarding employees’ misconduct, with definitions mostly centred on code of conduct or compliance violations, or other behaviour that may harm customers or the business interests and reputation of the firm.

Assessing behaviour involves a degree of trial and error, not least due to the limitations of indicators. In some jurisdictions (e.g. in Australia, Hong Kong, Italy, Singapore and the US) it is commonplace for banks to use a balanced scorecard approach to incorporate in performance assessments qualitative indicators reflecting both general aspects of employees’ conduct and behaviour (i.e. compliance with rules, regulation and internal guidelines) and more specific

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<sup>36</sup> One of the workshop findings is that boards are increasingly focusing on conduct issues, consistent with their fiduciary responsibility. Board members are asking whether risk-takers understand what the firm expects of them, what conduct issues should impact compensation, and where and how to draw the lines in terms of which individuals should be held accountable and what the right impact on compensation should be. Industry participants emphasised that conduct remains a collective issue that affects “the business unit, individual and supervisor”. The board’s focus is not only on appropriate compensation policies for those staff with low adherence to values, but also on how to adjust compensation to encourage positive behaviour. At the same time, credible deterrence remains a challenge. Individuals’ behaviour and conduct issues are typically addressed on a case-by-case basis, and compensation systems appear not to be sufficiently developed to address conduct issues on an ex ante basis.

<sup>37</sup> One jurisdiction for example noted that banks monitor losses, exceptions, excesses, violations, etc., that help identify areas of concern with respect to a wide variety of risks. Conduct concerns are typically identified through proactive monitoring (i.e., internet, email, messaging services), process controls, client complaints, employee or management escalation notification from an external party (i.e., vendors, regulators, external auditors), compliance testing, self-assessments or corporate audits. Some banks require employees to attest to conduct in a number of areas. When identified, conduct concerns are escalated to the appropriate control functions for review and response, and more serious issues are escalated to senior management.

<sup>38</sup> “Misconduct” is defined under Australia’s Fair Work Regulations as broadly conduct by an employee that is intentional and inconsistent with the continuation of the contract of employment (e.g. refuses to carry out a lawful and reasonable instruction), or causes serious immediate risk to either the health or safety of a person (e.g. assault), or the reputation, viability or profitability of the business (e.g. fraud).

considerations on a broader spectrum of performance (e.g. failure to follow processes, completion of mandatory trainings, treating customers fairly and customer satisfaction, results of internal audits, fraud and other criminal activity). Among compensation tools, an adequate performance management framework (e.g. Key Performance Indicators - KPIs) is key to providing the right incentives to employees. The use of balanced scorecard approaches can also support better the balance between revenue targets and non-financial measures and reinforce banks' expectations on risk, control and compliance standards, being a powerful tool to include conduct consideration in compensation.

Both firms and supervisors are of the view that the existing compensation tools, if appropriately calibrated and used effectively, should enable firms to better prevent or deter misconduct. If applied rigorously, deferrals that are aligned with the time horizon of risks (particularly for employees in roles where the risks are harder to measure or will be realised over a longer time frame), as well as appropriate adjustments to variable pay (e.g. the introductions of "gate conditions" (granting access to the variable part of remuneration) related to compliance<sup>39</sup> and the use of ex-post risk adjustments such as malus and clawback) can be effective in demonstrating a firm's intent to take action in the event of misconduct.

That said, the effectiveness of these mechanisms remains to be tested. While supervisors have been engaging with firms on their policies for employees involved in misconduct only in a small number of cases have supervisors actively examined compensation structures and/or the operation of malus and clawbacks in relation to misconduct cases (Germany, Singapore, Switzerland, UK,<sup>40</sup> and the U.S.).

More generally, the level of information supervisors have on the use of malus is at this stage sparse and insufficient to properly assess whether there is any strong evidence that compensation has been appropriately adjusted— and therefore whether these tools are sufficiently developed and effectively used in shaping individual incentives towards appropriate conduct and deterrence of misconduct risks. A key finding of the 2014 progress report was that there is an emerging consensus on what results in effective application of malus and clawback, including ensuring clarity of communication to employees, proper governance, consistent application, and having enough variable compensation "at risk" of forfeiture. In terms of triggers, in several jurisdictions they are flexible enough for malus and clawback to apply in cases of misconduct. For a few jurisdictions however the prevalent practice is still to confine the application of malus to adverse financial outcomes, such as in the case of material losses. Annex F provides examples of malus and clawback clauses in use by banks in various jurisdictions that are related to personal conduct issues, based on the responses provided to a stock take conducted in 2014 and public disclosure.

One of the challenges noted by firms is how to assess and justify, once malus triggers have been hit, the quantum of risk adjustment to individual remuneration for misconduct.<sup>41</sup> This

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<sup>39</sup> In Italy, for example, the absence of any disciplinary action represents a "gate condition" for the bonus to be awarded.

<sup>40</sup> The UK has focused on the firm's overall approach, including the potential for reductions in the bonus pools, rather than the compensation structure of individuals. In cases where the firm has faced more serious cases of misconduct or losses, adjustments have been made to the bonus pool of specific group levels or business units, as the most common use of malus applies to "in year" bonus.

<sup>41</sup> One authority noted that in the event of a risk- or conduct-related event, some banks would consider a number of factors in deciding the accountability of each individual (including the line managers) involved in the incident. These, for

requires robust governance processes around the use of discretion to ensure consistent application of the malus and clawback clauses. Some institutions have sought to establish objective processes by setting up committees or other oversight mechanisms for reviewing cases where malus and clawbacks could apply. Such committees, which include control function participation, can make recommendations for example on the scale of severity of the incident and the extent of the financial penalty to be applied. This type of oversight recommendation would also enable a consistent application of the clauses.<sup>42</sup>

Firms also note that there is a significant cost to litigating and arbitrating disputes around the world to enforce malus and clawback provisions and a risk that employees in different jurisdictions will not be treated consistently. Finally, also in the case of malus, practical application issues may arise, for example when a settlement is preferred, because of reputational risks or expectation that a court case may lead to higher costs.

Banks who participated in the FSB workshop noted that the most common form of risk adjustment is reduction of current-year bonus awards and possibly demotion before looking to apply malus and limited experience makes the incentive effects of these tools harder to assess. As one authority noted, usually misconduct cases end with the employee being fired and losing any non-vested remuneration.

Establishing a more direct, transparent and immediate link between conduct issues and the award of variable remunerations could help to reduce the incidence of misconduct.

More generally however, compensation is seen as an important, but not the only, tool to address misconduct. Participants at the FSB workshop noted that credible deterrence remains a challenge. Individuals' behaviour and conduct issues are typically addressed on a case-by-case basis, and compensation systems appear not to be sufficiently developed to effectively address conduct issues on an ex ante basis. As an example, "total reward" programmes which combine remuneration with other benefits and career prospects, as well as training and development, offer considerable leverage when used in addressing misconduct risk. More broadly, a combination of strong leadership and governance processes ("tone from the top"), robust risk and control environments independent from inappropriate influence by lines of business, and consideration of conduct-related performance when deciding upon promotion are seen as key drivers of firm culture. All these aspects, together with compensation awards, have an important role to play in demonstrating the extent of firm's intolerance for certain behaviour. Examples of other measures that are seen important for preventing misconduct are outlined in Table 2 below.

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example, include the degree of the employee's responsibility for the circumstances contributing to the event or his/her managerial responsibility for a culpable employee, the magnitude or financial impact of the incident, and the extent to which internal controls had failed."

<sup>42</sup> A few banks participating in the FSB workshop indicated that they have created regional review/disciplinary committees to increase consistency of approach, minimise the incidence of exceptions, ensure greater awareness among middle management and act on training and promotion levers.

**Table 2**

<b>Other measures for preventing misconduct</b>
Tone at the top as “role model” and expectations set by top management (weigh the “how” equally to the “what”)
Wide and effective communication within the firm (“storytelling” and “zero tolerance policy”)
Effective internal control systems, including frequent independent reviews by control functions, which should be strong and independent from business activities.
Thorough periodic reviews of compliance processes
IT systems for systematic controls based on collection and analysis of hard information
Effective internal and institutionalised mechanisms for unusual events reporting / whistle blowing programs
Dealing with minor incidents before they grow
Robust disciplinary action grid, including demotion mechanisms and termination for cause
Closure of business lines or teams
Training programs and promotion programs and decisions
Surveys and internal discussion of actual case studies, and other coaching tools

Several authorities noted that firms must recognise the importance of ensuring that there are consequences when norms and standards for behaviour and, even more so, regulations and laws are violated. Such consequences should be well-specified, clearly communicated and routinely enforced. In certain circumstances misconduct will be addressed through fines and criminal prosecutions of firms and individuals. As firms noted at the workshop with the banking industry, while compensation is a powerful tool if enough pay is at risk, dealing with conduct at some point goes beyond compensation and “it is dismissal, sanction and prosecution”. Industry participants noted that misconduct issues could be better dealt with by improving the culture, risk awareness and individual responsibility at firms.

The synergies between governance, compensation and culture merit further investigation. Boards (and supervisory authorities) are increasingly looking at compensation within a broader context of greater awareness and better understanding of the high-level objectives of sound compensation policies, and creating a culture that is attractive to people in the longer term.

The “new frontier” is to establish compensation practices that support prudent risk-taking but also hold individuals accountable for inappropriate behaviour as well as reward positive behaviour. Issues to be further explored include: how rewarding positive conduct as well as penalising misconduct can be conducive to sound risk culture<sup>43</sup>; how to ensure that an adequate proportion of remuneration is “at risk” in order to help align individual’s incentives and encourage a sound conduct culture at firms; to what extent the look-back period should be extended to align the possibility of applying malus and clawbacks with the likely periods over which any misconduct or mismanagement will come to light.<sup>44</sup>

<sup>43</sup> For example, reviewing the use of balance scorecard approaches and the use of conduct-based gate conditions to be eligible for incentive payments.

<sup>44</sup> See, for example, the speech by Federal Reserve Bank of New York President William Dudley of October 2014, on the use of “performance bonds” for senior executives, a firm’s contingent liability to the employee that can be written down

## V. Compensation policies and practices in the insurance sector

There are important differences in the implementation of the P&S in the insurance sector across jurisdictions. Several jurisdictions (in particular those with integrated supervisors) have extended the scope of implementation to insurers. In Australia for example, the prudential regulation authority expectations apply in full to all deposit-taking institutions, life and general insurers, and superannuation trustees and executives operating in Australia (locally-incorporated entities, foreign-owned subsidiaries and foreign branches). In Canada all federally regulated financial institutions (including insurance companies) since 2009 are expected to comply with the FSB Principles and DSIBs and the three largest life insurance companies are expected to comply with both the Principles and the Standards. Also in other jurisdictions, such as Germany, the Netherlands, Singapore, insurance firms are covered by similar law, regulation and guidance as the banks.<sup>45</sup> In Germany, criteria for “significance” have also been defined and significant insurers have to fulfil more stringent regulation.

Other jurisdictions have just passed relevant regulation or prepared draft regulation. In South Africa the Governance and Risk Management Framework for insurers took effect in April 2015 and contains detailed guidance on compensation, under which insurers are required, among other things, to develop and regularly review an overall risk management policy that includes a distinct remuneration policy, where the matters that must be addressed in the policy are also prescribed.<sup>46</sup> Brazil and Saudi Arabia expects to issue new regulation at the end of 2015.<sup>47</sup> In Europe, the P&S will be incorporated with the application of Solvency II, starting from 1 January 2016.<sup>48</sup> Hong Kong is in the process of revamping its guidance relating to remuneration matters covering aspects such as compensation governance structure, and performance measurement.

In the majority of cases, however, there is currently no dedicated regulation or guidance on compensation issues for these insurance firms (see Table 3 below).

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or converted into equity under certain circumstances. See <http://www.newyorkfed.org/newsevents/speeches/2014/dud141020a.html>.

<sup>45</sup> There may be some differences due to the evolution of regulation for the different sectors. In Germany, for example, the regulations for each sector used to be essentially identical and based on the P&S (2010). Since then the developments in the banking sector have been much faster also due to the CRD IV. Thus, the two regulations are not identical anymore.

<sup>46</sup> See <http://www.fsb.co.za/Departments/insurance/Documents/Board%20Notice%20158%20of%202014%20%20Governance%20and%20Risk%20Management%20Framework%20for%20Insurers.pdf>

<sup>47</sup> In Brazil, one of the key features will be the mandatory designation of a risk manager for every insurance company, with the objective of, among others, evaluate if the metrics used for assessing the performance of senior executives and key employees, especially those concerning compensation, may impact the risk management. In Saudi Arabia, the remuneration strategy will need to be submitted to the supervisor.

<sup>48</sup> See “Solvency II” Directive 2009/138/EC ( [http://ec.europa.eu/finance/insurance/solvency/solvency2/index\\_en.htm](http://ec.europa.eu/finance/insurance/solvency/solvency2/index_en.htm) ). The P&S will be explicitly applicable via article 275 of [Commission Delegated regulation](#) 2015/35 which specifies the principles applicable to compensation policies. This regulation is part of Solvency II and completed by the Guidelines 9 and 10 of the Guidelines on System of governance edited by EIOPA. The high-level features are: implementation of remuneration schemes for all employees and specific remuneration schemes for the management body, the supervisory body, persons who effectively run the undertaking or have other key functions or “risk”-takers; Disclosure of the remuneration schemes to all employees; Specific remuneration schemes contains e.g. the following: i) an appropriate balance between fixed and variable income; ii) possibility to cut the variable pay due to the performance of the person as well of the company as a whole; iii) the variable pay will be paid in a timeframe of at least 3 years; iv) termination pay is also connected to the performance of the person and the company so that failure is not rewarded.

Table 3

Jurisdictions for which the P&S are incorporated in insurance regulation	Jurisdictions for which insurance regulations has not incorporated the P&S
<i>(In parenthesis the level of implementation of the P&amp;S by significant firms as assessed by the domestic supervisor)</i>	
Australia ( <i>high</i> ) Canada ( <i>high</i> ) China ( <i>medium</i> ) Germany ( <i>high</i> ) Hong Kong (under revision; <i>high</i> ) Italy ( <i>medium; higher for significant undertakings</i> ) Japan ( <i>medium</i> ) Korea ( <i>high</i> ) Netherlands ( <i>high</i> ) Singapore ( <i>medium</i> ) Switzerland ( <i>high</i> )	Argentina (Information not available) Brazil (draft regulation expected by end 2015; <i>low</i> ) France (expected in 2016 with implementation of Solvency II; <i>low</i> ) India (information not available) Indonesia ( <i>NA</i> ) Mexico ( <i>low</i> ) Russia ( <i>low</i> ) Saudi Arabia (draft regulation expected by end 2015; <i>low</i> ) Spain (expected in 2016 with implementation of Solvency II; <i>low</i> ) Turkey (Information not available) UK (expected in 2016 with implementation of Solvency II; <i>NA</i> ) US (selected provisions are applicable on the basis of other regulations; <i>medium</i> )

*The high/medium/low level of implementation by significant firms is assessed by domestic supervisory authorities and does not derive from or imply an assessment of the compliance of the domestic regulation with respect to the P&S.*

If the jurisdictions with integrated supervisory authority are excluded, supervisory activity related to compensation also appears somewhat less common than in the case of banks. In Brazil for example the oversight by the private insurance superintendence doesn't cover compensation practices. However in some jurisdictions compensation practices in the insurance sector are subject to intense monitoring and oversight. In China for example the supervisory authority focuses on several aspects of compensation design and outcomes (including if the level of compensation is out of proportion to the company's risk profile), and circumstances are specified in which the compensation of senior executives and directors is determined by the regulator. Hong Kong conducted a horizontal review in 2013 to review different features of compensation policies and structures.<sup>49</sup> In Italy, after the entry into force in 2011 of the relevant regulation, the sector supervisory authority (IVASS) conducted an analysis on the policies adopted by companies and issued clarifications aimed to ensure a

<sup>49</sup> The survey found that insurers in Hong Kong generally make use of both financial and non-financial factors in performance measurement. The majority of the insurers make use of variable remuneration in their remuneration structure. Those insurers which have incorporated share-based remuneration usually have set a vesting period of three years. Senior management are commonly identified as MRTs.

correct and uniform application of the rules.<sup>50</sup> Korea plans to carry out a horizontal review on the adequacy of insurer's overall compensation assessment practices during the second half of 2015.<sup>51</sup> In the US, beginning in 2016 state insurance regulators will review and assess the compensation practices of insurers within the ORSA process and Corporate Governance Annual Disclosure.<sup>52</sup>

The FSB and IAIS organised an insurance workshop in May. The descriptions provided by participating firms of their compensation policies and practices seemed de facto to reflect some of the key FSB P&S, including those related to governance of compensation and the risk function (which plays a prominent role in identifying key risk takers and material risks). Generally, the compensation practices of internationally active insurers presented in the workshop seem fairly aligned across regions. According to information received at the workshop and as confirmed by the information submitted by national authorities in jurisdictions which actively oversee compensation practices in the insurance sector, compensation structures in the insurance industry generally differ from the structures in the banking sector: a lower number of risk takers is usually identified (typically at high level of seniority, above head of department ); the remuneration level and the proportion of variable remuneration are generally lower, and with less dispersion across covered employees; the portion of variable compensation that is deferred is higher at banks, although malus are included in contracts and insurers indicated that they are applied when needed. Clawbacks are also being introduced in contracts, at least for senior executives, although to a lesser extent also given legal impediments. Insurers indicated that the longer-term business and risk horizon, both in terms of career and compensation arrangements, result in a lower number of MRTs and imply fewer reasons for ex-post risk alignment. The use of deferrals and malus conditions and their alignment with the risk time horizon of different businesses, given the long tails on businesses such as life insurance, might be an area for further investigation.

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<sup>50</sup> The clarifications, issued in 2013, concerned, in particular: the identification of risk takers; the relationship between fixed and variable remuneration; the objectives, which must be based primarily on the results of the long-term average; indicators of performance measurement, which must incorporate adequately the prospective risks; the business strategy of the parent company and the differentiation of the remuneration policies of the subsidiaries due to the specific companies.

<sup>51</sup> The supervisory authority in Korea conducts regular assessments on the adequacy of insurers' compensation-related governance issues, parameters used for determining fixed or performance-related remuneration, deferred payment of performance-related remuneration, and severance packages. The FSS also meets with the management of the insurers or send out guidance letters to encourage them to make necessary changes to identified deficiencies.

<sup>52</sup> Other provisions also apply, for example to insurance companies that are subject to the federal securities laws. These insurance companies are required to provide disclosures about executive compensation arrangements. Further, certain insurance companies and banks that are part of publicly held groups are subject (or proposed to be subject) to public disclosure and exchange listing requirements related to executive compensation, compensation committees at the board level, risk management, bonus structures (including claw-back policies), and use of compensation consultants.

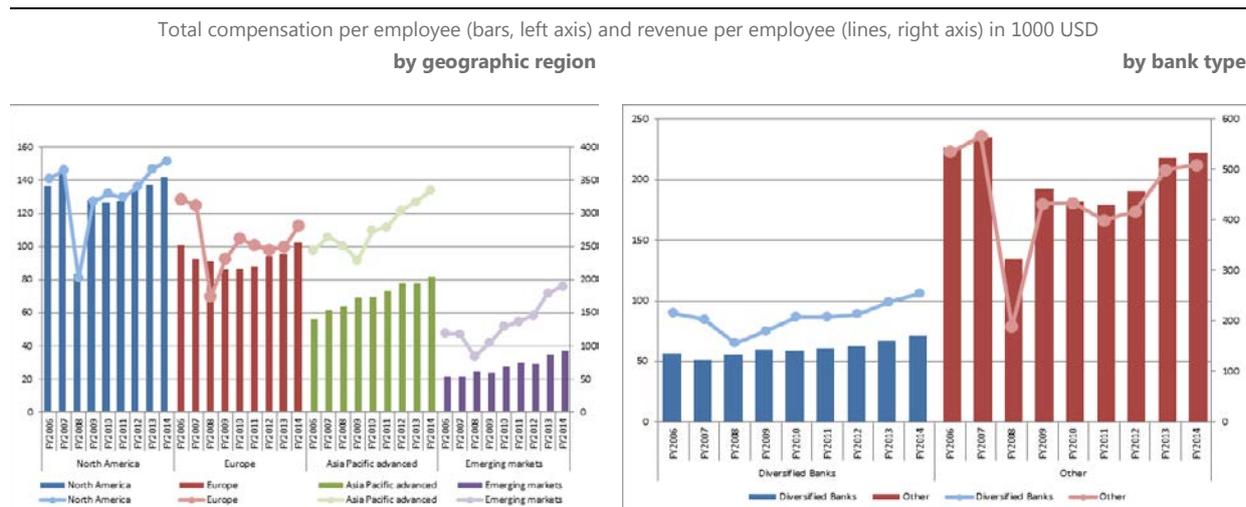
## Annex A: Evolution of compensation in the banking industry

This Annex provides a brief overview of compensation trends for significant banks in recent years, and it was prepared by the FSB Secretariat on the basis on publicly available information.<sup>53</sup> The underlying data and analysis should not be interpreted as vetted or necessarily endorsed by the CMCG. While not directly focussed on the link between compensation structures and risk alignment, which is the main focus of the CMCG, the analysis is meant to provide background information on the evolution of compensation costs and structures for the banking sector. This may offer additional context to the trends reported by national authorities in the main text of the report.

Graphs 1 and 2 show the evolution of compensation costs in relation to revenues per employees, and the share of net revenues accounted for by compensation costs (compensation ratio). Average compensation per employee for significant banks recovered after the crises and shows a mild upward trend in recent years. There are large differences in levels across regions, with banks in North America having the highest total compensation per employee as well as highest revenue per employee.

Compensation costs and revenue per employee

Graph 1



Total compensation per employee and revenue per employee over 2006-2014 for banks surveyed by national supervisors for the purposes of this report (see Annex D). Total compensation costs include salaries, wages, bonuses, commissions, changes in reserves for future stock option expense and other employee benefit costs, including pension and other employee benefits. Any expenses related to employment or retirement benefits, whether paid or deferred, are recognised during the period.

Left panel: banks have been grouped by region as follows: North America (US/Canada), Europe, Asia-Pacific advanced (Japan/Hong Kong/Australia/Korea/Singapore), Emerging Markets. Right panel: banks have been grouped by business model based on S&P Capital IQ classification. "Diversified banks" are predominantly commercial banks. "other banks" are investment/wholesale banks. Not classified banks have been included in the group of Diversified banks (Banco Mercantil Del Norte, S.A., Banco Nacional de Mexico, S.A., BPCE SA, Coöperatieve Centrale Raiffeisen-Boerenleenbank B.A., Gazprombank (Open Joint - stock Company), BBVA Bancomer, S.A., The Hongkong and Shanghai Banking Corporation Limited, HSBC Bank Argentina S.A., HSBC Mexico, S.A., ING Groep N.V., KB Kookmin Bank, Landesbank Baden-Wuerttemberg, Macquarie Bank Limited have been included in the sample of diversified banks). Source: S&P Capital IQ; BIS calculations.

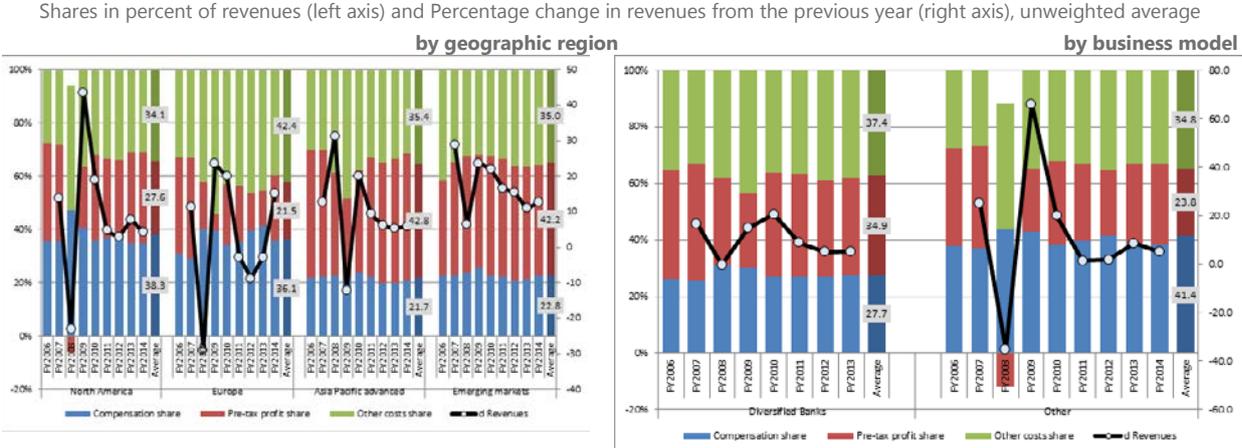
Recent increases in compensation costs per employee are bringing the advanced economies in the Asia-Pacific region to levels similar to those in Europe, where such costs have remained

<sup>53</sup> This includes Bloomberg, S&P Capital IQ, SNL and remuneration reports by the European Banking Authority (EBA).

fairly stable after the crisis. Compensation costs per employee in the emerging markets are smaller, but growing rapidly. Compensation costs per employee for investment/wholesale banks are significantly higher than other banks and substantially more volatile.

In all regions, the compensation ratio (share of revenues accounted for by compensation costs) has remained relatively stable over time (Graph 2). This observation, which has also been highlighted for some institutions in the latest EBA report on remuneration practices in the EU,<sup>54</sup> indicates a low correlation between profitability and compensation, which might suggest a weak link between pay and performance at the aggregate level. The compensation ratio is similar (and higher) in North America and Europe than for other regions, and is also higher and more volatile for investment / wholesale banks.

Share of compensation, pre-tax profits and other costs Graph 2



Share of [net] revenues represented by compensation costs, pre-tax profits and other costs over 2006-2014 for banks surveyed by national supervisors for the purposes of this report (see Annex D). Net revenues are calculated as the sum of net interest income after provision for credit losses and total noninterest income. Left panel: banks have been grouped by region as follows: North America (US/Canada), Europe, Asia-Pacific advanced (Japan/Hong Kong/Australia/Korea/Singapore), Emerging Markets. Right panel: banks have been grouped by business model based on S&P Capital IQ classification. “Diversified banks” are predominantly commercial banks. “other banks” are investment/wholesale banks. Not classified banks have been included in the group of Diversified banks (Banco Mercantil Del Norte, S.A., Banco Nacional de Mexico, S.A., BPCE SA, Coöperatieve Centrale Raiffeisen-Boerenleenbank B.A., Gazprombank (Open Joint - stock Company), BBVA Bancomer, S.A., The Hongkong and Shanghai Banking Corporation Limited, HSBC Bank Argentina S.A., HSBC Mexico, S.A., ING Groep N.V., KB Kookmin Bank, Landesbank Baden-Wuerttemberg, Macquarie Bank Limited). Source: S&P Capital IQ; BIS calculations.

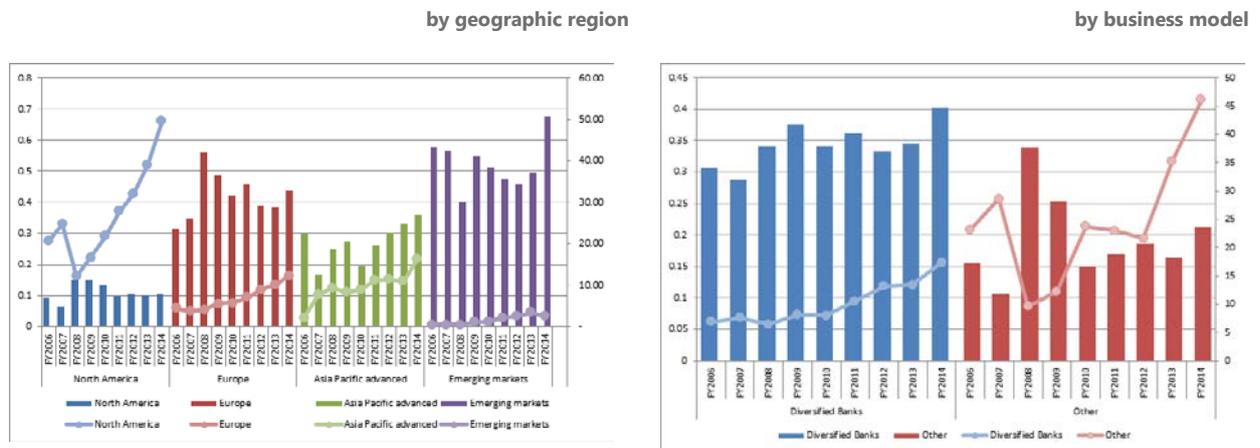
In terms of compensation trends for senior bank executives, the proportion of total pay accounted for by fixed compensation is significantly lower in North America than in other regions (Graph 3). That portion has remained relatively stable in Europe and North America in recent years. At the same time, the proportion of fixed compensation picked up markedly in Asia Pacific advanced economies and has remained at a high level in emerging markets. The level of total compensation is higher and the ratio of fixed to total compensation is lower for investment / wholesale banks, although this ratio increased across business models in recent years, more so for commercial banks.

<sup>54</sup> The EBA noted that "no strong correlation between the average net profit of institutions and the remuneration of identified staff could be observed... However, during these years remuneration was significantly restructured and fixed remuneration increased."

## Proportion of fixed compensation and total compensation

Graph 3

Ratio of fixed compensation / Total compensation (bars, left scale) and Total compensation (lines, right scale, in millions of USD) of the top 10 professionals by rank, by geographic region



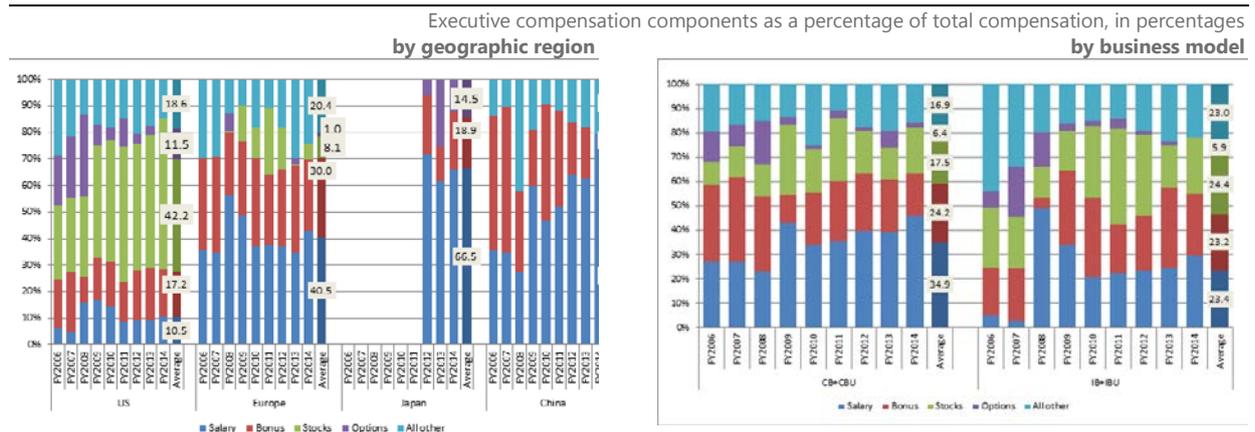
Fixed/total compensation ratio (left-hand axis) and the absolute amount of total compensation (right-hand axis) of senior executives ranked from one up to top ten (\*) (including the CEO, CFO, COO etc.) over 2006-2014 for banks surveyed by national supervisors for the purposes of this report (see Annex D). Total compensation includes salary, bonus, other annual compensation, restricted stock awards, stock grants, LTIP (long term incentive plans), option awards, all other compensation, change in pension plan/non-qualified deferred comp earnings. Fixed compensation is the amount paid as salary to the executives for that year. Top panel: banks have been grouped by jurisdiction as follows: North America (US/Canada), Europe, Asia-Pacific advanced (Japan/Hong Kong/Australia/Korea/Singapore), Emerging Markets. Right panel: banks have been grouped by business model based on S&P Capital IQ classification. “Diversified banks” are predominantly commercial banks. “other banks” are investment/wholesale banks. Not classified banks have been included in the group of Diversified banks (Banco Mercantil Del Norte, S.A., Banco Nacional de Mexico, S.A., BPCE SA, Coöperatieve Centrale Raiffeisen-Boerenleenbank B.A., Gazprombank (Open Joint – stock Company), BBVA Bancomer, S.A., The Hongkong and Shanghai Banking Corporation Limited, HSBC Bank Argentina S.A., HSBC Mexico, S.A., ING Groep N.V., KB Kookmin Bank, Landesbank Baden-Wuerttemberg, Macquarie Bank Limited a have been included in the sample of diversified banks). Source: S&P Capital IQ; BIS calculations

(\*)The executives rank is determined on how they appear in the remuneration report or annual report. The data is extracted for executives up to rank 10, and aggregated.

For G-SIBs identified in 2014, Graph 4 shows the evolution of the various components of compensation, confirming that salary is becoming an increasing share of total compensation in particular for diversified banks.

## Total compensation components for senior executives for G-SIBs

Graph 4



Total compensation components for executives ranked up to 10 (see graph 2a) for G-SIBs identified in 2014 (see <http://www.financialstabilityboard.org/2014/11/2014-update-of-list-of-global-systemically-important-banks/>)

Salary: amount paid as salary for the year. Bonus: amount paid as bonus for the year. Stock: value of stock awards granted during the year that do not have option like features. Other: value of all other compensation that is not disclosed in other columns.

Left panel: grouped by jurisdiction (G-SIBs: China, Europe, Japan, US)

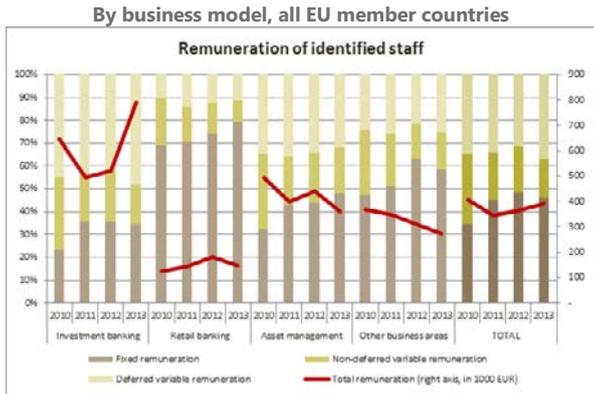
Right panel: grouped by business model. Left panel: IB: investment banks; IBU investment banking – oriented universal banks; CB: commercial banks; CBU commercial banking – oriented universal banks. See Gambacorta Van Rixtel, Structural bank regulation initiatives: approaches and implications, [BIS WP 412](#).

Source: S&P Capital IQ; BIS calculations.

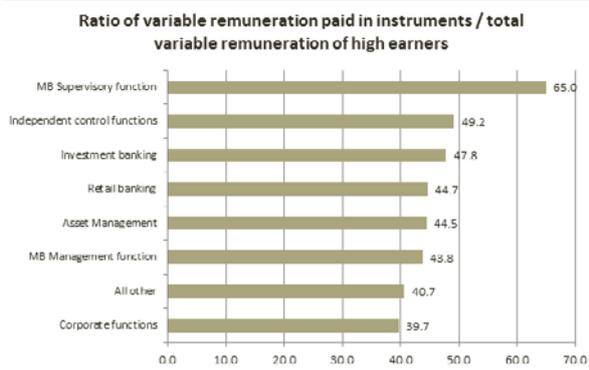
A more detailed breakdown of the structure of compensation by business model and area is currently only available for banks operating in the EU, for which a systematic data collection exercise is being conducted by the EBA (Graph 5).<sup>55</sup> Both the level of total compensation for material risk takers ('identified staff'), and its split between fixed and variable compensation, differ substantially between business areas. Investment banking exhibits the highest level of total remuneration per employee (which has grown in recent years), the lowest proportion of fixed remuneration, but also the highest proportion of variable pay that is deferred.

Remuneration of high earners and identified staff in EU banks

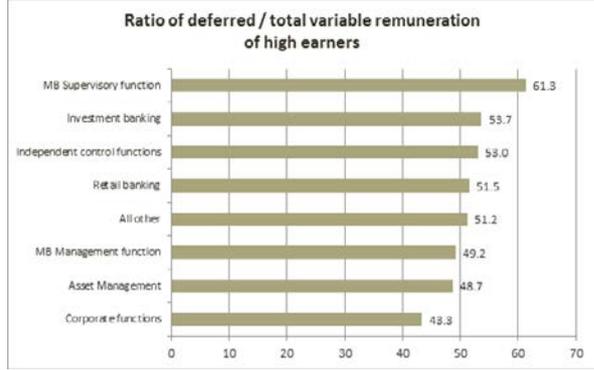
Graph 5



2013, only FSB jurisdictions that are members of the EU by business area, in %



2013, only FSB jurisdictions that are members of the EU by business area, in %



Source: EBA survey on remuneration practices at EU level and data on 'high earners' (defined as individuals who earn at least EUR 1,000,000). Home EU member state authorities are required to collect and provide information on the compensation components (salary, bonus, long-term award and pension contribution) and by business area (investment banking, retail banking, asset management, other business area). The data are collected by national authorities on behalf of EBA (EU regulation No 575/2013, Art 450(1)). The data on high earners are published by member state, while those on material risk takers ("identified staff") are published on an aggregate member state basis. Total fixed remuneration includes payments, proportionate regular (non-discretionary) pension contributions, or benefits (where they are without consideration of any performance criteria). Total variable remuneration includes additional payments or benefits depending on performance or, in exceptional circumstances, other contractual elements but not those which form part of routine employment packages (such as healthcare, childcare facilities or proportionate regular pension contributions). Both monetary and non-monetary benefits are included. Amounts are reported gross, without any reduction due to the application of the discount rate for variable remuneration for the categories of total variable remuneration, variable in cash, variable in shares and share-linked instruments, and variable in other types of instruments. Total amount of variable remuneration awarded in year N which has been deferred in accordance with Article 94(1)(m) of Directive 2013/36/EU. (EBA, July 2014). See EBA Report on 2014 at: <http://www.eba.europa.eu/-/eba-updates-on-remuneration-practices-and-high-earners-data-for-2013-across-the-eu> and EBA-Report: [Benchmarking of Remuneration Practices at Union Level, EBA, September 2015](#).

In terms of 'high earners' (defined as individuals who earn at least EUR 1 million) for banks in FSB jurisdictions that are EU member states, the proportion of variable remuneration that

<sup>55</sup> Six FSB jurisdictions are covered by the EBA data collection exercise, which aggregates granular and homogeneous information on the structure of compensation. See EBA Report on 2014 at: <http://www.eba.europa.eu/-/eba-updates-on-remuneration-practices-and-high-earners-data-for-2013-across-the-eu> and EBA-Report: [Benchmarking of Remuneration Practices at Union Level, EBA, September 2015](#)

is deferred or not paid in cash is relatively similar across business functions. The main exception is for senior management, which has a higher proportion in both cases. The proportion of fixed remuneration remained stable in investment banking and increased both in retail banking and in asset management.

## Annex B: 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).<sup>56</sup> 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 2014 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
<i>Effective governance of compensation</i>																								
<b>P1</b>	R	R	R	S	S	R	R	S	R	R	R	S	S	R	R	S	R	R	R	R	R	S	R	R
<b>P2</b>	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
<b>P3</b>	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
<i>Effective alignment of compensation with prudent risk taking</i>																								
<b>P4</b>	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
<b>P5</b>	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 <sup>57</sup>	R	R	S	S	R	R	S	R	IP	R	S	S	R	R	S	R	S	R	R	R	S	R	S

<sup>56</sup> The effective implementation of the Principles and Standards can be achieved through a variety of approaches, including different mixes of regulation and supervisory oversight.

<sup>57</sup> 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	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	S	R	S	S	R	R	S	R	IP	R	S	S	R	R	S	R	S	R	R	R	R partly (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	S	R	S	IP	R	R	S	R	IP	R	S	S	R	R	S (partly)	R	S	R	R	R	IP (NA)	R	S
S9	R	S	R	S	S	R	R	S	R	IP	R	S	S	R	R	S	R	S	R	R	R	R partly (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	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	S	IP	S	S	R	R	S	R	IP	R	S	S	R	R	S	S	S	R	R	NA	IP (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 C: Remaining gaps in national implementation

Country	Remaining gaps in national implementation	Principle not yet implemented	Standard not yet implemented	Reason / additional information
<b>Argentina</b>	Effective alignment with risk taking		5 (partly) and 10	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 <a href="http://www.bcra.gov.ar/pdfs/marco/MarcoLegalCompleto.pdf">http://www.bcra.gov.ar/pdfs/marco/MarcoLegalCompleto.pdf</a> .
<b>Brazil</b>	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 ( <a href="http://www.bis.org/bcbs/implementation/12_br.pdf">http://www.bis.org/bcbs/implementation/12_br.pdf</a> ) 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.
<b>China</b>	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.
<b>India</b>	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. Standard 10 on effecting changes in remuneration structures of executives in financial institutions will be addressed in the Financial Sector Regulation Bill. This draft legislation has been submitted to Parliament and promulgation is expected in 2016
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 (partly), 8, 9 (partly), 14	As for S7, the supervisory guidance requires banks to pay the variable remuneration in instalments by taking account of the time dimension of the risks and some banks pay their variable remuneration in two or three instalments. As regards S9, the supervisory guidance requires banks to take back any unvested portion of variable remuneration of employees who are responsible for a serious financial downturn. <b>There are initiatives under preparation to fully align our implementation with the S7, S8, S9, S14.</b>
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.

## Annex D: List of banks surveyed by national supervisors for the purposes of this report <sup>58</sup>

*Updated in 2015*

Country	Firms
<b>Argentina</b>	1. Banco Santander Rio 2. Banco Galicia 3. HSBC Bank Argentina
<b>Australia</b>	4. Commonwealth Bank of Australia 5. National Australia Bank 6. Australia and New Zealand Banking Group 7. Westpac Banking Corporation 8. Macquarie Bank Limited
<b>Brazil</b>	9. Itaú 10. Bradesco
<b>Canada</b>	11. Royal Bank of Canada 12. Toronto-Dominion Bank 13. Scotiabank 14. Canadian Imperial Bank of Commerce 15. Bank of Montreal
<b>China</b>	16. Industrial and Commercial Bank of China 17. Bank of China 18. Agricultural Bank of China
<b>France</b>	19. BNP Paribas 20. Société Générale 21. Crédit Agricole 22. BPCE
<b>Germany</b>	23. Deutsche Bank 24. Commerzbank 25. Landesbank Baden Württemberg
<b>Hong Kong</b>	26. The Hongkong and Shanghai Banking Corporation Limited 27. Standard Chartered Bank (Hong Kong) Limited
<b>India</b>	28. ICICI Bank 29. HDFC Bank 30. Kotak Mahindra Bank 31. Axis Bank
<b>Indonesia</b>	32. Bank Mandiri 33. Bank Central Asia 34. Bank Danamon

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<sup>58</sup> All these firms are considered by the respective authorities as significant for the purposes of the P&S.

<b>Country</b>	<b>Firms</b>
<b>Italy</b>	35. Unicredit 36. Intesa San Paolo
<b>Japan</b>	37. Mizuho Financial Group 38. Mitsubishi UFJ Financial Group 39. Sumitomo Mitsui Financial Group
<b>Korea</b>	40. Kookmin Bank 41. Shinhan Bank
<b>Mexico</b>	42. Banco Mercantil del Norte (Banorte) 43. Banco Nacional de México (Banamex) 44. BBVA Bancomer 45. HSBC México 46. Banco Santander
<b>Netherlands</b>	47. ING Group 48. Rabobank
<b>Russia</b>	49. Sberbank 50. VTB 51. Gazprombank
<b>Saudi Arabia</b>	52. National Commercial Bank 53. SAMBA Financial Group
<b>Singapore</b>	54. DBS Bank 55. Oversea-Chinese Banking Corporation 56. United Overseas Bank
<b>South Africa</b>	57. Nedbank 58. Standard Bank
<b>Spain</b>	59. Santander 60. BBVA
<b>Switzerland</b>	61. Credit Suisse 62. UBS
<b>Turkey</b>	63. Isbank 64. Akbank
<b>UK</b>	65. Barclays 66. HSBC Holdings 67. Lloyds Banking Group 68. The Royal Bank of Scotland Group 69. Standard Chartered
<b>USA</b>	70. Citi 71. Goldman Sachs 72. Morgan Stanley 73. JP Morgan Chase 74. Bank of America 75. Wells Fargo 76. State Street 77. Bank of New York Mellon

## Annex E: Changes in effective implementation by the firms and remaining challenges cited by various national regulators<sup>59</sup>

Changes in effective implementation and remaining challenges		
	Changes 2011-2014	Challenges
<b>Governance</b>	<p>Boards are more actively involved in the design of compensation policies and in reviewing their implementation.</p> <p>Boards have created a dedicated committee to govern compensation arrangements.</p> <p>Greater board involvement in conduct and ethics issues.</p> <p>Greater involvement of the CRO/ risk management/other control functions in the approval process of performance/risk measurement indicators and in the performance assessment process.</p> <p>Compensation systems are subject to robust controls and periodic reviews to ensure integrity, alignment with regulations and consistency of outcomes with intentions.</p> <p>Revised reporting structure and performance goals of control function staff to increase independence.</p> <p>Alignment of compensation policies at different group levels and better monitoring at group level.</p> <p>Periodic internal audits and compensation systems' performance assessments based on relevant risk indicators; formal monitoring and validation programs for compensation programs and outcomes.</p> <p>Introduction of 360-degree review process involving independent control functions, peers and direct reports.</p>	<p>Room for improvement in internal firm documentation.</p> <p>Lack of adequate systems to generate the information needed for the remuneration committee.</p> <p>Need for more effective monitoring of remuneration systems by the remuneration committee.</p> <p>Effective challenge of management decisions, particularly for compensation decisions of executive management.</p> <p>Effectiveness of local board or management's authority and discretion over risk adjustments, such as the exercise of malus or clawback in the case of subsidiaries or branches of foreign firms.</p>
<b>Risk alignment</b>	<p>Greater use of deferred pay and increase in deferral periods and non-cash components.</p> <p>Introduction of malus and clawback clauses and increased use of malus.</p> <p>Increased use of risk-based performance metrics; risk taken into account in the calculation of the bonus pool; improved consistency with indicators used for risk management and Risk Appetite Framework purposes.</p> <p>Improvements in a mix of quantitative and</p>	<p>Gate conditions not set at "challenging" levels, which makes variable compensation likely to be awarded.</p> <p>Clawback remains a practical and legal hurdle, and is not readily pursued due to business culture and legal uncertainty.</p> <p>Sustainable effectiveness of <i>ex-post</i> adjustments (mainly relating to conduct issues).</p> <p>Risk-adjusted performance is measured at the business unit or firm level and may not be</p>

<sup>59</sup> Note that this annex represents the combined views of national regulators, and largely reflects practices at significant banks. Not all observations are relevant for every supervised organization.

## Changes in effective implementation and remaining challenges

	<p>qualitative methods in making <i>ex-ante</i> risk adjustments; increased use of qualitative risk measures, e.g. related to Internal Audit, compliance etc. Greater focus on compliance risk.</p> <p>Improvements in KPIs and performance management systems to reduce number of KPIs, simplify performance management and make the link between compensation and performance more transparent.</p> <p>Gate conditions and malus clauses progressively refined, increasing their “potential impact” on variable compensations.</p> <p>Well established and progressively sounder processes for identification of MRTs; more clarity on the classification of MRTs.</p> <p>Constant evaluation of metrics and methodology. Risk objectives and regular “risk reviews” are now commonplace.</p>	<p>directly linked to the individual performance of all material risk-takers.</p> <p>Defining measurable goals and objectives in quantifying the risk at individual employee level with its time horizon remains a challenge. Also assigning a numerical measure to an individual for the collective risk decisions taken by a group of executives (e.g. ALCO) of whom the individual is part.</p> <p>Improvements needed in the <i>ex-ante</i> information concerning the formula to be applied at individual level (aligning objectives and metrics), so that the individuals can have a clear understanding of the relevant parameters. Need for improvements in the analysis of potential hedging activities.</p> <p>Methodologies are not yet covering situations that could arise by systemic factors, outside the influence of the risk decisions takers.</p> <p>Need for better documentation of risk adjustment process and decisions and more widespread use of effective performance indicators.</p> <p>Progress in developing and implementing appropriate risk adjustments remains uneven, not only across firms, but within firms.</p>
<p><b>Stakeholder engagement</b></p>	<p>Increased and improved public disclosure of compensation policies, including on compensation governance and risk alignment; banks’ public disclosures have strengthened in line with the Basel Committee’s Pillar 3 guidance.</p> <p>Growing clarity and completeness of the information disclosed to the public on compensation payout amounts, deferrals and ratio between variable and fixed components of the remuneration for identified staff, including data regarding directors, managers and other key management personnel categories.</p> <p>The remuneration policies are approved by the shareholders’ meeting, and are brought to the attention of the market. Overall, an increasing role of proxy advisors and shareholders involvement is observed.</p> <p>Shareholders are able to play an increasingly important role within firms. In the EU, the role of shareholders has been made more important with the need for approval of 2:1 variable fixed compensation arrangements.</p>	<p>Remaining room for improvements concerning clarity and comprehensiveness of disclosures.</p> <p>Uneven level of granularity in the information provided to the public.</p>

## Annex F: Examples of triggers for malus and clawbacks clauses related to personal conduct

TRIGGERS	
<b>TRIGGERS</b>	<ul style="list-style-type: none"> <li>• Breach of risk limits</li> <li>• Staff member is subject to an investigation and/or disciplinary process for a potential act of misconduct; internal and external findings (audit results)</li> <li>• In the event of engagement in conduct or performance of acts which are considered malfeasance or fraud</li> <li>• Misconduct or material error that resulted in the firm suffering a material downturn in financial performance;</li> <li>• Misconduct or material error that might be reasonably expected to cause significant financial or reputational harm. -</li> <li>• Violation of law, regulation or internal policies and this leads to significant financial or reputational harm</li> <li>• Personal misconduct, breach of law/ firm’s internal policy, damage to the firm’s reputation, disciplinary layoff</li> <li>• Compliance or regulatory breaches, material breaches of risk and compliance policies and procedures (for example, a breach of the group's code of conduct, internal control rules or risk management procedures, risk and compliance policy).</li> <li>• Serious violation by the employee of provisions of law, group’s compliance rules, company policies or values, with particular reference to the code of conduct and considering any internal or external findings</li> <li>• In the event the group or the business line in which the relevant staff member works suffers a significant failure for risk management;</li> <li>• Engagement in improper or inadequate risk management or failure to raise such concerns</li> <li>• Knowingly providing inaccurate information related to the institution’s risk management.</li> <li>• Uncooperative behaviour regarding risk tasks or requests by the risk officer.</li> <li>• Staff knowingly engaged in providing materially inaccurate information relating to publicly reported financial statements</li> <li>• Incident of wilful and deliberate misrepresentation / misreporting of financial performance (inflating the performance), gross inaccuracy,</li> <li>• Violation of accounting rules and/or submission of false information on the activities of credit institution’s unit;</li> <li>• Disclosure of confidential information</li> <li>• Increase in the number of complaints/claims on banking and other transactions effected by the credit institution’s unit or the employee.”</li> <li>• Employee engaged in conduct that has directly or indirectly resulted in:             <ul style="list-style-type: none"> <li>○ financial loss or reputational harm to the bank</li> <li>○ the need for restatement of the financial results</li> <li>○ adverse change in the risk profile or rating of the bank, or detrimental to the Bank or Group</li> <li>○ material violation of risk limits, material losses due to negligent risk taking or inappropriate behaviour</li> <li>○ Misconduct or fraud leading to termination</li> <li>○ Neglect or failure to exercise proper risk management which results in significant losses or reduction in business, including those related to legacy or tail risk from prior roles within the institution.</li> </ul> </li> <li>• Reasonable evidence of employee misbehaviour or material error and/ or the firm or relevant business unit suffers a material failure of risk management, in situations where the employee participated in or was responsible for conduct which resulted in significant losses to the firm or failed to meet appropriate standards of fitness and propriety.</li> </ul>

EXAMPLES OF CLAUSES	
<b>EXAMPLES OF CLAUSES</b>	<ol style="list-style-type: none"> <li>1. Shares and unvested deferred cash will be cancelled if it is determined that the employee:- Breaks internal regulations, particularly those relating to risks;- Receives the award based on materially inaccurate publicly reported financial statements;- Knowingly engages in providing materially inaccurate information relating to publicly reported financial statements;- Materially violates any risk limits established or revised by senior management and/or risk management;- Engages in behaviour constituting misconduct or exercises materially imprudent judgment that caused harm to any of the company's business operations, or that resulted or could result in regulatory sanctions (whether or not formalized);- Fails to supervise or monitor individuals engaging in, or failed to properly escalate behaviour constituting, misconduct (whether or not gross misconduct) in accordance with the policies regarding the reporting of misconduct, or who exercised materially imprudent judgment that caused harm to any of the operations;- Fails to supervise or monitor individuals engaging in, or fails to properly escalate, behaviour that resulted or could result in regulatory sanctions(whether or not formalized);- Is sanctioned for a serious breach of the conduct code and internal normative, particularly the one related to risks.</li> <li>2. Example: Malus (reduction or forfeiture) applies to unvested stock awards if (i) There is reasonable evidence of misbehaviour or material error by the Participant; or (ii) The Group, the Company, the Employer Company or the relevant business unit suffers a material downturn in its financial performance, for which the participant can be seen to have some liability; or (iii) The Group, the Company, the Employer Company or the relevant business unit suffers a material failure of risk management, for which the participant can be seen to have some liability.</li> <li>3. Awards are subject to cancellation for competition, cause (i.e., any act or omission that constitutes a breach of obligation to the Company, including failure to comply with internal compliance, ethics or risk management standards and failure or refusal to perform duties satisfactorily, including supervisory and management duties), disclosure of proprietary information and solicitation of employees or clients.</li> <li>4. The Company's equity awards generally are subject to cancellation for, among other things, engaging in anti-competitive activity, termination for cause, violating the Company's compliance, ethics or risk management standards, soliciting clients or employees and misuse of proprietary information. Equity awards are also subject to clawback for, among other things, engaging in conduct (including with respect to direct supervisory responsibilities) detrimental to the Company, including causing a restatement of the Company's consolidated financial results or violating the Company's risk policies and standards</li> <li>5. All deferred incentive compensation awarded to any [ ] employee, including the named executive officers, is subject to the [ ] Clawbacks. [ ] Clawbacks provide for the forfeiture or cancellation of non-vested incentive compensation if the Committee determines that the employee: (a) received an award based on materially inaccurate publicly reported financial statements, (b) knowingly engaged in providing materially inaccurate information relating to publicly reported financial statements, (c) materially violated any risk limits established or revised by senior management and/or risk management, or (d) engaged in gross misconduct.</li> </ol>

## **Annex G: Members of the FSB Compensation Monitoring Contact Group**

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