FSB FINANCIAL STABILITY BOARD

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

Second progress report

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

Second Progress Report

Executive Summary

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

First, all FSB member jurisdictions except two (Argentina and Indonesia) have now completed the implementation of the FSB Principles and Standards (P&S) in their national regulation or supervisory guidance. The focus now is on effective supervision and oversight of implementation of these rules by relevant firms. All FSB jurisdictions include the oversight of compensation structures in their ongoing supervisory plans, and most of them have intensified supervision in this area to varying degrees. Such actions are enabling supervisors to engage in a more constructive dialogue with firms and to better influence compensation practices. Most supervisory authorities report that they now have a good sense of pay practices in their markets, and exercise a good degree of oversight on the evolution of pay structures at supervised institutions.

Second, disclosure of compensation practices has improved. Most jurisdictions report that the majority of their supervised firms now disclose in annual remuneration reports significant and detailed information on compensation structures. This can be attributed partly to enhanced disclosure requirements for publicly listed firms and partly to the enactment of specific prudential disclosure requirements, including those for Pillar III of the Basel II/III framework.

Enhanced disclosures can lead to more awareness by firms' Boards of the need to explain their remuneration decisions. They have also contributed, and in some cases been the response to, increased attention given to executive compensation by various stakeholders, particularly shareholders. In some jurisdictions public attention has further increased recently in connection to specific incidents (e.g. Libor investigations), which have also prompted institutions to issue public reports and to be more responsive in adjusting compensation for both negative performance and compliance and risk issues. Disclosures may be less useful when they are too detailed or technical and the institution fails to clearly convey the major features of its remuneration approach. It is still generally difficult for policymakers and the public to reliably access easy to understand and consistent data on compensation structures for significant firms across jurisdictions.

Third, authorities report that firms' implementation efforts continue and that progress is being made. Most authorities are of the view that the implementation of the P&S and related supervisory action, among other factors, has had a high impact on changes in compensation practices for supervised institutions. It has also been noted that, although there are still improvements to make, the mind-set of institutions has changed, as they are now willing to comply and acknowledge that risks stemming from variable remuneration have to be managed. Reported trends since the 2011 peer review suggest that most compensation

structures are being revised in the direction indicated by the P&S. Most jurisdictions report increases in the percentage of pay that is deferred and/or longer periods of deferral; increases in the use of equity as a form of compensation; and increased use of maluses for both financial performance and compliance or behaviour issues.

Fourth, several authorities note that firms still express some level playing field concerns with regard to jurisdictions that may not have fully implemented the P&S or that do not supervise their firms adequately for this purpose. At the same time, however, national authorities have yet to see any real evidence that the implementation of the P&S has impeded or diminished the ability of supervised institutions to recruit and retain talent. The Bilateral Complaint Handling Process, which the FSB initiated for the purposes of addressing level playing field concerns, has not so far been activated by firms in FSB member jurisdictions.

Fifth, certain regulatory initiatives currently being implemented could materially change compensation structures in some FSB member jurisdictions. In particular, the adoption by the European Union (EU) of the fourth Capital Requirements Directive (CRD IV) includes requirements on compensation structures that go beyond those in the P&S. The implementation of the Directive will foster convergence of compensation practices for all credit institutions and designated investment firms operating in the European Economic Area. At the same time, concerns have been expressed, particularly by a few non-EU FSB member jurisdictions, about the prescriptive nature of these requirements. In particular, these jurisdictions suggest that the introduction of a limit on the ratio between fixed and variable compensation for MRTs may have unintended consequences, such as creating obstacles to the ability of internationally active firms to implement a global approach to compensation structures, or resulting in the adoption of a larger proportion of fixed compensation in their EU operations. These issues are also relevant to ensuring a level playing field.

Sixth, further work is needed on the identification criteria for material risk takers (MRTs). This is an area where there is a broad range of practices across jurisdictions and firms, partly due to differences in relevant national regulations and supervisory guidance (and on their level of prescriptiveness), and partly because of the different size, nature or complexity of institutions. It is not yet clear whether the diversity in practices and experimentation among firms and jurisdictions is leading to significantly different outcomes or which approaches are most effective.

In summary, while good progress continues to be made, more work needs to be done by national authorities and firms to ensure effective implementation of the P&S, in terms of effectively leading to more prudent risk taking behaviour. This will take time, and there is still some way to go before the improvements in compensation practices can be deemed effective and sustainable.

Several supervisors highlight the need to continue the ongoing monitoring of compensation practices, both at national and international levels. The implementation of the P&S by significant firms is an ongoing process and there remain practical challenges to embedding risk management in firms' compensation practices. Assessing effectiveness is a multidimensional task because the relationship between compensation, performance, governance and risk taking will differ across firms and time depending on the nature of business and of business conditions. Further interaction and exchange of views by supervisors and firms at bilateral and multilateral levels is needed on some technical challenges to

implementation, in order to encourage the sharing of experiences and thereby improve supervisory and firm practices.

In light of these findings, the report recommends the following actions as next steps in this area:

1. **National implementation of the FSB Principles and Standards**

Those few FSB jurisdictions that have not yet implemented the P&S should do so promptly. In addition, jurisdictions that have not adopted a few P&S due to their non-applicability or incompatibility with local laws should regularly review their framework in order to ascertain whether these exceptions give rise to regulatory arbitrage by and material risks for significant firms in their jurisdictions. If found material, these exceptions should be addressed appropriately, including by legislative actions, to ensure full, consistent and effective implementation of the P&S.

Moreover, it is important for all jurisdictions that have already adopted the P&S to proactively monitor and oversee their effective implementation by firms via ongoing supervision. Those jurisdictions that are at a relatively early stage in this process should continue to enhance their supervisory oversight and gain a better understanding of the level of implementation at their firms. This will help foster the necessary degree of attention to developing proper compensation structures in the industry.

2. **Material risk takers**

Given the existing differences in approach and points of view by jurisdictions on MRTs, the FSB will survey and compare the range of practices in this area across its membership, with a view to identifying good practices while recognising firms' differences and the need for proportionality. The first stage of such work will be to identify the relevant facts. This will enable national authorities to verify in more detail any gaps and evaluate the severity of potential problems before the FSB determines what further action (if any) is necessary.

3. **Addressing remaining challenges and assessing effectiveness**

The FSB will continue to monitor the implementation of the P&S and promote good practices among supervisors and firms, particularly in areas such as the use of maluses and clawbacks. As part of this effort, the FSB will continue to engage with the industry to discuss trends and remaining challenges to effective implementation, including by organising another workshop by year-end to share experiences and views.

I. Introduction

In 2011, the G20 Leaders called on the FSB to "undertake an ongoing monitoring and public reporting on compensation practices focused on remaining gaps and impediments to full implementation [of the FSB *Principles for Sound Compensation Practices* and their *Implementation Standards* (P&S)] and carry out an ongoing bilateral complaint handling process to address level playing field concerns of individual firms."[1] In response, the FSB established in 2012 a Compensation Monitoring Contact Group (CMCG) comprising national experts from all FSB member jurisdictions with regulatory or supervisory responsibility on compensation practices (see Annex D). The CMCG is responsible for monitoring and reporting on national implementation of the P&S, based primarily on the responses to an annual questionnaire by FSB member jurisdictions. The FSB also established the Bilateral Complaint Handling Process (BHCP), which is a mechanism for national supervisors from FSB jurisdictions to bilaterally report, verify and, if needed, address specific compensation-related complaints by financial institutions based on level playing field concerns.

The first implementation progress report in this area was published in June 2012.[2] It confirmed the conclusions of the 2011 peer review that achieving lasting change in behaviour and culture and effectively aligning compensation practices with prudent risk-taking is a long-term challenge. The report recommended that the FSB promote the sharing of experiences among supervisors and with external parties with expertise in firms' compensation practices, particularly in areas where progress was still needed.

The FSB organised a workshop in November 2012 to share experiences and lessons learned by financial institutions, focusing on three areas: alignment of compensation with ex ante risk taking; alignment of compensation with performance; and the identification of material risk takers. The workshop findings were subsequently published on the FSB website[3] and are incorporated in this second progress report, which also focuses on key implementation challenges and evolving practices in the above areas.

The report is structured as follows. Section II describes the overall progress made by national authorities in implementing the P&S since the 2012 progress report as well as recent regulatory initiatives and supervisory oversight and actions. Section III outlines the status of implementation by firms, including observed trends in compensation structures and developments in firm disclosure and stakeholder engagement on compensation matters. The section also reports on the supervisory authorities' assessment of firms' compensation practices. Section IV reports on the implementation challenges and evolving practices in the areas of ex ante and ex post risk adjustment; alignment of compensation with performance; and identification of material risk takers (MRTs). Section V concludes and describes next

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[1] See the G20 Cannes Summit Communique, available at http://www.g20.org/documents/#p2.

[2] See http://www.financialstabilityboard.org/publications/r_120613.pdf.

[3] See http://www.financialstabilityboard.org/publications/r_130124.pdf. Officials from FSB member organisations participating in the FSB CMCG and senior executives from global systemically important banks (G-SIBs) and from several consulting firms took part in the workshop.

steps to address the remaining challenges to full implementation of the P&S in order to effectively align compensation practices with prudent risk-taking behaviour.

II. Implementation by national authorities

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

All FSB jurisdictions except two (Argentina and Indonesia) have now completed the implementation of the FSB Principles and Standards (P&S) in their national regulation or supervisory guidance.[4] National implementation of the P&S can therefore be considered largely complete and the focus now is on effective supervision and oversight of firms. Annex A provides an update on the status of national implementation since the 2012 progress report, while Annex B describes the remaining gaps in implementation.

In Indonesia, the regulation on corporate governance, amended in early 2013, covers some elements of the P&S and also requires the regular submission by banks to the supervisory authority of data on remuneration structures. Even though the regulation does not focus explicitly on risk alignment, the Indonesian authorities report that several major banks have aligned their remuneration with risks both on an ex ante and ex post basis by integrating risk management consideration into their remuneration systems through the use of key performance indicators as well as some forms of malus and clawback clauses in compensation arrangements. An amendment to a guideline on Corporate Governance for the banking industry by the Indonesia National Committee on Corporate Governance, containing a proposal to align remuneration with risk, will be issued later this year.

In Argentina, legal restrictions affecting Standards 5-10, 12 and 14 remain effective, although the authorities report that this is not a matter of concern and that there are no significant problems concerning the relationship between compensation and risk taking in the domestic banking system. Since the 2012 progress report, Argentina has updated the supervisory manual to include procedures to monitor the implementation of selected P&S, and in particular the rules on corporate governance including the "Policy on Employees' Incentive Payments".

The 2012 progress report also noted that a few other countries (Brazil, China, India, Turkey) had chosen not to implement one or more Standards related to the alignment of compensation with risk-taking, either because they are not deemed applicable or because of domestic constraints (e.g. labour laws).

As for other relevant developments in national implementation since the 2012 progress report, the Bank of Russia issued in October 2012 a regulation introducing criteria for the supervisory assessment of remuneration systems of banks as part of the overall evaluation of management quality. The assessment criteria reflect all substantial components of the P&S.

[4] The links to relevant national regulation and supervisory guidance can be found on the FSB website: http://www.financialstabilityboard.org/publications/r_120709.pdf.

The first quarterly assessment started in July 2013, with initial results available in October. In order to provide the supervisory authority with additional powers enabling it to take appropriate measures in case of shortcomings in remuneration systems, as well as to specify Board's functions relative to compensation systems , an amendment to the central bank law and to the law on banks and banking activities were adopted in July 2013. The supervisory authority has highlighted some significant implementation challenges, related to the statutory limit of 20% for non-cash share remuneration, as well as the fact that the majority of credit institutions are non-listed. These factors, together with the fact that remuneration in debt instruments is forbidden by the law, create difficulties for banks to use financial performance-linked remuneration.

South Africa issued two regulations in December 2011 implementing the P&S, and in December 2012 has included detailed disclosure requirements related to banks' remuneration policies, processes and procedures in the regulation implementing Basel III. The new regulation also requires the Board of Directors to establish a Remuneration Committee.

2. Recent regulatory initiatives

Although implementation of the P&S is largely complete, a few jurisdictions have issued new regulation or supervisory guidance on aspects related to the P&S. In January 2013, the Canadian supervisory authority (OSFI) published its updated Corporate Governance Guidelines, which clarifies its expectations surrounding the Board's role in compensation oversight and that firms' risk appetite statement should be linked to compensation programs. In June 2012, China issued the *Capital Rules for Commercial Banks,* in which compensation management and disclosure requirements are further clarified. In February 2013, it then issued a regulation setting out a series of requirements to reform the income distribution system, including a paragraph dedicated to strengthening the compensation management of senior executives of state-owned enterprises. [5] Hong Kong introduced in April 2013 amendments to the Banking Disclosure Rules, which require locally incorporated authorised institutions to disclose the extent of their compliance with the guidelines on remuneration disclosure and the reasons for any failure to comply with those guidelines.

In Europe, both Netherlands and Spain issued in 2012 new legislation establishing limits and conditions on variable remuneration for institutions benefiting from state aid. [6] The UK revised the scope of application of its Remuneration Code in relation to the guidance on proportionality.[7] In addition, several FSB jurisdictions (France, Italy, Netherlands, Spain) that

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5 One FSB principle and one standard (P7 and S8) are still in preparation, also due to the fact that compensation is mainly in the form of cash. The supervisory authority has initiated communications with the main shareholders at large commercial banks to promote long term incentive plans via the use of remuneration in the form of equity. The plan is to then issue guidelines if necessary.

6 In particular, institutions applying for state support in the Netherlands and Spain will have to comply with special requirements, which are more stringent than those prescribed by Standard 10; in Spain, limits also apply on fixed remuneration for directors and senior managers. Specific provisions for institutions benefiting from state aid (including the prohibition of variable remuneration to members of management bodies) are also in place in Italy since March 2011.

7 The 'Proportionality Guidance' sets out expectations on how the 2,700 banks, building societies and investment firms subject to the Remuneration Code ('Code') should implement its provisions, taking into account their size, internal organisation and the nature, scope and complexity of their activities. It groups firms into three levels based on total assets. Levels 1 and 2 encompass the largest and most significant firms which are subject to all of the Code's

are members of the European Union (EU) have issued in 2012 new regulations to implement the provisions of the Capital Requirements Directive (CRD) III requiring enhanced transparency on remuneration.[8] CRD III, as further clarified through European Banking Authority (EBA) Guidelines, requires competent national authorities of all EU member states to collect information on the number of individuals per institution in pay brackets of at least EUR 1 million ("high earners"), including the business area involved and the main elements of the salary, as well as on the structure of remuneration for MRTs for a representative sample of banks, with the objective of disclosure and benchmarking practices across the EU.[9]

Some authorities have revised, or are in the process of revising, their guidance on financial intermediaries other than banks. In Hong Kong, a new guidance is expected in 2013 for insurers, which will apply to domestically-incorporated insurers and other insurers that have a substantial portion of their business income generated in Hong Kong. In Korea, the scope of application of the P&S for financial investment companies has been expanded in 2013 to larger firms, and some amendments to the regulation have been made.[10] Mexico issued in November 2012 new rules extending the remuneration regime to investment advisors within banks and brokerage houses. The US issued rules in 2012 directing the national securities exchanges and national securities associations to adopt certain listing standards concerning compensation.[11] A number of other Dodd-Frank Act (DFA) compensation-related rulemakings remain in progress, including several on disclosure.[12]

Another important relevant regulatory development has been the adoption by the EU of CRD IV, the new legislative package on capital requirements for credit institutions and investment firms replacing CRD III, which includes detailed provisions on remuneration that go beyond those found in the P&S. The European Commission has also recently adopted a "Banking Communication" concerning state aid rules that includes certain provisions on remuneration to staff in banks that receive state aid (see Box 1).

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requirements. Firms in Level 3, which comprises predominantly investment firms, can normally disregard the application of specific Code requirements, such as payment in instruments, retention periods and deferral.

[8] In Germany, full compliance with these guidelines is already ensured under existing regulation, which is currently under revision in light of supervisory experience gained over the last years and to implement CRD IV.

[9] The guidelines for the data collection can be found at http://www.eba.europa.eu/regulation-and-policy/remuneration/guidelines-on-the-data-collection-exercise-regarding-high-earners and http://www.eba.europa.eu/documents/10180/111703/EBA-GL-2012-04---GL-4-on-remuneration-benchmarking-exercise-.pdf. The findings on the "high earners" for 2010 and 2011 by EU member state can be found at: http://www.eba.europa.eu/documents/10180/16145/EBA-Report-High_Earner_results.pdf.

[10] The relevant regulation has been revised to require that only senior managers are allowed to have a significant portion of their variable compensation paid out in the form of equity. The revised guidance also requires the Remuneration Committee to maintain records of its activities.

[11] These rules, which are required by Section 952 of the DFA, direct exchanges to establish listing standards concerning compensation advisers and require each member of a listed issuer's compensation committee to be an independent member of the board of directors. The rules also require disclosure of the use of compensation consultants and related conflicts of interest.

[12] The rulemakings still in progress include: DFA 951 (requirement for every institutional investment manager subject to Section 13(f) of the Securities Exchange Act of 1934 to report at least annually how it voted proxies on Section 14A votes), DFA 953 (additional executive compensation disclosure, including internal pay equity and the relationship of pay to performance), DFA 954 (listing standards relating to recovery of compensation in the event of an accounting restatement), DFA 955 (disclosure on whether employees and directors are permitted to hedge equity securities), and DFA 956 (enhanced compensation structure reporting).

Box 1: Main provisions on remuneration found in the EU's CRD IV and state aid rules

The new EU legislative package on capital requirements, which *inter alia* implements the Basel III agreement, was adopted on 26 June 2013 and is comprised of a regulation ('CRR')[13] and a directive ('CRD IV').[14] The CRD IV rules apply to all credit institutions and those investment firms[15] covered by the regulation on a consolidated basis.[16] The rules therefore apply to: i) branches and subsidiaries outside the European Economic Area (EEA) of institutions with a head office in the EEA; and ii) subsidiaries inside the EEA of institutions with a head office outside the EEA.

As regards remuneration, CRD IV essentially carries over the previous provisions of EU legislation (contained in CRD III) that had already incorporated the P&S into EU law. The requirements are subject to the principle of proportionality: national authorities must apply the rules in a manner and to the extent that is appropriate to the firms' size and internal organisation and to the nature, scope and complexity of their activities. With the aim of tackling excessive risk taking, CRD IV inserts a new provision with regard to the relationship between the variable (or bonus) component of MRT remuneration and the fixed component (or salary). The key elements of this new rule, which will apply to remuneration awarded for services and performance provided from 2014 onwards, are:

(i) The variable component of the total remuneration must not exceed 100% of the fixed component of the total remuneration of individual MRTs;

(ii) EU member states may allow shareholders, acting by a qualified majority,[17] to approve a higher maximum level for the variable component provided that this level does not exceed 200% of the fixed component. In this context, for the purposes of calculating the maximum ratio, the use of deferred and bail-in-able instruments is encouraged through a provision that allows member states to permit the application of a notional discount rate (to be based on further technical guidance by the EBA) to up to 25% of total variable remuneration, provided that it is paid in instruments that are deferred for at least five years; and

(iii) The competent authorities are to be informed of recommendations to shareholders regarding any increased maximum ratio and of the result of any shareholder vote, which must not conflict with institutions' obligations to maintain a sound capital base.

In order to address the wide variations found in MRTs across institutions and member states, and to provide for a more harmonised approach to this issue throughout the EU, the EBA is mandated to draft

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[13] Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012; Official Journal of the European Union L 176, 27.6.2013, p. 1.

[14] Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC; Official Journal of the European Union L 176, 27.6.2013, p.338.

[15] For the purposes of CRD IV, investment firms are those defined in Directive 2004/39/EC (MiFID), i.e. firms that provide one or more investment services to third parties and/or perform one or more investment activities on a professional basis, with some exceptions (i.e. "local firms", dealing for their own account on markets in financial futures or options or other derivatives and on cash markets for the sole purpose of hedging positions on derivatives markets, or dealing for the accounts of other members of those markets and being guaranteed by clearing members of the same markets, where responsibility for ensuring the performance of contracts entered into by such a firm is assumed by clearing members of the same markets, as well as firms that only provide investment advice or receive and transmit orders and that may not hold client money or securities and may not be in debt with their clients).

[16] CRD IV provides that "[t]he application of [the remuneration provisions] shall be ensured by competent authorities for institutions at group, parent company and subsidiary levels, including those established in offshore financial centres" (Article 92 CRD IV). This provision already existed in CRD III. Recital 67 further clarifies that the remuneration "principles and rules" are to be applied "on a consolidated basis, that is at the level of the group, parent undertakings and subsidiaries, including the branches and subsidiaries established in third countries". Recital 23 addressed the situation of branches in the EU of non-EU headquartered institutions.

[17] The qualified majority involves either a minimum representation requirement for shares or equivalent ownership rights of 50 % and a voting majority of two thirds or no minimum representation requirement and a 75 % voting majority.

regulatory technical standards, to be adopted by the European Commission, which will set out the criteria to be used by institutions to identify their MRTs. The EBA is also charged with drafting regulatory technical standards to specify the classes of instruments, in addition to shares and other equivalent instruments, which are suitable for paying MRTs' variable remuneration.

CRD IV also introduces additional transparency and disclosure requirements relating to the number of individuals earning more than 1 million Euro per year, and enhances the enforceability of malus and clawback arrangements, although the latter provisions are subject to general principles of national contract and labour laws.[18] Finally, the legislation provides for a review by 30 June 2016 of the impact of compliance with the principle regarding the ratio between fixed and variable component of the total remuneration, including in respect of competitiveness and financial stability.

The European Commission has also recently adopted a "Banking Communication", which adjusts previous crisis communications by adapting the parameters for the compatibility of crisis-related state aid to banks. Among other provisions, the Communication contains provisions on remuneration to staff in banks that receive state aid. The main idea is that there should be incentives for banks' managements to undertake far-reaching restructuring in good times in order to minimize state support. To this end, more stringent remuneration policies should apply. The Communication sets a cap on remuneration to staff, including board members and senior management that is referenced on 2 indicators: it may not exceed 15 times the national average salary in the Member State where the beneficiary is incorporated or 10 times the average salary of employees in the beneficiary bank. The reference to the average salary in the Member State or in the bank is intended to cater for differences across Member States and different types of banks. The rules will apply to all banks that receive aid (except for liquidity guarantees) after 1 August 2013.

The new EU regulation should foster convergence of compensation practices and reduce concerns about an uneven playing field through the application of the same rules to all credit institutions and designated investment firms operating in the EEA. The objective of the regulation, which constrains the overall levels of variable remuneration that may be awarded to MRTs, is to mitigate the incentives for such staff to take risks that are contrary to a firm's long term interests. As previously noted, several EEA member states have, or intend to put in place, stricter national legislation regarding limitations on bonuses.

While the actual effect on risk-taking incentives can only be seen after the regulation has been implemented in practice, a few FSB jurisdictions have concerns that the bonus cap provision of CRD IV constraining the relationship between the variable and fixed component of compensation for MRTs goes beyond the objectives of the P&S. In their view, this would limit the scope to align compensation with incentives for prudent risk-taking because it might reduce the amount of compensation that is linked to risk or performance. In addition, the prescriptive nature of the new rules, which apply not only to the operations of institutions within Europe, but also to the operations of EU firms in other jurisdictions, are seen by these jurisdictions as potentially having unintended consequences, such as constraining the ability of internationally active firms to implement a global approach to compensation structures. These jurisdictions suggest that the introduction of a limit on the ratio between fixed and variable compensation could also create an incentive for firms to raise the level of fixed

[18] A new provision (in Article 94 (1)(n)) states: "Up to 100 % of the total variable remuneration shall be subject to malus or clawback arrangements. Institutions shall set specific criteria for the application of malus and clawback. Such criteria shall in particular cover situations where the staff member: (i) participated in or was responsible for conduct which resulted in significant losses to the institution; (ii) failed to meet appropriate standards of fitness and propriety".

compensation in order to maintain competitive packages and to attract talent; such a development could potentially create prudential concerns by constraining firms' ability to make appropriate adjustments in a downturn, and undermine the effectiveness of ex post risk adjustments since the part of the total compensation susceptible to malus and clawbacks would be reduced.

3. Supervisory monitoring and action

Most FSB jurisdictions report that they have intensified their oversight of compensation practices over the past year, although they report to have done so to varying degrees of intensity. Ongoing supervisory action has enabled supervisors to engage in a constructive dialogue with firms and to influence compensation practices. Most supervisory authorities report that they now have a good sense of pay practices in their markets, and a good degree of oversight of the pay structures by supervised institutions.

Ongoing supervisory actions range from the inclusion of compensation practices in "business as usual" supervision to supervisory deep dives of various types. For example, a review was conducted by OSFI in Canada on implementation of the risk appetite framework at several firms, including alignment with compensation programs. In the Netherlands, medium-sized institutions were asked to complete a self-assessment in 2011, which was followed by supervisor action in 2012 to address identified issues. At the end of 2012, the supervisory authority started an on-site and off-site review of the 7 largest banks and insurers, with the aim of assessing implementation of the P&S in practice. In Russia, the 36 largest banks were asked to conduct a self-assessment in July 2012, which concluded that the level of implementation of the P&S was intermediate; a regular collection of data for the assessment of remuneration systems of credit institutions will start in October 2013. In the United States (US), supervisory authorities review, on an annual basis, senior executive arrangements and other aspects of the compensation framework (including monitoring and validation processes) at all 37 firms involved in the ongoing horizontal review on compensation practices.[19]

Other jurisdictions report that they have completed horizontal reviews dedicated to specific topics or within different lines of business;[20] dedicated cycles of on-site inspections explicitly

[19] As set out in the Interagency Guidance, large banking organizations in the US are expected to regularly review whether the design and implementation of incentive compensation (IC) processes and arrangements deliver appropriate risk-taking incentives. The review process should: 1) assess the likelihood of IC arrangements to provide balanced risk-taking incentives prior to implementation; 2) monitor compliance with policies and procedures, and 3) monitor the performance of IC arrangements post implementation (i.e. whether arrangements effectively balance risk-taking incentives). Enhanced supervisory expectations were developed, and with regard to monitoring the effectiveness of policies and procedures (validation), banking organizations involved in the horizontal review were required to submit validation pilots assessing IC arrangements. This entailed analysing the relationship between IC awards and payments, and risks taken and actual risk outcomes to determine whether awards and payments were actually reduced to reflect adverse risk outcomes and high levels of risk taken. Organizations involved in the second wave of horizontal analysis are in the process of developing and implementing monitoring and validation plans.

[20] For example, Saudi Arabia conducted an on-site horizontal review as a one-time special initiative to assess compliance with SAMA rules and the P&S; Spain has set up a dedicated unit to conduct a horizontal review; and a few countries (France, UK) have conducted specific reviews on ex ante and/or ex post risk alignment. Italy has conducted a multiyear analysis to check the effective alignment of the top management's remuneration of Italian listed banking groups to the evolution of a wide range of performance and risk indicators in the period 2008-2011. The US undertook a horizontal examination of compensation practices and arrangements within the commercial lending line of business.

to compensation;[21] and regularly collected compensation data for supervisory purposes, including in some cases detailed information regarding compensation pools and pay structures (notably Brazil,[22] China,[23] Indonesia,[24] Saudi Arabia,[25] Singapore[26]). Some countries have also included direct engagement with the chair of the Remuneration Committee of the firm as part of their supervisory activities.

Only one supervisory authority has reported an enforcement action against firms for compensation issue,[27] as firms have generally been responsive to the remediation requested by the supervisors. Some authorities have, however, adopted intensive supervisory actions concerning compensation practices. For example, France surveyed the 6 largest institutions in 2012, which had been asked by the prime minister to show restraint with regard to senior management remuneration policy and variable remuneration awards for 2011 given the economic context and the need to reinforce their capital. The analysis showed that the banks did reduce their variable remuneration awards, especially to employees in the business units that showed the largest fall in earnings. Italy issued two circulars in 2012 and 2013 requiring banks and banking groups to reduce, or even cancel, variable remuneration in order to increase self-financing capacity and strengthen the institutions' capital base in response to a protracted economic recession and the uncertain prospects for a recovery in domestic demand. In the UK, all Level 1 firms (i.e. 18 firms that are the most significant within the scope of the remuneration code) must submit to the supervisor an annual Remuneration Policy Statement, which is reviewed to assess firms' compliance with the Remuneration Code; the supervisory authority then issues a "sign off" template that records the final assessment of compliance, which enables institutions to proceed with paying the annual bonus round. In Saudi Arabia,

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[21] For example, Germany has carried out in 2013 its first on-site thematic inspections on the 14 largest institutions.

[22] Financial institutions must provide an annual report on the main features of the remuneration policy including: (i) the criteria used for performance measurement and risk adjustment; (ii) the relationship between pay and performance; (iii) the deferral policy of compensation; (iv) the parameters used to determine the percentage of cash compensation; and (v) other forms of remuneration. They also have to describe changes in remuneration policy over that period and their implications for the risk profile of the institution and on the behaviour of managers as risk-takers, and quantitative statements about the structure of directors' and managers' remuneration.

[23] The supervisory authority collects information on: compensation management structure and decision-making process; remuneration committees' composition and responsibilities of management; compensation amount; the distribution of compensation structure; the measurement and risk-adjusted standards of compensation and performance; deferred payment and the non-cash compensation; compensation of board of directors, senior management and significant staff; annual development of remuneration program; and any exceptions to disclosure.

[24] Indonesia collects in particular the ratios of the highest salary to the lowest salary for comparison across several categories of employees.

[25] All banks are required to submit to SAMA half yearly progress reports on the actions taken to ensure compliance with SAMA rules and the P&S. They are also required to submit information on: (i) compensation paid to different categories of employees including senior executives, material risk takers, employees in control functions, other employees and outsourced employees, with the details of fixed and variable compensation including performance bonuses in cash, performance bonuses in shares, other performance linked incentives, deferred compensation, etc.; and (ii) compensation paid to each of the top 12 highly paid senior executives, with the detail of fixed and variable compensation including performance bonuses in cash, performance bonuses in shares, other performance linked incentives, deferred compensation etc.

[26] Singapore collects data on bonus pools allocated to individual business and support functions, breakdown of MRTs' fixed and variable compensation, deferrals, and the exercise of malus and clawbacks during the year at the business line level.

[27] In July 2013, the Bank of Italy imposed administrative pecuniary sanctions against the members of the Board of directors and the Board of auditors of an Italian listed bank for breaches of remuneration rules relating to payments made to the former general manager of the bank at the termination of his office. The sanctioned parties have the right of appeal.

supervisory actions included asking to re-establish the Remuneration Committee to ensure independence of the members, redetermination of MRTs, revisiting bonus plans etc.

Many authorities have inserted compensation structures in supervisory risk assessment systems, but the use of specific detailed metrics is still at an early stage. Most authorities review compensation practices within their assessment of firms' governance frameworks, while some of them also do that in the context of risk reviews; in a few cases, compensation is reviewed as part of the Pillar 2 assessment, i.e. in the context of overall capital and liquidity adequacy. However, only in a few cases have the authorities developed specific detailed metrics to monitor selected aspects of compensation structures, such as in relation to firms' performance. For several jurisdictions, the supervisory analysis relates to peer group benchmarking and compensation trends analysis (i.e. comparing institutions of similar size and/or business models).[28]

III. Implementation by firms

1. Observed trends in compensation structures

Most of the observed trends in compensation structures since the 2011 peer review indicate that pay structures are being revised in the direction indicated by the P&S. In particular, while some jurisdictions report no change, others report that their banks are increasing the percentage of variable pay that is deferred and/or the periods of deferrals, the use of equity as a form of compensation, and the use of malus based on financial performance, adverse risk outcomes and/or compliance or behaviour issues. In particular, in some jurisdictions there has been an increase in the amount of incentive compensation at risk of forfeiture as a result of the use of broader malus provisions that cover more conditions or more employees. Annual awards of variable compensation still seem to depend in large part on the actual financial performance during the relevant year (lower variable pay in years of negative performance), notwithstanding the fact that firms are now more actively focused on risk-taking behaviours over a multi-year period. On the other hand, awards are sometimes reduced or eliminated in cases where malus is activated.

At the FSB workshop in November 2012, it was noted that, while firms are undertaking significant efforts to implement the P&S, at the same time important cultural changes are underway in the way they approach remuneration practices. Firms recognised that they are experiencing benefits from the process, including improved risk governance and increased

[28] For example, in Australia periodic peer reviews are undertaken to benchmark entities' remuneration policies against best prudential practice. In Canada, the key monitoring process entails performing benchmarking of payout analysis of firms, based on information disclosed in proxy circulars. In Hong Kong, the aggregate data of incentive awards to different categories of employees collected by the supervisory authority form the basis for benchmarking the individual institution's remuneration practices in the banking industry. Switzerland uses comparative methods to assess an institution relative to its competitors and looks at year-over-year and national and international trends. Italy has established a dedicated task force to conduct peer group and trend analyses that integrate the reviews conducted at single banking group level within the framework of the risk assessment system.

awareness around remuneration-risk alignment.[29] Compensation structures are seen as a way to more transparently set goals and incentivise sound behaviour. Enhanced transparency fosters greater employee awareness, via performance reviews that better reflect employee behaviour and the quality (and not just the sheer volume) of the business. By the same token, due to the better interaction between the senior management and the board of directors on compensation issues, more robust review and challenge processes have emerged. This has brought sizeable improvements in the articulation of risk appetite statements and more focus on actual risk taking behaviour and has encouraged greater discussion at the Board level of appropriate types and levels of rewards in relation to both performance and behaviour.

A few authorities have highlighted unintended consequences in the implementation of the P&S, mostly in terms of an observed increase in fixed remuneration. As noted above, an increase in fixed pay could reduce a firm's flexibility to make appropriate adjustments to its overall expenses in a downturn.

2. Disclosure and stakeholder engagement

The attention given to executive compensation by various stakeholders, particularly shareholders, has increased due to a variety of factors. This trend has benefited from, and has also contributed to, enhanced disclosure requirements. For example, shareholders are now more active on executive compensation issues concerning publicly listed firms, particularly in certain jurisdictions (e.g. EU, Switzerland, US).[30] Some jurisdictions (e.g. Australia) have adopted regulation to enhance shareholders engagement with firms' Boards regarding compensation levels.[31] In South Africa, a specific regulation prescribes that banks shall annually publicly disclose sufficiently detailed qualitative and quantitative information regarding their remuneration policies, processes and procedures.

In addition, in some jurisdictions (e.g. UK) there has been increased supervisory scrutiny as well as public attention stemming from specific incidents (e.g. Libor manipulations) that have increased the responsiveness of institutions in adjusting compensation for both negative performance and compliance and risk issues. In the UK, a number of institutions have had third party reviews to identify areas for improvement, including appropriate incentives for prudent risk taking behaviour and sound corporate culture. However, at least one authority highlighted the fact that, while shareholder activism has clear positive benefits, it can also create challenges. Aligning the interests of employees and shareholders may not always be sufficient as some shareholders may be more focused on shorter-term price performance and may therefore be inclined to tolerate higher degrees of risk than would be appropriate to preserve longer-term safety and soundness of the firm.

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[29] For example, one firm had observed that the number of trader limit breaches has curtailed significantly due to: 1) the firm actually exercising its discretion to adjust employee's variable compensation; and 2) the increased awareness amongst employees that the firm has and will continue to exercise its discretion.

[30] In Italy, shareholders are required to approve listed firms' remuneration policies and structure since 2008.

[31] Australia amended the Corporation Act to include a "two strikes" law, effective from July 20111, designed to hold directors accountable for executive salaries and bonuses. In practice, an entire company board can face re-election if shareholders disagree with how much executives are being paid.

There is agreement that the amount of information disclosed by firms on compensation practices has increased and is reported to have improved across a number of jurisdictions. Enhanced disclosures can lead to more awareness by firms' Boards of the need to explain their remuneration decisions. In some cases, Boards have explicitly adjusted variable remuneration because of reputational as well as operational and other risks. At the same time, however, disclosures may be less useful for stakeholders when they are too detailed or technical and the institution fails to clearly convey the major features of its remuneration approach. It is still generally difficult for policymakers and the public to reliably access easy to understand and consistent data on compensation structures for significant firms across jurisdictions.

3. Supervisory assessment of compensation practices

Almost all authorities report that the level of effective implementation of the P&S in their jurisdiction is, in their view, medium or high. Most authorities are of the view that the implementation and related supervisory action has had a high impact on changes in compensation practices for supervised institutions. It has also been noted that, although there are still improvements to make, the mind-set of institutions has changed, as they are now willing to comply and acknowledge that risks stemming from variable remuneration have to be managed. Many authorities report that, in the course of their supervisory work, they have requested firms' Boards to address deficiencies in existing practices and put appropriate processes in place. It has also been observed however that, while improvements are visible, the extent and quality of implementation varies among institutions, with in many cases more progress being seen among larger or more significant institutions. Most institutions could still benefit from increased attention to incentives for risk-taking within their remuneration arrangements.

Most jurisdictions report that their supervised firms now disclose in annual remuneration reports significant and detailed information on compensation structures. This can be attributed partly to enhanced disclosure requirements for publicly listed firms and partly to the enactment of specific prudential disclosure requirements, including those for Pillar III of the Basel II/III framework.

Several supervisors identify a number of areas for attention and highlight the need to continue the ongoing monitoring of compensation practices, both at national and international levels. In particular, challenges remain at the operational level in: a) translating the principle of risk and performance adjustment into practice, including by aligning compensation with well-articulated risk appetite frameworks that incorporate risk limits disaggregated at trading desk and business units levels and more generally by ensuring adjustments that better reflect actual risk taking; b) ensuring robust, effective and consistent governance and policies at both group and local levels, while maintaining the ability to recruit and retain talent.

At the same time, the large number of regulatory and supervisory initiatives currently underway creates additional challenges for firms, which must manage many competing priorities. As an example, firm risk managers play a key role in promoting risk-sensitive compensation practices, but their attention is also required for many other internal or regulatory and supervisory initiatives.

At the FSB workshop in November 2012, firms expressed concern about the high compliance costs of meeting different local rules and supervisory approaches on compensation. Large internationally active firms would prefer to design and operate a single set of global compensation packages, but the priorities of domestic supervisors in the jurisdictions in which the firms operate might differ and also change over time.

Several authorities note that firms still express some level playing field concerns with regard to jurisdictions that may not have fully implemented the P&S or that do not supervise their firms adequately for this purpose. Moreover, a few authorities express concerns about potential competition from other non-regulated industries and the ability to retain talent. As previously noted, the adoption of CRD IV by the EU may reopen the debate on the relative effectiveness of compensation frameworks with different levels of prescriptiveness, and the implications for a level playing field.

With respect to the impact of implementing the P&S, national authorities have yet to see any real evidence that such implementation has impeded or diminished the ability of supervised institutions to recruit and retain talent. The Bilateral Complaint Handling Process, which the FSB initiated for the purposes of addressing level playing field concerns, has not so far been activated by any firm in FSB member jurisdictions. Member jurisdictions report, however, that it is useful to have such a process in place as the possibility of raising and addressing complaints via an internationally agreed process gives some degree of comfort to the industry about the level of attention being given by national authorities to level playing field issues.

IV. Implementation challenges and evolving practices

The 2012 progress report had found that some of the major technical challenges faced by financial institutions in implementing the P&S are in the areas of: a) ex ante risk adjustment; b) alignment of compensation with performance and the ex post realisation of risk outcomes (including maluses and claw-back mechanisms); and c) identification of MRTs. These areas were further discussed during the November 2012 FSB workshop with the industry, which confirmed that institutions are still experimenting with a variety of approaches and are seeking to find the best balance between risk considerations and other goals of the pay system, such as fostering talent and contributing to good performance. A brief summary of the responses by national authorities and of the workshop discussion can be found below.

1. Alignment of Compensation with Ex Ante Risk-Taking

Firms seem to be converging on similar methodologies and processes to incorporate ex ante risk taking adjustment into compensation packages and procedures. In particular, these generally start from setting specific targets by establishing market comparables and building bottom up, or by setting a revenue or economic profit overall goal and working top down. The bonus pool is then adjusted to take account of risk and the cost of capital via the use of risk-adjusted (including forward-looking) measures.[32] Key performance indicators are used to take

[32] Examples of risk-adjusted performance quantitative metrics used to incorporate risks into remuneration decisions and mostly applied at the bank or the divisional level for determining and allocating the bonus pool, are: RAROC (risk

into account other factors, such as performance relating to relationship management (e.g. client satisfaction), franchise issues (e.g. new products, cost effectiveness and retention needs), and other non-financial aspects (mainly managerial, compliance and internal audit issues). Some firms apply further modifiers, or "hold backs" at the pool level to account for unknown risks.

Compensation decisions for individual employees are often based on individually agreed performance and risk targets (profitability and value creation, business development, productivity, sustainability etc.), complemented by qualitative performance criteria.[33] In general, improvements in the structure of compensation packages for individual employees can be seen, with more granularity embedded both in the performance reviews and in setting an individual's objectives in relation to risk taking and other elements of risk culture. Increasingly, firms are either embedding a risk component in performance scorecards or designing separate risk scorecards and/or requiring input from compliance and other control functions before performance awards are granted.[34]

While firms' methodologies and practices are converging and generally moving in the right direction, some supervisors still see scope for further progress in ex ante risk-adjustment of compensation packages. In part, this is because risk-adjusted indicators do not fully reflect the risk profile of the firm (including Pillar 2 profiles assessed by supervisors) and the actual risk-taking behaviour of individual employees. Another concern is that compensation structures and parameters are not fully aligned with the firms' risk appetite framework. In some cases, this might arise because firms are not using sufficiently well-articulated risk appetite statements.

Discretion by a firm's management or the Board of Directors can play a rather big role in pool setting, adjustment and allocation. This can be necessary when quantitative measures of risk capture only a portion of the actual risks taken and forward-looking risk assessments, so judgment must be used to incorporate other elements of risk assessments. Generally the firm's Board or the Remuneration Committee retains discretion to adjust the outcome of the remuneration process to take into account other factors, such as changes in general economic conditions or remuneration market practices, the occurrence of low frequency/high impact events, the effectiveness of business processes, the need to recognise strategic objectives (such as the development of new business or products) that may not otherwise be achieved, and increasingly the results of stress testing. Further discretionary adjustments can be made at the level of individuals triggered by, for example, breaches to risk limits, non-conformance with policies or qualitative and quantitative assessments of actual risk-taking behaviour. More generally, several authorities report that Boards or Remuneration Committees retain the

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adjusted return on capital), RORAC (return on risk adjusted capital), VaR (value at risk), operational risk losses, regulatory capital. ROE (return on equity), EVA (economic value added) and net profit are sometimes adjusted to take into account the cost of risk, liquidity, and capital. Some examples of qualitative indicators of risk are: (i) timely implementation of internal and external audit issues; (ii) fulfilment of compliance requirements; (iii) penalties for operational risk losses and for reputational risk events; and (iv) results of broad-based annual risk reviews.

[33] Examples of non-risk related factors include: customer and colleagues survey results; adherence to corporate values and culture; achievements related to the contribution to the overall strategy of the firm; and the assessment of personal leadership and other capabilities.

[34] Behaviour towards compliance and/or actual levels of risk-taking can be used as a performance target or as a "gate" to the payout of variable remuneration.

discretion to reduce or withhold payments under annual incentive plans, and they can also choose to reduce the pay-out value at vesting of previously granted awards.

Many authorities report challenges in assessing the role played by discretion, and noted that, while a degree of discretion and judgment is appropriate since a purely formulaic approach may not be sufficient to create an adequate link between compensation, risk and performance, this may result in a lack of transparency with regard to the impact that risk adjustments have on the bonus pool. Some supervisors are concerned that adjustments to protect other corporate goals (such as key manager retention, employee morale etc.) might undermine ex ante and ex post risk adjustments. One way to reduce such concerns would be to put in place good governance arrangements concerning the use of discretion, including documentation and reporting processes.[35]

Another challenge discussed at the FSB workshop is that of aligning compensation with ex ante risk taking without excessively penalising "good" risk taking that is consistent with the firm's expressed risk appetite and that is being properly managed. Some participants in the workshop noted that the best approaches are those that closely align compensation to a firm's risk governance, which means ensuring adequate input from risk management and other control functions and full oversight by the board of directors ("it's all about the right people having the right information and incentives to make the right decisions"). In this respect, one specific challenge is related to the compensation structure of the risk management function. In some cases, it has been observed that banks pay a relatively high variable compensation to the CROs, a choice apparently in line with market practices. The different nature of the responsibilities of key positions in control functions (e.g. when the CRO has also deliberative powers, for example as voting member of a credit committee) creates challenges in terms of evaluating the appropriateness of the chosen pay mix.

2. Alignment of Compensation with Ex Post Risk

Most authorities report that firms are increasingly introducing the possibility of ex post risk adjustments (including malus and/or clawback provisions) in their employment contracts and remuneration policies. These clauses tend to relate to: a) financial performance; b) managerial oversight of risk and supervision of other personnel; and c) personal conduct/compliance performance. These are increasingly used to promote prudent risk management as well as a disciplinary tool.

However, progress is not even across all jurisdictions or firms in this area. There are considerable differences in terms of the triggers for ex post adjustments, the nature and size of the employee population covered by ex post adjustments, and the potential impact of such adjustments. For example, in some cases the trigger is quite low (e.g. any violation of company policy), while in others the trigger requires evidence of intentional malfeasance or major contribution to a significant company loss or financial restatement, or indeed the actual

[35] For example, authority to exercise discretion above certain levels should lie only with the remuneration committee. Another example is that discretionary adjustments should be kept within boundaries set by criteria approved in advance and, if there is material divergence, this would need to be discussed with the supervisor or disclosed at (if not approved by) the firm's shareholders meeting.

termination of the employee for cause. In some cases, any ex post adjustments due to regulation or decision by the firm are limited to certain portions of the employee population (e.g. top senior executives), while in other cases they apply to a large number of employees. The potential impact (i.e. how much of compensation is at risk) can differ from affecting only a portion of the award in question to up to 100% of unvested amounts outstanding.

In addition, some authorities are uncertain about the extent to which firms are actually fully applying and enforcing these new clauses where they exist. While these clauses have been successfully applied in a few jurisdictions, several others have no evidence yet of such clauses actually having been used to cause meaningful ex post reductions or forfeitures.

With respect to the possibility of a firm reclaiming shares or amounts awarded after vesting, many jurisdictions point to legal, fiscal, or social pension constraints in their actual application. Even where they may include a clause to this effect in the employment contract or remuneration policy, some firms fear being drawn into long legal battles if the employee were to challenge enforceability, though at least one authority reports that such clauses have withstood legal challenge. Where there are enforcement uncertainties, the actual deterrent effect of claw-back clauses (and its level of attention by the authorities) may not be as strong if used in isolation when compared to long-term malus clauses. Nonetheless, some firms report that having such claw-back clauses creates pressure on an employee to return monies requested by the firm, even if ultimately the outcome would be uncertain if litigated.

Jurisdictions report that:

- Different firms apply ex post risk adjustment at various timings: 1) adjustment prior to vesting; 2) adjustment after vesting but prior to the employee exercising or taking possession of the cash or shares; 3) adjustment after the employee has taken possession and is still employed by the company; and 4) adjustment after the employee has taken possession and is no longer employed by the company.
- The timing of the adjustment can influence the ease and success of application. Whereas cases 1 and 2 above are the easiest to implement, case 3 is more difficult but can be accomplished by netting out any new awards due to the employee against any previous awards that need to be forfeited or reduced, while case 4 is the most difficult to implement.
- There is no common terminology across jurisdictions or firms: consistent with the P&S definition, some consider an adjustment prior to vesting as "malus" (example 1 above), while adjustments after vesting (examples 2 to 4) are sometimes referred to as "clawbacks".[36] Some jurisdictions and firms use the terms interchangeably, while others refer instead to "cancellation" or "forfeiture" (in part of in whole) in the case of an adjustment prior to vesting and to "reimbursement", "repayment", "recapture", "recovery" or "recoupment" in the case of an adjustment after vesting.

[36] In its 2010 paper on 'The Range of Methodologies for Risk and Performance Alignment of Remuneration', the Basel Committee distinguishes between the two terms as follows: "Malus and clawbacks are both methods for implementing explicit ex post risk adjustments. Malus operate by affecting vesting (reduction of the amount due but not paid). Clawbacks operate by requiring the employee to return a specified amount of money to the firm."

- When performance-based pay is subject to a substantial period of deferral, differences between malus adjustments and clawbacks could become less significant since the longer the deferral period the greater the chance that risk can materialise and be appropriately reflected in payouts. In such cases, the need for clawbacks may be reduced.
- Some authorities are also requiring collective ex post adjustments, i.e. where an individual's award can be reduced or forfeited not only on the basis of his or her conduct or direct contribution to a loss, but also on the basis of that by others in the department or unit.

3. Identification of Material Risk-Takers

As reported in the 2012 progress report, national authorities have made different choices with respect to the identification of employees as MRTs. Several jurisdictions have provided detailed guidance on the definition of MRTs (Australia, Brazil, France, Hong Kong, India, Italy, Japan, Netherlands, Spain, United Kingdom), others use a principle-based approach or have required firms to have adequate processes in place to identify MRTs (Canada, Singapore, Saudi Arabia, Switzerland, United States, Germany), while others have not provided any specific regulatory definition or guidance. Examples of each type of approach exist that have yielded both large and small numbers of MRTs, implying that the substance of the requirements is probably more important than the category of the approach.

All EU member states in particular have issued regulation or guidance based on the provisions of CRD III and Guidelines on Remuneration policies and practices initially published by the Committee of European Banking Supervisors (CEBS) and now under review by the EBA.[37] Notwithstanding the common base guidelines, the EBA conducted a survey in 2012[38] and found that the current practices in the EU were resulting in wide variations in the numbers of identified MRTs and that generally their numbers were low. The EBA is now in the process of preparing regulatory technical standards on the criteria for identification of MRTs pursuant to CRD IV (see Box I), for adoption by the European Commission. These will be directly applicable in EU member states and will result in a more harmonized and consistent approach in the identification of MRTs, which may lead to a larger number of MRTs than has so far been the case.

Most authorities report that firms have established internal criteria to identify MRTs, either by complying with the definitions in national guidelines or regulations where these have been provided, or by identifying internal criteria (see Annex C). Firms generally adopt a combination of quantitative and qualitative criteria. Qualitative criteria mostly refer to the position occupied by the individual within the firm (designation); to the nature of supervision or management responsibilities that the person exercises; to his/her authority to take decisions that might impact the risk taken by the firm; and to the job function (e.g. employees in front office / trading roles or heads of control functions). Quantitative criteria are usually based on

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[37] See http://www.eba.europa.eu/regulation-and-policy/remuneration.

[38] See http://www.eba.europa.eu/-/survey-on-the-implementation-of-the-guidelines-on-remuneration-policies-and-practices.

responsibilities and limits assigned to the individual (e.g. portfolio size or risk limits) as proxies for the level of contribution to the firms' risk profile. In several cases, quantitative criteria are directly based on the structure or amount of remuneration, with established thresholds on the proportion of variable versus fixed remuneration, or with respect to the employee's variable or total remuneration. Some firms have also established criteria for the identification of collective MRTs, based on organisational groupings (e.g. individuals in certain business or risk committees), or groups for which aggregate risk limits have been established or that are subject to the same or similar incentive compensation arrangements and that, in the aggregate, may expose the organization to material amounts of risk.

In almost all cases, the top management as well as the most relevant heads of business units / profit centres are included in the definitions. In addition, key employees of risk and internal control functions as well as other (non-executive) highly compensated individuals are often identified as MRTs. The percentage of identified staff varies greatly depending on the business segment: on average, based on responses by a few jurisdictions, the percentage can vary from 0-2% for retail banking to 10-20% for investment banking businesses.

In most jurisdictions, firms tend to prefer a group-wide approach to identifying MRTs, also taking into account the characteristics of different subsidiaries in terms of their main lines of business as well as differences in requirements in each jurisdiction in which they operate. Some authorities note that different local requirements create operational challenges to firms, as they have to adapt their group-wide approaches to such requirements.

The FSB workshop in November 2012 noted that the area of MRTs is one where the range of practice across jurisdictions is probably broader, with less consistency in the definition and approaches used by firms and their supervisors. The most important questions are: "what is material and how to define it in a consistent way" and also "what are the consequences of being a MRT". Several firms in that workshop asked for less prescription in regulatory requirements for MRTs, while others asked for more consistent guidance, which may be difficult to achieve without being specific. More consistency is desired both on parameters for identification and on the implications of being designated as an MRT, and firms noted the challenge of customising pay packages for very large numbers of MRTs as opposed to fewer employees ("one can do less with more identified staff, and more with less"). However, firms' desire for consistency seemed to derive mostly from a desire to reduce overall compliance costs, rather than to increase their effectiveness in providing good risk-taking incentives.

V. Conclusions and next steps

1. National implementation of the FSB Principles and Standards

The implementation of the P&S in national regulation or supervisory guidance is largely completed, and the focus now is on effective supervision and oversight of implementation by relevant firms. Most FSB jurisdictions report that they have intensified their oversight of compensation practices over the past year, although to varying degrees.

Those few FSB jurisdictions that have not yet implemented the P&S should do so promptly. In addition, jurisdictions that have not adopted a few P&S due to their non-applicability or incompatibility with local laws should regularly review their framework in order to ascertain whether these exceptions give rise to regulatory arbitrage by and

material risks for significant firms in their jurisdictions. If found material, these exceptions should be addressed appropriately, including by legislative actions, to ensure full, consistent and effective implementation of the P&S.

Moreover, it is important for all jurisdictions that have already adopted the P&S to proactively monitor and oversee their effective implementation by firms via ongoing supervision. Those jurisdictions that are at a relatively early stage in this process should continue to enhance their supervisory oversight and gain a better understanding of the level of implementation at their firms. This will help foster the necessary degree of attention to developing proper compensation structures in the industry.

2. Material risk takers

There is a broad range of practices across jurisdictions and firms in the identification of MRTs, partly due to differences in relevant national regulations and supervisory guidance (and on their level of prescriptiveness). It is not yet clear whether the diversity in practices and experimentation among firms and jurisdictions, which may increase firms' compliance costs, is leading to significantly different outcomes or which approaches are most effective.

The identification of MRTs is seen by some authorities as the most relevant issue for the effective implementation of the FSB P&S and for promoting a level playing field among significant firms. A few authorities have observed that the identification of MRTs still poses some challenges for supervisors because the firms' internal criteria are seen as not always being "risk sensitive" enough, and because of different jurisdictional interpretations of the "materiality" condition. This is seen as potentially creating challenges for the ability of firms to adequately structure the incentives and for both firms and supervisors to oversee the effective functioning of the compensation packages across different entities in several countries. These authorities support further work at the international level to arrive at a more harmonised definition of the criteria for the identification MRTs, as they feel that the absence of a common definition within the P&S may lead to different interpretations of specific concepts and ultimately a divergent application that would negatively impact the effectiveness of the P&S.

Other authorities are of the view that the identification of MRTs depends on the size, nature or complexity of institutions, and cannot and should not be uniform across institutions. These authorities believe that a case has not yet been made that the definition of MRTs warrants standardisation, and are of the view that the concept of materiality will always differ across firms depending on their business models, making it an issue best addressed via a principles-based approach supplemented by supervision.

Given the existing differences in approach and points of view, the FSB will survey and compare the range of practices in this area across its membership, with a view to identifying good practices while recognising firms' differences and the need for proportionality. The first stage of such work will be to identify the relevant facts. This will enable national authorities to verify in more detail any gaps and evaluate the severity of potential problems before the FSB determines what further action (if any) is necessary.

3. Addressing remaining challenges and assessing effectiveness

As noted in the report, most authorities are of the view that the implementation of the P&S and related supervisory actions has had a high impact on changes in compensation practices for their supervised firms. Indeed, most of the observed trends in compensation structures in recent years indicate that they are being revised in the direction indicated by the P&S.

At the same time, however, several supervisors highlight the need to continue the ongoing monitoring of compensation practices, both at national and international levels. The implementation of the P&S by significant firms is an ongoing process and there remain a range of practical challenges to embedding risk management in firms' compensation practices. Assessing effectiveness is a multidimensional task because the relationship between compensation, performance, governance and risk taking will differ across firms and time depending on the nature of business and of business conditions.

Until a longer history can be built up and assessed, assessments must be based on judgmental reviews of whether firms' practices are improving and whether firms are effectively taking risk into account in making compensation decisions. One of the points raised in the November 2012 workshop is that a full assessment of effectiveness may require some experience of compensation practices during an economic upturn, when the demand for talent in the banking industry will be stronger than today, as well as an economic downturn after firms have fully implemented all the changes they plan. In the meantime, supervisors will need to continue their interaction with firms in order to promote an active role for the Board of Directors to: a) improve the mechanisms for risk and performance alignment; b) optimise the execution of policies and processes; and c) ensure on an ongoing basis that actual pay-outs are justified economically and in terms of performance and risk.

Further interaction and exchange of views by supervisors and firms at bilateral and multilateral levels is needed on some technical challenges to implementation, in order to encourage the sharing of experiences and thereby improve supervisory and firm practices. For example, it would be useful to better understand the use of malus and clawbacks and the role and impact of discretion by a firm's management or the Board of Directors in both ex ante and ex post risk adjustments. Several potential vehicles for such sharing are possible, including relevant work streams by standard-setting bodies, bilateral and multilateral exchanges among supervisors, and additional work by the CMCG.

The FSB will continue to monitor the implementation of the P&S and promote good practices among supervisors and firms, particularly in areas such as the use of maluses and clawbacks. As part of this effort, the FSB will continue to engage with the industry to discuss trends and remaining challenges to effective implementation, including by organising another workshop by year-end to share experiences and views.

Annex A: Status of national implementation

The table below provides a snapshot of the status of implementation in FSB member jurisdictions. The table does not provide an assessment of the degree of compliance with the particular Principle or Standard, rather an indication of whether regulatory or supervisory initiatives have been taken to implement the Principles and Standards (or elements thereof);[39] initiatives are at the preparatory stage (i.e., regulation or supervisory guidance being drafted or under consultation); under consideration; or not currently underway. The table was developed by the FSB Secretariat based on the responses to the template provided by member jurisdictions, and national entries have been checked for accuracy by the relevant authorities. The cells highlighted in orange indicate those areas where there have been changes since the 2012 implementation progress report (in parenthesis, the status before the change).

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

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

	AR	AU	BR	CA	CN	FR	DE	HK	IN	ID	IT	JP	KR	MX	NL	RU	SA	SG	ZA	ES	CH	TR	UK	US
P5	R	R	R	S	S	R	R	S	R	IP	R	S	S	R	R	S (IP)	R	R	R	R	R	S	R	S
S5	NA	R	R	S	S	R	R	S	R	IP	R	S	S	R	R	S (IP)	R	S	R	R	R	S	R	S
P6	R	R	R	S	S	R	R	S	R	IP	R	S	S	R	R	S (IP)	R	R	R	R	R	S	R	S
S6	NA	S	R	S	S	R	R	S	R	IP	R	S	S	R	R	S (IP)	R	S	R	R	R	S	R	S
S7	NA	S	R	S	S	R	R	S	R	IP	R	S	S	R	R	S (IP)	R	S	R	R	R	S	R	S
P7	R	S	R	S	IP	R	R	S	R	IP	R	S	S	R	R	S (IP)	R	R	R	R	R	S	R	S
S8	NA	S	R	S	IP	R	R	S	R	IP	R	S	S	R	R	S (partly) (IP)	R	S	R	R	R	S	R	S
S9	NA	S	R	S	S	R	R	S	R	IP	R	S	S	R	R	S (IP)	R	S	R	R	R	S	R	S
S11	R	S	R	S	S	R	R	S	R	IP	R	S	S	R	R	S (IP)	R	S	R	R	R	S	R	S
S12	NA	S	R	S	S	R	R	S	NA	IP	R	S	S	R	R	S (IP)	R	S	R	R	R	S	R	S
S14	NA	S	IP (NA)	S	S	R	R	S	R	IP	R	S	S	R	R	S (IP)	S	S	R	R	S	NA	R	S
Effective supervisory oversight and engagement by shareholders																								
P8	R/IP	S	R	S	S	R	S	S	S	S	S	S	S	R	R	S (par	S	S	R	R	R	S	R	S

	AR	AU	BR	CA	CN	FR	DE	HK	IN	ID	IT	JP	KR	MX	NL	RU	SA	SG	ZA	ES	CH	TR	UK	US
																tly)								
S10	NA	NA	NA	S	S	R	R	R	R	R	R	R	S	R	R	R	R	R	UC	R	R	R	R	R
S13	S (IP)	S	R	S	S	R	R	S	R	IP	R	S	S	R	R	S	S	S	R	R	S	S	R	S
S16	S (IP)	S	R	S	S	R	S	S	S	S	S	S	S	R	R	S	S	S	R	R	S	S	R	S
S17	S (IP)	R	R	S	S	R	R	S	R	IP	S	S	S	R	R	S	S	S	R	R	R	S	R	S
S18	S (IP)	S	R	S	S	R	R	S	R	IP	S	S	S	R	R	S	R	S	R (S)	R	R	S	R	S
P9	R	R	R	S	S	R	R	S	R	R	R	R	S	R	R	R	R	R	R	R	R	S	R	R
S15	R	R	R	S	S	R	R	S	R	R (par tly) (IP)	R	R	S	R	R	R	R	R	R	R	R	S	R	R

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

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

Annex B: Remaining gaps in national implementation

Country	Gaps in governance, effective alignment with risk taking, or disclosure	Principle not yet implemented	Standard not yet implemented	Reason / additional information
Argentina	Effective alignment with risk taking		5-10, 12, 14	Standards 5-10, 12 and 14 on effective alignment of compensation with prudent risk-taking and government intervention have not been implemented. According to the authorities, there are currently no significant problems with compensation and risk-taking in Argentina's domestic banking system. The authorities also state that domestic labour laws limit their capacity to act in this area.
Brazil	Effective alignment with risk-taking		10 and 14	The implementation of Standard 14 is under preparation. 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.
China	Effective alignment with risk-taking	7	8	Currently, compensation is overwhelmingly paid in cash. China is considering increasing the use of long-term incentive plans with stock-linked instruments.
India	Effective alignment with risk-taking		12	Standard 12 has not been implemented as any payment of compensation to whole time directors and CEOs during and after employment requires RBI approval on a case-by–case basis. Given the above, the authority is of the view that no further measures are required to be taken.
Indonesia	Effective alignment with risk-taking	5, 6, 7	4-14	These Standards remain under consideration.

Country	Gaps in governance, effective alignment with risk taking, or disclosure	Principle not yet implemented	Standard not yet implemented	Reason / additional information
Russia	Effective alignment with risk-taking		8 (partly)	Legislative and market practice constraints (most institutions are non-listed companies, and remuneration with debt instruments is not allowed).
South Africa	Effective alignment with risk taking		10	South Africa is currently in the process of adopting a twin-peaks regulatory structure. Principle 10 could possibly be addressed in the above legislation, although this is an ongoing process and the implementation timelines are not yet clearly specified.
Switzerland	Effective alignment with risk-taking		14	Even though there is no formal guidance, the Standard concerning no hedging in respect of remuneration is addressed by larger institutions through internal compliance processes. The adherence by larger institutions to this Standard can now be confirmed.
Turkey	Effective alignment with risk-taking		14	On 9 June 2011, the Standards were adopted into the domestic framework with some flexibility in implementation.
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 C: Proportionality and identification of Material Risk Takers

Country	Scope of application of the FSB Principles and Standards (P&S)	Treatment of branches versus subsidiaries	Identification of Material Risk Takers (MRTs) – Quantitative and qualitative criteria used by firms
Argentina	The P&S are applied to all financial institutions authorised by the monetary authority.	No differentiation	**No explicit regulatory definition.** The common criterion used by systemic institutions for the identification of "material risk takers" is qualitative and depends on the responsibility assigned to them, their positions in the organization structure, and their contribution and impact to the business.
Australia	All deposit taking institutions and insurers (life insurers and general insurance institutions) operating in Australia.	Requirements apply equally to locally-incorporated entities, foreign owned subsidiaries and foreign branches.	**Supervisory guidance.** MRTs are defined as all other persons for whom a significant portion of total remuneration is based on performance and whose activities, individually or collectively, may affect the financial soundness of the institution. Firms identify MRTs by the role and remuneration. The application aligns with APRA's Governance standard and Remuneration prudential practice guide, which focuses on employees who receive substantial variable pay linked to volume or other non risk-based metrics (financial market traders, other transaction-oriented staff, commissioned sales personnel and intermediaries such as agents and brokers).
Brazil	All financial institutions that are supervised by the Banco Central do Brasil (BCB) except for credit cooperatives and microcredit institutions (insurers are not under the supervision of the BCB).	No differentiation	**Regulatory guidance.** Only administrators (board of directors and executive officers) are subject to the provisions of the Resolution 3921/2010. Some institutions have adopted internal criteria to define MRTs (treasury executives, all the personnel who earn more than a fixed amount as variable compensation) A few firms follow a uniform group-wide approach.

Country	Scope of application of the FSB Principles and Standards (P&S)	Treatment of branches versus subsidiaries	Identification of Material Risk Takers (MRTs) – Quantitative and qualitative criteria used by firms
Canada	FSB Principles: All federally regulated financial institutions FSB P&S: 6 largest banks and 3 largest life insurance companies (*Conglomerate Canadian financial institutions*)	No differentiation	**No explicit regulatory definition.** Firms are expected to have in place sufficient processes to identify MRTs. By and large, the process of identifying MRT's begins with assessing individuals' titled position within the firm, with more senior positions flagged for consideration. Then, quantitative (e.g. size of incentive compensation or the amount of risk an individual can expose the firm to) and qualitative criteria (e.g. complexity of products, volatility of risk in business, and/or riskiness of strategy) are considered to confirm (or not) that an individual is an MRT. This assessment is also performed for those who, by virtue of their job activity (e.g. traders), may expose the Bank to significant risks. Some firms report that groups of employees, who in aggregate may expose the firm to material amounts of risk, can be classified as a collective group of MRTs. The proportions of MRTs are mostly allocated to wholesale/capital market businesses. Firms apply uniform group-wide criteria; however, in some instances, additional processes are established to meet local requirements..
China	All commercial banks under the supervision of CBRC, excluding non-bank financial institutions	No differentiation	**No explicit regulatory definition.** Firms normally identify group level senior management, heads of domestic tier-one branches and heads of major business units of the group.

Country	Scope of application of the FSB Principles and Standards (P&S)	Treatment of branches versus subsidiaries	Identification of Material Risk Takers (MRTs) – Quantitative and qualitative criteria used by firms
France	All banks and investment firms	No differentiation (except that EU branches are supervised by the home member state).	**Regulatory guidance based on EBA Guidelines on remuneration.** Assessment of "material impact" of each activity on the risk profile is made at the consolidated level and is based on the level and type of risk of the activity as well as the level of the position with regard to risk management and compliance. A level of remuneration comparable to that of risk takers is also used as a criterion of inclusion in the perimeter of individual MRTs. The collective identification which is based on the nature of the activity as well as the level of risk associated with that activity. Significant institutions on average identify 1.75% of their staff. The ratio varies depending on the business line: Retail banking 0.14%; Investment banking: 17%. Firms follow a uniform group-wide approach.
Germany	All banks - Major banks (Total assets > € 40 billion, or based on self risk analysis, taking into account size, remuneration structure, nature, scope, complexity risk content and international scale of business activities conducted): More demanding requirements applying to remuneration schemes of management board and other material risk takers - Other institutions: general requirements applying to institutions and employees; institutions that are not "major" may not apply Standards 6-8.	No differentiation (except that EU branches are supervised by the home member state).	**Regulatory guidance based on EBA Guidelines on remuneration.** Based on the employee's designation and job function (e.g. employees in front office/ trading roles) and the composition of remuneration (e.g. high-earning employees whose compensation or whose ratio of bonus to fixed compensation exceeds certain pre-determined thresholds would be included). The identification of collective MRTs is mostly based on quantitative criteria as (aggregated) risk and limit responsibilities and on common product and business activities. Percentage of staff identified, on average for significant firms, in the main business lines: Investment banking: 3%; Retail banking: 0.2%; Asset management: 0-0.3%; All other: 1.7%. Firms follow a uniform group-wide approach.

Country	Scope of application of the FSB Principles and Standards (P&S)	Treatment of branches versus subsidiaries	Identification of Material Risk Takers (MRTs) – Quantitative and qualitative criteria used by firms
Hong Kong	All Authorised Institutions (AIs), including, in the case of locally incorporated AIs, their overseas branches and subsidiaries subject to the Hong Kong Monetary Authority's (HKMA) consolidated supervision.	No differentiation	**Regulatory guidance.** AIs are required to identify senior executives, key personnel and other relevant employees for the purposes of application of the HKMA's Remuneration Guideline based on the following criteria: a. Senior management and key personnel (including but not limited to executive directors, the chief executive and other senior executives who are responsible for oversight of an authorized institution's key business lines or risk management or control functions); b. Staff members whose duties or activities in the course of their employment involve the assumption of risk or the taking on of exposures on behalf of the institution (including but not limited to proprietary traders, dealers, and lending officers); c. Staff members who are incentivised to meet certain quotas or targets by payment of variable remuneration (including but not limited to personnel in marketing, sales and distribution functions); and d. Staff members within risk control functions (including but not limited to risk management, financial control, compliance, and internal audit). As regards quantitative criteria for identification of key personnel, some institutions would make reference to the level of contribution made by the senior employees of the business lines to the institution's operating profit, the size of the risk control limits managed by the employees concerned, the portfolio size of assets under management, credit approval authority etc. Firms follow a uniform group-wide approach.
India	All banks in private sector and foreign banks operating in India.	No differentiation	n.a.
Indonesia	The relevant regulation has not yet been issued	n.a	n.a.

Country	Scope of application of the FSB Principles and Standards (P&S)	Treatment of branches versus subsidiaries	Identification of Material Risk Takers (MRTs) – Quantitative and qualitative criteria used by firms
Italy	All banks 1) "Major" banking groups (total assets > €40 billion) are required to adopt all the provisions on compensation (corresponding to the whole set of the FSB P&S): currently 11 banking groups 2) "Medium" banks and banking groups (€3.5 billion > total assets > € 40 billion) are required to apply all the general provisions on compensation and to consider (on a case-by-case analysis) to what extent Standards no. 6-9 may be applied to their identified staff. 3) "Minor" banks (total assets < € 3.5 billion), may not adopt Standards 6-9, but have to comply with all the other FSB P&S on compensation policies and practices.	No differentiation (except that EU branches are supervised by the home member state).	**Regulatory guidance based on EBA Guidelines on remuneration.** "Identified staff" (unless a bank proves the contrary): Executive directors, senior executives, top managers (people responsible for the main business lines, corporate functions and geographical areas) and those directly reporting to the governing bodies, as well as people responsible for the internal control functions (including the higher staff within those control functions) The main criteria for the identification of "risk takers" by banking groups are the "hierarchical level" and "organisational roles and responsibilities". An assessment of individual tasks, operational limits and delegated deliberative powers is also generally performed. In many cases additional resources are identified based on a threshold (in terms of total or variable compensation and/or of incidence of the variable compensation on the total). The membership in a committee with autonomous collective power to assume risks is considered relevant for the identification of the so called "collective" MRT. Firms follow a uniform group-wide approach.

Country	Scope of application of the FSB Principles and Standards (P&S)	Treatment of branches versus subsidiaries	Identification of Material Risk Takers (MRTs) – Quantitative and qualitative criteria used by firms
Japan	The supervisory guidelines revised in March 2010 that implement the P&S apply to all banks and branches of foreign banks; large and internationally-active securities companies, foreign securities companies, and branches of foreign securities companies; internationally-active insurance companies; and Norinchukin Bank. The regulations and guidelines revised in March 2012 in line with BCBS disclosure requirements for remuneration apply to all deposit-taking institutions, including all banks and cooperative credit institutions, and large and internationally-active securities companies designated by the Japanese Financial Services Agency (JFSA).	No differentiation	**Regulatory and supervisory guidance.** "Identified Employees" - for the purposes of compensation disclosure requirements - are those who satisfy both the following two conditions: - highly remunerated; - the employee's action has a material impact on the risk profile of the firm. The supervisory guidelines state that employees remunerated more than the senior management at headquarters in Japan can be Identified Employees if their actions have material impact on the risk profile of the firm. Quantitative criteria are an average annual compensation of directors through 3-4 years (major banks have bars at 30-50 million yen). Qualitative criteria are materiality of employees' duty and impact on bank's profit and loss.
Korea	Financial holding companies, financial investment business entities, banks and insurance companies. (financial investment with total asset of KRW two trillion or more; insurance companies with total asset of KRW five trillion or more). The scope of application has been expanded to smaller insurance companies and financial investment institutions.	Applied to the subsidiaries of foreign banks but not to branches	**No explicit regulatory definition.** Based on the duties of the senior managers or employees (e.g., in case of a financial investment company, P&S are applied to those senior managers who make important management decisions, and to employees working in high risk / high compensation departments, such as investment banking. The percentage of identified staff is highest for retail banking, followed by corporate banking, asset management and investment banking Firms follow a uniform group-wide approach.

Country	Scope of application of the FSB Principles and Standards (P&S)	Treatment of branches versus subsidiaries	Identification of Material Risk Takers (MRTs) – Quantitative and qualitative criteria used by firms
Mexico	All institutions in the Mexican banking system (including regulated non-bank banks and all brokerage houses)	n.a. (there are just subsidiaries)	**No explicit regulatory definition.** Common criteria used by the firms include: i) Personnel in charge of finding new costumers or business lines; ii) Personnel in charge of granting of new products or services to existing customers; iii) Personnel in charge of authorising new business lines; iv) Senior management; v) The amount of risk brought-on by an employee's operations. Consistency is observed between foreign group practices and their application to Mexican subsidiaries.
Netherlands	All banks, investment firms, insurers and other financial institutions. Scope of application not limited to systemically relevant financial institutions: Based on EBA Guidelines, proportionality defined according to size, internal organization and nature, scope and complexity of the activities. Institutions have to motivate the proportionate application of each article of the Regulation on sound remuneration policy.	No differentiation	**Regulatory guidance based on EBA Guidelines on remuneration.** Institutions are required to use this supervisory guidance, which includes the categories of executive board, senior management, control staff, staff in the "same remuneration bucket" and other risk takers. For the latter, DNB distinguishes three categories: decision takers, staff who execute activities within the risk profile and monitoring functions. Firms follow a uniform group-wide approach.
Russia	Banks (credit organizations) and State controlled institutions.	Not applicable: establishment of branches is not allowed.	Explicit regulatory definition of MRTs is currently under consideration. Banking practices in this area vary significantly.

Country	Scope of application of the FSB Principles and Standards (P&S)	Treatment of branches versus subsidiaries	Identification of Material Risk Takers (MRTs) – Quantitative and qualitative criteria used by firms
Saudi Arabia	All banks including their non-banking subsidiaries and branches of foreign banks operating in Saudi Arabia.	No differentiation	**No explicit regulatory definition.** Banks identify and disclose MRTs based on their internal policies and supervisory guidance provided by SAMA. This is mainly based on the qualitative factors, area of business, nature of activities of the employees, their level in hierarchy, etc. Banks are required to take into account the guidance provided in the BCBS document on "Range of Methodologies for Risk and Performance Alignment of Remuneration". Banks are also required to publicly disclose the number of employees engaged in material risk taking activities and the compensation paid to them. These disclosures are reviewed by SAMA (Saudi Arabian Monetary Agency) to ensure consistency across the industry. Firms follow a uniform group-wide approach. The percentage of staff identified as MRTs on average ranges between 3-10% of total staff for most of the banks.
Singapore	All banks, financial holding companies and significant insurers incorporated in Singapore	Branches are not subject to the Corporate Governance regulation, which incorporates the P&S. Almost all branches with significant operations in Singapore are subject to the P&S by their home regulators	**No explicit regulatory definition.** Banks use decision making authority and empowerment, proxied by designation, as the main criteria. Collectively, a group of senior executives would be deemed to have a major influence on the long term performance of their bank. This is supplemented with other considerations based on the employees' job functions (e.g. employees in front office/ trading roles would be included) and the composition of remuneration (e.g. high-earning employees whose compensation or whose bonus to salary ratio exceed certain pre-determined thresholds). The high level FSB Principles in relation to Standards 6 to 9) apply to each "executive officer", defined as any employee who is principally responsible for the management and conduct of the business of the company. This is intended to cover at least management staff who are division or department heads, and the locally-incorporated banks' definitions are in line with the supervisor's expectations. Firms follow a uniform group-wide approach. The percentage of staff identified as MRT varies based on business lines: Retail and Corporate Banking: less than 2%; Treasury function: 10%.

Country	Scope of application of the FSB Principles and Standards (P&S)	Treatment of branches versus subsidiaries	Identification of Material Risk Takers (MRTs) – Quantitative and qualitative criteria used by firms
South Africa	All banks	No differentiation	**No explicit regulatory definition.**
Spain	All financial institutions, including insurance and financial services companies Institutions with total assets < € 10 billion are exempted from complying with some requirements (e.g. Remuneration Committee); the Bank of Spain (BoS) can require any of these institutions to comply. Relevant regulation states two levels of requirements: - Global requirements: apply to the entire organization - Specific requirements: Those related to performance assessment and ex ante risk adjustments apply to all groups for which there is variable remuneration. - Additionally, ex post adjustments on the variable remunerations should be applied to the identified staff (material risk takers). The BoS can exempt institutions with total assets < € 10 billion or officers with variable remuneration below €100.000 from complying with certain requirements (i.e. deferred remuneration; compensation by shares; ex post adjustments etc.). These limits are currently under revision.	No differentiation (except that EU branches are supervised by the home member state).	**Regulatory guidance based on EBA Guidelines on remuneration.** Identified staff includes executive members; senior management; staff responsible for independent control functions; other risk takers; other employees whose total remuneration takes them into the same remuneration bracket as senior managers and risk takers. Collective MRT criteria include: Executive directors and senior managers, heads of division and country managers; Members of the most relevant executive committees and control committees Individual MRT criteria include: Professionals responsible for the control functions (internal control; internal audit; compliance function; legal department; risks control; financial management; general control and management control; human resources); Managers with total or variable remuneration for the year above certain threshold. Firms use a uniform approach for the group. In order to comply with national jurisdictions, there may be differences between group MRTs and local MRTs. The percentage of staff identified as MRT varies based on business lines: Retail banking: 20%; Investment banking: 35%; Asset management (non-significant); other (corporate staff): 45%.

Country	Scope of application of the FSB Principles and Standards (P&S)	Treatment of branches versus subsidiaries	Identification of Material Risk Takers (MRTs) – Quantitative and qualitative criteria used by firms
Switzerland	- Direct application of the Remuneration circular for institutions (banks and insurers) with regulatory capital exceeding CHF 2 billion. - For other institutions, Remuneration circular applies indirectly as best practice guidance.	Foreign branches out of scope. The regulation/guidance applies to Swiss firms foreign subsidiaries and branches which are mandatorily included in consolidation.	**Regulatory and supervisory guidance.** "Key Risk Takers" are generally interpreted to include the Management Board and CEO and the institution's highest earners, as well as key decisions makers across the institution, including heads of divisions, heads of control functions, individuals having the ability to make or influence major financial or risk decisions or making major commitments on behalf of the company. The remuneration arrangements for this group are subject to higher conditions and are expected to receive greater oversight by the Board of Directors. Firms usually identify the leadership team of the company and high earners, along with additional persons named after an analysis of key functions and positions in the firm, which might have a material impact on the risk profile of the firm. Firms would use a group-wide uniform approach, if they were not confronted with different definition and approaches across the jurisdictions. Percentages are lower for institution that do not outsource back offices and other functions, and have therefore a proportionately higher number of lower level employees.
Turkey	Investment firms (which operate as capital markets institutions). The regulation on corporate governance is applied to all banks and there is no discrimination depending on their size or complexity.	No differentiation	**No explicit regulatory definition.** Some rules and policies are in place concerning the compensation of senior management of the firms. Investment firms are required to determine the proportion of fixed and variable components of compensation and a maximum ratio (variable/total) has to be defined for each department of the firm. The greater the responsibility and authority of an employee in the firm, the greater that ratio should be. No consolidated data is collected from firms on this issue. Firms do not follow a uniform group-wide approach.

Country	Scope of application of the FSB Principles and Standards (P&S)	Treatment of branches versus subsidiaries	Identification of Material Risk Takers (MRTs) – Quantitative and qualitative criteria used by firms
United Kingdom	The UK Prudential Regulation Authority (PRA) Supervisory Statement LSS8/13 (ex FSA Remuneration Code) covers approximately 2,700 banks, building societies and investment firms. Based on EBA Guidelines, proportionality defined according to size, internal organization and nature, scope and complexity of the activities Four tiered proportionality framework, providing indication of which of the rules certain firms may be allowed to neutralise, based on key metrics: - Business model type - Regulatory permissions/activities - Size (capital for UK firms; total assets for non-EEA branches) Tier 1 and 2: large and medium-sized banks, building societies and broker dealers - *Apply all the remuneration rules* Tier 3: small banks and building societies and firms that may occasionally take short term risk on their balance sheet. – *May not apply certain rules*. [Tier four: firms that generate income from agency business that does not put their balance sheets at risk. – *Same as Tier 3]*	UK subsidiaries of EEA firms are directly subject to the Remuneration Code. Branches of EEA firms operating in the UK under EU passporting are subject to the requirements of their Home Member state's implementation of CRD3. UK branches and subsidiaries of non-EEA firms are directly subject to the Remuneration Code.	**Regulatory guidance based on EBA Guidelines on remuneration.** **T**he "Code staff" comprises categories of staff including senior management, risk takers, staff engaged in control functions and any employee receiving total remuneration that takes them into the same remuneration bracket as senior management and risk takers, whose professional activities have a material impact on the firm's risk profile". Further supervisory guidance to firms to include as Code Staff a person: who performs a "significant influence function"; or is a "senior manager"; or a head of a significant business line; or a head of a support and control function. A proportionate approach is also applied at the individual level: certain provisions do not apply, based on thresholds of variable remunerations or total remuneration The requirements on the identification of Code staff apply uniformly across each firm. Firms are expected to have a robust internal process in place. Practices for identification in firms vary; in general firms consider staff who hold "significant influence functions", other senior managers and heads of key business units or control functions. Firms then consider other staff they deem to be material risk takers (e.g. some firms use threshold metrics such as amounts of revenue or assets under management or value-at-risk); and individuals in the same remuneration bracket as senior management and risk takers, to assess whether their professional activities have a material impact on the firm's risk profile. For the Level 1 firms, the identification methodology is reviewed annually on an individual firm basis.

Country	Scope of application of the FSB Principles and Standards (P&S)	Treatment of branches versus subsidiaries	Identification of Material Risk Takers (MRTs) – Quantitative and qualitative criteria used by firms
United States	Supervisory guidance applies to global consolidated operations of all US-headquartered banking organizations and to the US operations of foreign banking organizations with a branch, agency, and commercial lending company in the United States. Supervisory action prioritized on large banks, including all US-headquartered banks that are internationally active	No differentiation	**Supervisory guidance.** Supervisory guidance requires banks to distinguish "covered employees" from other employees, based primarily on control and influence over risk: those receiving incentive compensation who have an ability, either alone or as a member of a group, to take or influence risk that is material to the bank or a business within the bank. A jurisdictional approach is used to identify covered employees within the United States. Firms follow a uniform group-wide approach.

n.a. = non applicable

Annex D: Members of the FSB Compensation Monitoring Contact Group

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