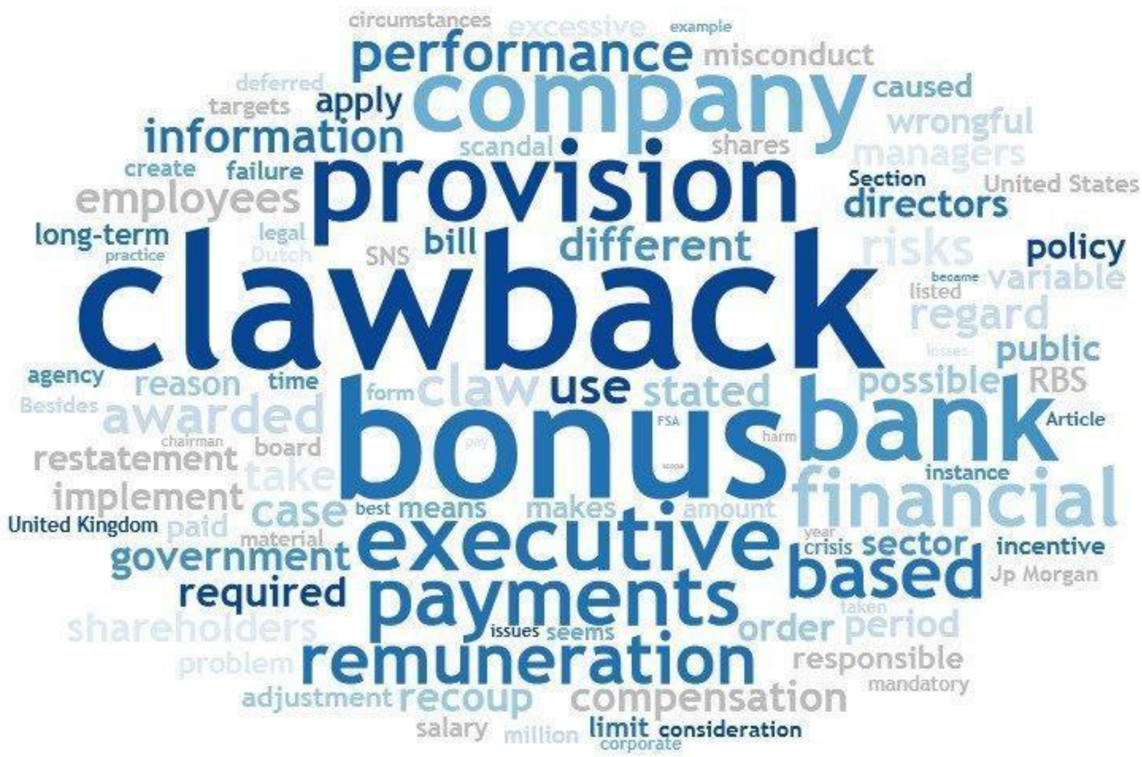

The claws are coming out

A comparison between the implementation and enforcement of clawback provisions in the Netherlands, US and UK

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Preface

Before you lay my thesis of the master's program International Business Law. After finishing my study Criminology and Bachelor Dutch Law, this master was definitely a new challenge for me. A challenge which I have never regretted. Instead, this master confirmed I made the right choice and provided me with useful practical and theoretical knowledge for my future.

My first word of thank goes to Priyanka, for her supervision and responses under considerable time pressure. I really appreciated her positive reactions and useful comments.

Special thanks goes to Sanne, who has provided me with very valuable and competent guidance in the completion of this thesis. I also would like to thank my parents. I am very grateful for the financial and motivational support they always gave me. Without their trust in me I would probably never completed two studies within six years. And last but certainly not least my thank goes to Rob, for his patience and understanding. He never complained when I was spending most of my time in the library writing this thesis.

Timke den Exter

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1. Introduction

The last couple of years, many banks that were on the brink of collapsing were bailed out by the government, which caused public and political consternation. The 'innocent taxpayer' had to bear the burden of failing banks, while executives got away with high (and even extreme) bonuses. Besides that, different scandals in the banking sector made bonus payments seem unjustified. Consequently, different provisions were created and enforced in order to limit or recover bonuses. An increasingly used mechanism is the clawback provision in order to recoup bonus payments if the bonus was awarded on wrongful information or led to a financial restatement.[1] Although the concept of a clawback seems quite easy, it causes several practical and legal issues.

With the nationalization of the Dutch bank SNS Reaal on the first of February 2013, there was a strong need to clawback the awarded bonuses of the executives who were engaged in mismanagement. However, the act that should make this possible is not implemented yet in the Netherlands, because it still needs approval of the Senate. In this thesis, the mandatory and voluntary clawback provisions with regard to banks of the Netherlands, United States and the United Kingdom will be discussed. An answer will be given to the following research question:

How are the clawback provisions regarding banks in the Netherlands, United States and the United Kingdom implemented and enforced and what are the legal challenges of drafting clawback provisions for banks?

This thesis proceeds as follows. The next chapter will describe the clawback provision as a solution to the asymmetric nature of bonuses. The provision should diminish agency problems and moral hazards associated with the banking sector. Chapter 3, 4 and 5 will discuss the clawback provisions on national level in the Netherlands, United States and the United Kingdom. Of each country a specific example of a bank that actually enforced (or in case of SNS wants to enforce) its own implemented provision will be mentioned. In chapter 6, I will recommend that a mandatory clawback provision is desired to obtain more legal certainty and unity. Besides that, I will argue that lawyers should support banks in implementing their clawback provisions. Banks now have possibly too much discretion in implementing these provision. This might later on cause issues such as legal claims of employees. For that reason, it is important that clawback provisions on the one hand meet the conditions of the national provision, but on the other hand allow for other legislation and practical issues in applying the provision. The final chapter concludes.

[1] Foster & Turner 2013.

2. Theoretical Framework

Many corporate failures can be traced back to corporate governance problems within a company. In financial institutions, problems as information asymmetry and moral hazard may serve as a base for agency problems.[2] For that reason, the agency theory can be applied to bank failure in the banking sector. Executive compensation is an important corporate governance mechanism that is being used to improve the performance of a company and is a widely discussed topic today. Section 2.1 describes what banks differentiates form 'normal' companies and how two types of the agency problem are applicable to bank failure. Section 2.2 discusses how a system of performance based remuneration fits into this theory as a possible solution to solve these problems. However, bonus payments also create unwished side effects, which will be described in section 2.3. Finally, the clawback provision will be discussed as a tool that should deal with the asymmetric nature of bonuses.

2.1 Agency Problems in banks

The banking sector differs substantially from other corporate sectors. More generally, the role of banks in the economy and society is very critical. Some banks seem to have a privileged status because they are regarded as 'too big to fail', which means that these banks have so many customers or are connected with other institutions that a failure of this bank may threaten the solvency of other (financial) institutions. In the worst scenario this can create a domino effect and lead to the collapse of the whole financial system or an economic recession.[3] The financial crisis also left its mark on the banking sector. Suddenly, bankers were blamed for earning outraging bonuses. They would have been incentivized to take excessive risks with the money of innocent people. Therefore, the payment of bank executives is regarded as a part of the cause of the financial crisis and this has affected remuneration policies considerably.[4]

The literature on corporate governance describes the agency perspective generally as a separation of ownership of control: investors (principals) own the company and agents (managers) control the company.[5] The agency theory focuses in its essence on the problem that the interests of the principal and the interests of the agent are not aligned. According to the definition, an agent is appointed by the principal to act on his behalf, meaning that the agent should act in the best interest of the principal. A problem occurs when the agent acts in his own interest and disregards the interests of the principal. Agency problems can lead to failure of a

[2] Mullineux & Murinde 2003, p. 367.
[3] Stern & Feldman 2004, p.1.
[4] Bowers et al. 2013.
[5] Shleifer & Vishny 1997, p. 738.

company. Regarding to normal companies, failure most of the time means insolvency. However, in the banking sector failure means not just insolvency but also government intervention through taking over the bank and pressuring the bank to merge with a healthy bank.[6] The level of protection by the government differs, but fact is that banks distinguish themselves from normal companies, because there will be at least some form of protection most of the time.[7]

In the banking literature, there are different kinds of agency problems described that are characteristic for banks. Demsetsz, Saidenberg & Strahan (1997) distinguish two main types of agency problems banks can face: the shareholder/bondholder agency problem and the 'shareholder/manager agency problem'. The shareholder/bondholder agency problem is also known as the 'moral hazard problem associated with deposit insurance'. The fact that shareholders are just limited liable encourages them to desire high-risk strategies and thereby taking money from bondholders. The problem is that bondholders do not have an incentive to protect banks from excessive risk taking by efficiently monitor and constrain risk taking, since they know that the government will protect them if the bank fails.[8] Different actors like managers, regulators, customers and investors have different information about the current state of the banks' health. Customers like small depositors are, in most cases, the ones who know least about their bank. Due to this information asymmetry, depositors are often protected by a deposit insurance scheme. If the bank fails, their deposit is protected to a certain amount. For that reason, they have no incentive to protect the bank against risks.[9]

The second problem Demsetsz, Saidenberg & Strahan (1997) describe is the shareholder/management agency problem. This type of agency problem is not limited to financial institutions, but applicable to different types of companies. Managers are the people that run the bank and know what the situation really is. They have an informational advantage over the shareholders. Normally, managers should act in the best interest of the shareholders by creating maximum shareholder wealth. Due to this informational advantage however, managers can get incentives to behave opportunistically and transfer some of that wealth into their own pockets at the expense of shareholders.[10] This typically happens when a company is public. Public companies have a higher focus on share price and are known for more widely dispersed ownership. This implicates that there is a higher degree of information asymmetry within public firms.[11]

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[6] Mullineux & Murinde 2003, p. 366.
[7] Mullineux & Murinde 2003, p. 366.
[8] Demsetsz, Saidenberg & Strahan 1997, p.1.
[9] Mullineux & Murinde 2003, p. 377.
[10] Hansmann & Kraakman 2004, p. 21; Munzig 2003, p. 13.
[11] Beatty & Harris 1998, p. 299.

The agency problems, information asymmetry and moral hazards can cause serious damage to the banking sector. In order to mitigate these problems, many corporate governance mechanisms are developed. One of these governance mechanisms lies within the compensation policy of a company.

2.2 Bonus as a solution

Performance based remuneration is considered to be one of the most accepted tools to mitigate the agency problem.[12] There are different types of performance-based remuneration like stock options, salary revisions, bonuses and performance based dismissal decisions.[13] Bonus payments to executives are by some regarded as the 'holy grail' of the incentive structures.[14]

Bebchuk & Fried (2003) describe the relationship between executive compensation and agency problems. One possible way is to consider executive compensation as a *solution* to agency problems; the 'optimal contracting approach'. The optimal contracting approach considers performance-based compensation as an instrument used by shareholders to prevent agency problems. In the corporate world, bonuses are commonly seen as an efficient tool for avoiding agency problems by trying to align the interests of the shareholders and managers.[15] The agent gets a put option on the performance of the company. If the company performs well, the agent will get a bonus. According to Jensen & Murphy (1990), the agency theory predicts that the management compensation scheme will create an incentive of management to act in the interests of shareholders and to maximize shareholder wealth.[16]

2.3 Bonus as a problem

Although pay for performance schemes are commonly regarded as an efficient solution to the agency problem, it seems to create other problems that can be disastrous for a company. This type of remuneration is only granted on conditional basis and is only awarded if manager's behavior actually affects the company in a positive way. This implies that the performance of executives has to be at least in some degree measurable. Most of the time corporate performance is measured by rolling annual targets. However, the problem is that bonus structures incentivize managers to focus on these short-term profits, but they do not create incentives for the long-time performance of a company.[17] Consequently, executives are encouraged to take high and even excessive risks.[18] This is exactly what happened during the

[12] Maskara, Esere & Claassen 2012, p. 1.
[13] Jensen & Murphy 1990, p. 226.
[14] HayGroup 2009.
[15] Maskara, Eser & Claassen 2012, p.1.
[16] Jensen & Murphy 1990, p. 226.
[17] HaysGroup 2009.
[18] Kirkpatrick 2008, p. 13.

crisis in which a lot of banks became bankrupt. Managers took excessive risks to reach short-term objectives and obtain the associated bonus. However, in some cases it turned out that these objectives were unsustainable in the long term and therefore the managers were not acting in the best interest of the bank and its shareholders.[19] But instead of taking fewer risks, high-risk taking in banks continued and lead to other giant bank bailouts.[20] The last couple of years, a lot of banks where bailed-out by the government. This means the taxpayer[21] should ultimately bear the costs of the bailout, while bankers got away with high bonuses. This affected the sense of justice of the taxpayer and caused a growing anti-bank sentiment. There is a common sense that if a bank fails while excessive risks were taken, the taxpayers don't have to face the consequences but the bankers should be the first ones.[22]

An additional problem is that bonuses have an asymmetric nature: a bonus provides an incentive for success without a corresponding disincentive for failure.[23] On the one hand the amount of bonuses sometimes is unlimited, but on the other hand it is limited to zero.[24] If the bank performs well, managers and shareholders share profits, but if the bank fails to do so, the losses are just for the shareholder (and in case of a bail-out also for the taxpayer). This creates a situation in which it is easier for an executive to take excessive risks, because he has nothing to lose.[25]

The optimal contracting approach predicts that exogenous forces (observable luck) are not translated into payments. Luck is described as those observable conditions linked to performance that are not caused by the behavior of an executive. However, Bertrand & Mullainathan (2001) argue that executives are not only rewarded for performance of the company, but also for luck. If a company has a high level of dispersed ownership, shareholders seem to be more passive. The consequence is that, in this kind of ownership structures, there is a higher chance that executives are rewarded for luck. The better a firm is governed, the lower the pay-for-luck sensitivity of a company.[26] Garvey & Milbourn (2006) predict something different than a standard agency framework would do. They suppose that there is an asymmetric performance evaluation in compensation contracts. Executives are rewarded more

[19] Van der Stede 2009, p. 8.
[20] Taleb 2011.
[21] It is not always the case that the taxpayer has to bear the burden of a failing bank. If we look at the most recent bail-out in Europe, that of bank of Cyprus, we see a shift from the taxpayer to the depositor as the one that has to contribute.
[22] Chu 2013.
[23] Taleb 2011.
[24] Kirkpatrick 2008, p. 14.
[25] Shleifer & vishny 1997, p. 744.
[26] Bertrand & Mullainathan 2001, p. 901.

for good luck than they are punished for bad luck. Moreover, according to Garvey & Milbourn, they are insulated from bad luck.[27] This is also called the 'rewarding failure'.[28]
For the reasons above, there are developed different mechanisms that should mitigate the negative side-effects of bonuses. One of these mechanisms is a clawback provision.

2.4 Claw Back

The clawback of executive compensation is not a totally new phenomenon. Traditionally, contracts with companies and executives in the financial sector included so-called 'bad boy provisions'. In case of for instance violation of non-competition or confidentiality provisions, bonuses could be recouped.[29] This thesis focuses however on clawback provisions with regard to the pay-for-performance aspect. A clawback provision can have two different forms: post-vesting and deferred vesting. In case of post-vesting, the bonus is based on specific performance targets. If these targets are met, the executive gets paid at the end of the performance-measuring period. If after this period shows that the measured performance (and thus the bonus) was based on wrongful information or a result of misconduct, then this may be a reason to claw back the bonus. However, this form of a clawback is not used often because of legal and practical issues. Clawback of remuneration that is already paid out might for instance be in conflict with national labor laws. The most common used form of a clawback is the deferred vesting, which means that bonuses are deferred for a certain period of time, also called the 'retention period'. In case of misconduct, a misstatement or another specified reason there could be decided to cancel the vesting and recoup the deferred bonus.[30]

Boards have a broad discretion in applying the clawback. Potential triggers for reclaiming bonuses can be compliance and governance failures, regulatory fines and miss-selling charges. Almost everything can be subjected to a clawback as long as it affects the results of the company.[31] The application of a clawback can be the result of individual, divisional or group behavior. However, most of the time it is applied to individuals who breach codes of conduct, compliance rules or as a result of specific losses can be attributed to their behavior.[32] Although the specific conditions of a clawback vary per company, the intention is to recoup bonuses in case of executive failure.[33] A clawback should discourage executives to act only to obtain short-term rewards. Through the idea of losing a bonus, long-term thinking should be stimulated and managers should be prevented of excessive risk taking. Executives should be encouraged to focus more on long-term goals of the company or even better, finding a balance between short-

[27] Garvey & Milbourn 2006, p. 3.
[28] Chu 2013.
[29] Lilienfeld& O'Conell 2010.
[30]Goff & Schäfer.
[31] Olson 2012.
[32] Goff & Schäfer 2013.
[33] Gibson, Dunn & Grutcher 2008, p. 1.

term profitability and long-term sustainability.[34] To achieve this balance, one can think of a bonus/malus system. This type of incentive plan restricts a part of the bonus to, for example, a third of the bonus in any given year. This is spread over three years and in the first year a manager cannot get more than one third of his bonus. The other two thirds remain in the bonus bank. When the executive does not achieve certain objectives, then the bonus will become a so-called 'malus'. This mechanism can be used to claw back a reasonable part of the bonus when it seems that it was determined on the wrong reasons. By way of a claw back scheme, the focus will change more in the direction of long-term sustainability.[35]

By the implementation of a claw-back scheme, there are different issues arising like to who should the provision be applied, under which circumstances can a bonus be recouped, to what extend is there discretion for the board and how far should these provisions reach?[36]
Besides that, the question is how many banks that have adopted such a policy, actually will make use of it. By 'punishing' an executive, the bank gives a sign that there is misconduct as well the bank is not capable of preventing breaches of compliance or ethical standards.[37] For that reason, banks may have a resistant attitude towards using claw back schemes. A recent example of a bank that refused to enforce its clawback provision even though the provision was triggered is Morgan Stanley in 2012. The firm refused to clawback bonuses of an executive who was closely engaged in the Facebook IPO that caused Morgan Stanley fined for $5 million (€5.8 million). Despite the fact that there were reasonable grounds to apply a clawback, the bank refused to enforce its provision.[38]
The risk of losing a bonus might also lead to banks searching for other options to pay their executives, for instance by raising the base salary that cannot be subjected to a clawback.

2.5 Conclusion

In this chapter we have seen that bonuses are awarded in order to mitigate moral hazard problems and shareholder/manager agency problems. However, bonuses seem to have an asymmetric nature, which means that executives are rewarded for performance but not punished for failure. Moreover, executives are even rewarded for luck without being punished for bad luck. A clawback rule should effectively approach these problems. However, the provision also has its own unwished side-effects. Because of a clawback is a relative new provision and its broad interpretation, the next chapters will discuss how clawback provisions of different countries are implemented and enforced.

[34] Van der Stede 2009, p. 8.
[35] Van der Stede 2009, p. 9.
[36] Gibson, Dunn & Grutcher 2008, p. 3-6.
[37] Tuttle 2013.
[38] Gandel 2012.

3. The Netherlands

On 1 January 2013 the Dutch bank SNS Reaal was bailed-out and became under (temporary) public ownership of the Dutch government. The Dutch newspaper NRC Handelsblad estimated the financial consequences of the bail-out for the Dutch taxpayer. This would be €265,99 per person and therefore is argued that it is unfair if executives who can be held responsible of the failure of the bank get away with high bonuses.[39]
For that reason the demand for a mandatory clawback provision became a public discussion, partly because existing codes were not sufficient to recoup bonuses from the executives. On this moment there is no mandatory clawback provision that applies in the Netherlands.
However, the country is in expectation of the approval of the Clawback Bill by the Senate. The proposal creates a legal authority for the Supervisory Board to clawback bonuses in case the awarding is based on wrongful information.
This chapter will first explain the different existing clawback provisions in the Netherlands and thereafter the Clawback Bill will be discussed followed by the example of the SNS case.

3.1 Existing provisions

Dutch Civil Code
Some provisions of the Dutch Civil Code could be used in order to claw back bonuses. However, in practice it proves to be really hard to use these rules for this purpose, if there is no additional law that explicitly authorizes the supervisory board to revoke promised bonuses. Normally contractual provisions can only be set aside under very stringent requirements and in exceptional circumstances.[40]

The Netherlands attach great importance to the principles of 'reasonableness and fairness', which can be found in Article 6:248(1) DCC. In this case, the Supervisory Board can refuse to pay out a promised bonus, because the circumstances of the concerning case are such that awarding the bonus seems unreasonable and unfair and therefore unacceptable. Besides that, the company can ask for a change or partial termination of the agreement based on Article 6:258(1) DCC. Furthermore, if a company awards a bonus to a director without a legal ground, the company can try to invoke the 'undue payment' which can be recovered by Article 6:203 DCC.

[39] Hensen 2003, p. 3.
[40] Kamerstukken II, 2009-2012 32 512, nr. 3.

Article 7:611 DCC obligates an employer and employee to behave as a good employer and employee. Dutch case law makes it possible for a company to change the conditions of the employment contract unilateral. In the Stoof/Mammoet case[41] the Dutch Supreme Court decided that an employment contract can be unilaterally changed if a the employer can find a good motivation while acting as a 'good employer' and if the proposal to change the contract seems reasonable and fair.

Dutch Corporate Governance Code

The Dutch Corporate Governance Code applies to listed companies and has established rules in order to adjust and revoke bonuses in best practice provisions II.2.10 and II.2.11. Provision II.2.10 exists of a test of reasonableness in order to *adjust* bonus payments. Provision II.2.11 foresees in the *clawback* of incentive based remuneration. Provision II.2.11 states that the Supervisory Board has the authority to claw back variable remuneration awarded to members of the Management Board if this remuneration is based on wrongful (financial) information. However, the Dutch Corporate Governance Code is not directly enforceable. The Code is based on the 'comply-or-explain' principle, which means that a company has the choice to deviate from the provisions. The intention of the regulation is that the supervisory board undertakes action to implement this clawback rule into contracts with directors of the company. This means that mutual consent is required for the application of the provision. If there is no mutual consent, a company can deviate from the Code if it provides an explanation for the deviation in the Annual Report.[42]

In the Monitoring Committee Corporate Governance Code report of December 2010, the clawback clause was more explained compared to other best practice provisions. Although the overall complying with the corporate governance provisions in 2009 was large, 26 of the 100 companies did not implement a clawback provision. Subsequently, they explained in their Annual Report why the company did not implement the clawback provision. One of the reasons for this can be the fact that 16 of these companies are still busy implementing the provision. Besides that, companies argue that they do not convert the best practice provision of the code into a provision in their corporate governance, because they are waiting for the upcoming (mandatory) statutory basis. Nevertheless, there are still 73 companies that complied with the provision. However, only 25 companies did implement an explicit reference to the provision of the code and 51 companies only referred implicitly.[43]

[41] HR 11 juli 2008, JAR 2008/204 (Stoof/Mammoet Transport B.V).
[42] De Waaij 2013.
[43] Monitoring Committee Corporate Governance Code 2010, p. 15-20.

Banking Code

The Banking Code, which is applicable from the first of January 2010, is just like the Corporate Governance Code a form of self-regulation. All banks with a banking license as stated in the Dutch Financial Supervision Act (FSA) fall under the scope of the Banking Code.[44] The Banking Code exists of equal clawback provisions as the Corporate Governance code. Section 6.4.5 of the Code states that the Supervisory Board has the authority to clawback the variable part of the remuneration if awarding was based on wrongful (financial) information. Only bonuses of members of the Board of Directors can be recouped.[45]

The Monitoring Commission Banking Code came in 2010 with a preliminary report on the implementation of the Banking Code. Without mentioning the exact number, the report states that Dutch banks are taking appropriate measures with regard to remuneration of the managing directors. Moreover, most of the banks reviewed by the Commission already established a clawback provision or are at least thinking about implementing it soon.[46]

The Cabinet considered the ‘comply-or-explain’ character of the Dutch Corporate Governance Code and the Banking Code not sufficient in order to provide sufficient provisions to clawback bonuses. Besides that, contracts that already existed before the introduction of both Codes could not be amended. These issues asked for a provision with a mandatory character that made a clawback of remuneration possible without establishing contractual provisions between the Supervisory Board and directors. For these reasons, the ‘Clawback Bill’ was introduced.

3.2 Claw Back Bill

In September 2010 the Parliament approved the ‘Bill for Revision and Claw Back of Executive Bonuses and Profit-sharing’ in order to amend the Dutch Civil Code and the Dutch Financial Supervision Act (FSA). Prospected was that the rule would come before 2011 into effect. Although the rule is in December 2012 approved by the House of Representatives, it is still pending for approval of the Senate.[47]

The bill introduces a legal mechanism for the Supervisory Board to (1) adjust bonus payments of executives based on grounds of reasonableness and fairness or to (2) recoup them if they are paid out based on wrongful information.[48] The proposal adds a new section to Article 2:135 DCC. Article 2:135(1) DCC requires that a company makes a remuneration policy with regard to their (executive) directors. The new section 8 will add to Article 2:135 DCC that the company is competent to claw back a total or partial bonus if it was based on wrongful information in

[44] De Brauw Blackstone Westbroek 2011.
[45] *Kamerstukken II*, 2009/12 32 512, nr. 3.
[46] Monitoring Commission Banking Code 2010, p. 15.
[47] *Kamerstukken II*, 2009-2012 32 512, nr. 3.
[48] Stibbe 2010.

consideration to the objectives or circumstances that underlie this wrongful information.[49] Companies that fall under the scope of the Clawback Bill have to create a new or adjust their existing remuneration policy in order to satisfy the conditions of the bill.[50]

The companies covered by the bill are directors of Dutch public limited liability companies (NV's), listed as well as unlisted directors of Dutch private companies with limited liability (BV's) and cooperatives that are banks, directors of all insurance companies and any person who's function is to fulfill the daily management of a financial enterprise as stated in Article 1:1 FSA (Financial Enterprise). Because excessive risks and exaggerated bonus payments took place in the financial sector mostly, the Dutch government decided that the meaning of 'Financial Enterprise' should be considered broadly.

The bill defines a bonus as 'any non-fixed part of the remuneration'. This can be cash, shares, other options or pension rights. Required is that there is a direct connection to certain indicators that are linked to performance, achievement of specific targets or the passing of certain events. The scope of this definition is also broad: golden parachutes, profit sharing and golden handcuffs might be considered as bonuses. With regard to financial institutions, the Clawback Bill applies to all bonuses and other variable payments.[51] Bonuses that are already paid can be subjected to adjustment and bonuses which payment is deferred, can be clawed back. If the bill will finally be approved by Parliament, the rules have valid power from their effective date. This means that bonuses that are promised before the effective date can also be subjected to adjustment or clawback.

The trigger to use the clawback mechanism is if a bonus was awarded based on wrongful information with regard to; (1) the achievement of certain targets or; (2) the occurrence of certain events. For both scenarios there has to be a connection between the target and/or event with the bonus payment. The period of clawback is limited to the period over which the misstatement was made. On the contrast, the best practice provisions of both codes are limited by the formal provision of 3:306 DDC, which limits the period to recover money to five years.[52]

Recent status of the bill

The in February 2013 published preliminary report of the Committee of Security and Justice on the preliminary research of the Clawback Bill is in general positive about its future implementation. The different fractions understand the importance of controlling the risks in

[49] Kamerstukken II, 2009/13 325 12.
[50] Stibbe 2010.
[51] Article 2:135(6) Legal Proposal TK 32 512.
[52] De Brauw Blackstone Westbroek 2011.

the financial sector and the limitation of excessive incentive-driven payments that stimulate short-term thinking. However, there are still a lot of questions and marginal notes about the bill. For instance, the VVD- and D66-fractions think that the Clawback Bill does not address the problem to its cause. The fraction states that the remuneration system is wrong and that we have to strive towards finding a balance between the fixed and variable components of the remuneration. The PVDA-fraction argues that the Bill now only aims at the possibility to claw back in case of a financial restatement if the restatement can be connected to performance. The fraction suggests that the violation by an executive director of the General Business Principles, statutes and laws also has to be taken into consideration.

Other questions asked by different fractions are what the expected side effects are, such as the increasing of the vast salary and a decreasing of the variable part. Also, it has been wondered what the exact relationship is with the European Convention on Human Rights (ECHR) and other international treaties?

The fractions have to wait for the reaction of the Dutch government, which is still not published. The only thing that is sure is that the implementation of the bill is deferred for a long period. Moreover, this period could even be too long. In the meantime, banks have to stick with the best practice provisions of the codes. Table 1 summarizes the different elements of the already existing and upcoming clawback provisions in the Netherlands. An important question is what would have happened if the Clawback Bill already could be applied when the Dutch government bailed out the bank SNS Reaal? The next section describes the mismanagement within SNS Reaal that stirred the debate about the actual implementation of the Clawback Bill.

Table 1: Dutch clawback provisions

	Dutch Corporate Governance Code	**Banking Code**	***Clawback Bill***
Mandatory?	• No, Comply or explain principle	• No, Comply or Explain	• *Yes, supposed to be implemented in Dutch Civil Code*
Companies covered	• Listed Companies	• All banks with a banking license under the Dutch Financial Supervision Act (FSA)	• *Public limited liability companies (NV's)* • *Private companies (BV's)* • *Cooperations that are banks* • *Financial enterprises*
Trigger	• If remuneration is based on wrongful financial information	• If remuneration is based on wrongful financial information	• *If bonus is paid based on wrongful information*
Subject to clawback	• Members of the Management Board	• Members of Board of Directors	• *Directors of NV's, BV's, cooperations that are banks* • *Any person with daily management of financial enterprise*
Amount	• Variable compensation	• Variable compensation	• *Any deferred bonus (i.e. payment that is in certain way linked to performance, targets or events)* • *Financial Sector: all variable remuneration*
Recovery Period	• No, but; • Restricted by formal law: Article 3:306 DDC gives a limitation period of five years	• No, but; • Restricted by formal law: Article 3:306 DDC gives a limitation period of five years	• *Period over which the restatement had to be made*
Enforcement	• Supervisory Board	• Supervisory Board	• *Supervisory board*

3.3 SNS Reaal

On the First of February 2013 the Dutch government nationalized Dutch bank SNS Reaal. Leader of the political party PVDA, Diederik Samson argued that the bonuses of top-executives of the bank should be recouped, because they were awarded on wrong grounds.[53] The Banking Code provides a clawback possibility for SNS. However, the period to clawback is restricted to five years by Article 3:306 DCC.[54] Because of the limited legal options, Dutch finance minister Jeroen Dijsselbloem stated in his clarification regarding the nationalization of SNS, that it would be decent of the SNS top-executives to recoup their awarded bonuses voluntarily.[55]

Reasons for the failing of SNS

On 18 May 2006 SNS did its Initial Public Offering (IPO) thereby raising €1.35 billion. Former director, Ronald Latenstein, emphasized that the bank was not intended to make profits out of the IPO. Latenstein explicitly mentioned that the bank should be 'predictable, with steady growth and low risks'. Contradictory to this statement, a few months later SNS bought the property finance fund 'Bouwfonds Property Finance' from ABN AMRO, another Dutch bank. This action made SNS the biggest provider of property finance in the Netherlands. Under chairman Sjoerd van Keulen, Property Finance obtained an internationally minded strategy with the ambition to expand rapidly, which would finally end up in the collapse of the entire concern.

The question is which actions and circumstances contributed to the collapse. First of all, Europe is in state of a financial and banking crisis, which makes it almost impossible for every financial institution to obtain good results. However, in case of SNS there are also other factors that affected the results of SNS negatively. The risks that were taken in the real estate branch of SNS seemed more extreme compared with those taken by other banks. Moreover, the control and monitoring mechanisms that should limit and prevent these risks, failed. Although SNS had internal procedures in order to limit the risks associated with the providing of real estate loans, in reality loans were made based on different terms. These terms were far less stringent than the procedures. The research of customers seemed to be insufficient, real estate projects were poorly monitored, cost overruns noticed too late, the bank was doing business with suspected companies and was continued investing millions in projects that were on the brink of a collapse. The most famous example of the poorly managed property financing was the € 370 million that was granted to real estate entrepreneur Roger Lips who build the longest shopping mall of Europe located in the Netherlands: the Wall. Although Property Finance and Lips agreed the loans on strict terms, the parties often failed to comply with the arrangements. For instance, even though the risk management of the bank gave a negative advise and SNS knew Lips could

[53] Posthumus 2013.
[54] De Waaij 2013.
[55] Stellinga 2013, p.2.

not fulfill his obligation to repay within the agreed period, the bank still decided to continue issuing loans to Lips. Finally, in May 2012 the failed Wall-project was taken over by Property Finance.[56]

The question is, who can be held responsible for the failure of SNS Reaal? First of all, the definition of responsibility needs to be explained. Responsibility means something different than liability in this case. It is difficult to establish liability for 'mismanagement' of the directors, because in that case there has to be proved that the failure of the bank was a consequence of mismanagement of the executives, which seems legally hard to prove. However, the Clawback Bill only requires 'wrongful information' on which the bonus is based. From this point of view, top-executive Sjoerd van Keulen can be partly blamed. He became chairman of SNS in 2002 and under his supervision SNS did its IPO in 2006. With a substantial part of the revenues of the IPO, Van Keulen bought Property Finance of ABN Amro. In 2009 he resigned and was replaced by Ronald van Latenstein, who resigned as chairman right after the government bailout of the bank. Latenstein was financial director from 2002 and thus also responsible for the acquisition of Property Finance. He was replaced in 2009 by Ference Lamp.[57]

Variable remuneration within SNS

Since the problems of SNS Reaal started after its IPO and the acquisition of Property Finance in 2006, the bonus payments within the bank will be discussed from this period until the bailout in 2013. The discussion is based on the remuneration reports of the financial Annual Reports of SNS Reaal.

The 2006 IPO led to the automatic applicability of the Corporate Governance Code to SNS. The bank decided to comply with most of the principles and best practice provisions of the Code. From 2006, SNS introduced a new bonus structure. It divided the bonus payments into short-term and long-term bonuses. With the splitting of the bonus, the executive remuneration within SNS Reaal existed of the following four parts:

1. The base salary;
2. A short-term bonus based on performance of the bank over the previous year;
3. A long-term bonus based on the average performance of the company over a period of three years;
4. Other benefits, like pensions.

The short-term bonus of the executive directors is awarded in cash. The Supervisory board determines the objectives on which the performance is based. Performance is linked to three elements: (1) financial performance(50%); (2) accomplishing strategic objectives (25%) and; (3) individual performance based on individual competences (25%) The long-term bonus will be

[56] Kreling & Roesenberg 2013, p. 2-3.
[57] Kreling & Roesenberg 2013, p. 2-3.

awarded by way of a conditional performance share. The criteria of performance are (1) financial indicators (70%); (2) qualitative criteria such as satisfaction of employees (30%). Required for participation in the long-term bonus plan is that an executive director has to buy shares in the company for at least one year salary within a maximum period of six years: shares are awarded after three years and are blocked on a bank account for another three years. According to the financial Annual Report, the first the long-term bonus should be awarded from May 2007. The long-term bonus was in 2007 a conditional awarding of shares existing of 40% of the base salary for executive directors and 50% for the chairman.[58]

On 11 December 2008, SNS received a capital injection of the Dutch state of €750 million. Therefore in 2008, the members of the Board of Directors of SNS did not obtain a bonus in 2008. Bonus remuneration is deferred until the new remuneration plan is established.[59]
With regard to the so called 'Herenakkoord' of 2009, Dutch Finance Minister Jeroen Dijsselbloem agreed with Dutch banks to limit bonuses in the banking sector. Consequently, the remuneration policy of SNS also changed in that year. In the Herenakkoord, bankers promised to moderate loans and bonuses in their sector. Banks were recommended to use more long-term than short-term bonuses.[60] SNS chose to reward no (short- and long-term) bonus to its directors in 2009. Only the shares awarded in 2007 are still fixed.[61]

Under Basel III[62] the rules regarding to bonus payments were tightened at a European level. These rules became public in 2010. In the Annual financial Report SNS chose to delete its long-term bonus provision, which was not applicable anymore from that date on. However, the shares as granted under the 2007 remuneration policy will become available in 2013, when the lock-up period is over.[63] In 2011 SNS established a new remuneration policy, that was conform the Regulation on Sound Remuneration Policy under the Dutch Financial Supervision Act. Consequently, performance-depended remuneration was split up in a direct and deferred element. Besides that, awarding of the bonus takes place half in cash and half in SNS shares. The criteria for performance are also sharpened and need to be conform the Challenging and Measurable Key Performance Indicators (KPI's), which are ascertained by the Supervising Board.[64]

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[58] SNS Reaal 2008, p. 100.
[59] SNS Reaal 2009, p. 87.
[60] NRC 2009.
[61] SNS Reaal 2010, p. 84.
[62] International Regulatory Framework for Banks (Basel 3).
[63] SNS Reaal 2011,p. 101.
[64] SNS Reaal 2012, p. 123.

The most recent financial Annual Report is that of 2012 and is published after the nationalization of SNS Reaal. SNS' remuneration policy is in accordance with all applicable legal provisions, like the Corporate Governance Code, the Banking Code, the Regulation on Sound Remuneration Policy and the Act bonus ban on State-supported Institutions. The intention of the latter Act is – as the title already mentions – that banks that obtain support of the state are prohibited of rewarding bonuses to their executives. As a consequence of the implementation, SNS did not reward variable bonuses to its executives in 2012.[65]

After the nationalization of SNS, the media published many discoveries about the bonuses of CEO Sjoerd van Keulen. He would have received €7 million on bonus payments. However, in practice this does not seem to be the case. In 2006, he was awarded a short term bonus of €537.000 in cash and in 2007 a long-term bonus of € 421.000 in shares, which were locked up for a period of five years. Besides that, if he wanted to profit from the long-term bonus provision, he was required to buy shares in SNS worth his annual salary and with his own financial means, which made him buy for an amount of €1.2 million shares in SNS. However after the nationalization, his investment was worth nothing.[66]

3.4 Conclusion

On this moment banks in the Netherlands only can rely on the best-practice provisions of the Dutch Corporate Governance Code and the Banking Code. Both of the codes apply to SNS Reaal. However, the recovery period reaches no further than a period of five years. This means that only the bonuses that were awarded to SNS' executives between 1 February and 12 November 2008 could be recovered. The Clawback Bill, which is more stringent, extends this period and makes it also possible to recover bonuses awarded prior to 2008. Since the mismanagement within SNS started from 2006, one could argue that a mandatory provision (which the Bill provides for) is desired.[67]

[65] SNS 2012, p. 133.
[66] Verhaar 2013.
[67] Volkskrant 2013.

4. The United States

In the United States, the implementation and enforcement of clawback provisions and expansion of already existing provisions increased considerably over the last several years and it still continues to rise. This is partly caused by the introduction of Section 954 of the Dodd-Frank Act that obligates public companies to adopt a clawback provision. If Section 954 actually is enforced, even more companies should have a clawback provision.
This chapter will first explain the mandatory clawback provisions of the United States. After that, the development of implementation and use of clawbacks in the United States will be briefly discussed. Finally, the JP Morgan case will be explained more detailed to give an example of one of the first companies that clawed back the maximum tolerated incentive-based remuneration of its employees.

4.1 Mandatory clawback provisions

In the US, the possibility to clawback remuneration is regulated in the Sarbanes Oxley Act (SOX Act) of 2002, the Dodd Frank Act of 2012 and, only for TARP recipients[68], in the Emergency Economic Stabilization Act (EESA) of 2008. The Dodd-Frank provision made an important extension to the SOX provision.

The Sarbanes Oxley Act

After corporate scandals like Enron and DotCom, there was a strong need to prevent corporate misconduct. For that reason, Congress introduced a clawback provision with Section 304 of the Sarbanes Oxley Act. Section 304 states that if CEO- or CFO-compensation is linked to earnings that have to be restated and if the misstatement was material and a result from misconduct, this compensation can be subjected to a clawback. The Securities and Exchange Commission (SEC) is the competent authority to enforce a clawback. Compensation can be recouped over a period of twelve months following the first improper filing. The SEC did however enforce the rule only a few times.[69] The SOX provision seemed poorly written and for that reason not very efficient. In the meantime, the SEC is extending Section 304. Case law shows us that liability under Section 304 does not necessarily require personal misconduct by the CEO or CFO anymore. Moreover, the bonus of the CEO or CFO can be recouped if there is misconduct by *'any officer, agent or employee who is acting within the scope of his or her employment'*.[70]

[68] Banks that are supported by the government of the United States and that meet the conditions of the TARP.
[69] Denis 2012, p. 6.
[70] Denis 2012, p. 2.

Dodd-Frank Act

In the wake of the recent financial crisis, there was a common need to improve the mandatory clawback provision in the United States. In order to come up with a solution that should overcome the issues with the SOX provision, section 954 of the Dodd-Frank Act was created. Section 954 provides a legal mechanism to recover erroneously awarded compensation. The provision requires the SEC to adopt a rule that obligates a listed company to develop and implement a clawback policy. Because the SEC has to implement Section 954 first, the provision is still not officially mandatory. However, many companies already meet the requirements of Section 954 in their clawback policy.

Section 954 provides for recouping incentive-based compensation of any current or former executive officer. This is possible in case of an accounting restatement because of material noncompliance with any financial reporting requirement of the company. Under section 954, intent or negligence of the executive is not required for the enforcement of a clawback provision. On the contrary, Section 304 of the Sarbanes-Oxley Act requires misconduct that has resulted in noncompliance Also different to the SOX provision is the possibility to claw back compensation over the period of three years before the date of the accounting restatement under the Dodd-Frank provision. Only the part of compensation that would have been paid under the restatement can be granted to the executive. A failure to adopt a clawback provision or a disclosure policy of a listed company will result in delisting.[71]

EESA/ARRA

The United States also have a third clawback provision which is only applicable to those companies that fall under the scope of the Troubled Asset Relief Program (TARP), which became law in 2008. Under the TARP, financial institutions can get support of the government of the United States. The government can purchase assets and equity of these institutions in order to save them from bankruptcy and create more financial stability.

A TARP recipient is required to comply with section 11(b)(3)(B) of the Emergency Economic Stabilization Act (EESA) of 2008, which is part of the TARP and also known as a 'bailout'. The EESA provision is later amended by the American Recovery and Reinvestment Act (ARRA) of 2009. The recipient has to establish executive payment standards, containing a clawback provision. Any bonus payment to a senior executive officer (SEO) or to one of the twenty most highly awarded employees within the TARP period can be subjected to a clawback. The trigger for a clawback is that if compensation was made on an inaccurate financial statement or any other inaccurate performance metric criteria. Misconduct or an accounting restatement are not required. The question whether a statement is inaccurate depends on all the relevant facts and circumstances of each case, but if an employee is engaged in purposely providing inaccurate

[71] Section 954(2) Dodd Frank Act.

information, this is considered to be of material inaccuracy anyway. However, if a company fails to make a GAAP restatement, this does not necessarily mean that compensation is subject of a clawback.[72]

The three clawback provisions differ substantially in various elements. Table 2 summarizes the differences between Section 304 of the Sarbanes-Oxley Act, Section 954 of the Dodd-Frank Act and Section 11(b)(3)(B) EESA/111 ARRA.

[72] Day, Ferreira & Zelikoff 2009, p. 10-14.

Table 2: US clawback provisions

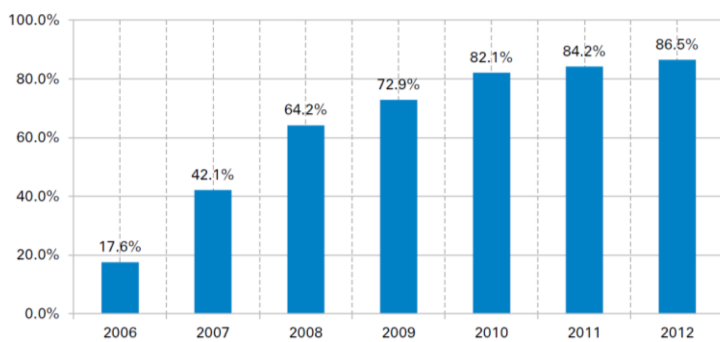
	§304 SOX	§ 954 Dodd-Frank	§11(b)(3)(B) EESA / 111 ARRA
Mandatory?	• Yes	• Not yet, only when implemented by SEC	• Yes, only for TARP recipients
Companies covered	• Companies that have to meet the requirements of the Securities and Exchange Act of 1934	• Listed Companies on a national securities exchange	• Companies that participate in TARP
Trigger	• Accounting restatement due to material noncompliance; • with any financial reporting requirement under securities laws; • as a result of misconduct	• Accounting restatement; • As a consequence of material noncompliance; • With any financial reporting requirement under securities laws	• Statements of earnings, revenues, gains or other earnings that seem to be material inaccurate; • Or any other materially inaccurate performance metric criteria
Subject to clawback	• CEO • CFO	• Current executive officers • Former executive officers	• SEO or; • One of the 20 most highly paid employees
Amount	• Any bonus; • Other equity based compensation; • Profits obtained by selling securities	• Incentive based compensation (including stock option awards) based on erroneous data and in excess of what would have been paid under the restatement	• Bonus; including • Retention award; or • Incentive compensation
Recovery Period	• Up to 12 months before first public issuance or filing of the misstatement	• Up to 3 years before the date of required accounting restatement	• Period of TARP participation
Enforcement	• CEO/CFO to bring the money back into the company • SEC in case of violation	• Company has to create and implement clawback policy • Exchanges and NASDAQ authorized to delist a company if it fails to comply with the Dodd-Frank	•

Although each provision has different elements and the Dodd-Frank Act tried to improve the issues with the SOX provision, all three provisions raise some questions. For instance, what does the Dodd-Frank Act exactly mean with executive officers? It is quite clear that the term embraces more than just the CEO and CFO (like the Sarbanes Oxley Act mentions). It is up to the implementation of the SEC to define this concept more narrowly. It is possible that the SEC uses Rule 3b-7 of the Securities and Exchange Act of 1934 to define 'executive officer'. If this were the case then the president, vice president(s) and others who have comparable functions that contain policy-making aspects would fall under the scope of 'executive officer'. The SEC also has also to make clear what it precisely mentions with 'material noncompliance' and how erroneous and excess compensation have to be calculated.[73]

4.2 The claws are coming out

Although the three mandatory clawback provisions raise issues and the Dodd-Frank still has to be implemented by the SEC, clawbacks have become a widely recognized corporate governance mechanism in the United States. The publicly disclosed clawback provisions adopted by Fortune 100 companies (under which JP Morgan) grew from 17,6 percent in 2006 to 86,5 percent in 2008 (figure 1).

Figure 1: Percentage of Fortune 100 companies with a disclosed clawback policy



Source: Equilar 2012

One of the reasons for the increasing amount of companies that implement clawback provisions is the prospected implementation of Section 954 of the Dodd-Frank act by the SEC. However, the 2012 Clawback Policy Report of Equilar shows that even before the introduction of Section 954, many Fortune 100 companies already fulfilled the requirements of the Dodd-Frank Act. This means that these companies had more extensive clawback provisions than the Sarbanes Oxley Act required of them. However, this is not strange because from the beginning of the financial crisis, shareholders were increasingly demanding stronger corporate

[73] Brown & Lifshits 2011.

governance mechanisms of companies in order to restrain excessive risk taking and create financial stability.[74]

When we focus on banks only, an increasing amount of banks can be ascertained that introduced clawback provisions.[75] Besides that, one can observe a tendency towards an expansion of the claw-back policies of the biggest banks.[76] The increasing amount of shareholder proposals delivers an important contribution to this expansion. For instance, shareholders exert pressure on banks to add the right to recoup a bonus when not the executive himself, but an individual he supervises makes mistakes. Or contrary, if the provision only applies to the responsible employee shareholders want to see an extension to those who supervise this employee.[77] In 2012 Goldman Sachs, Morgan Stanley and JPMorgan Chase already implemented an expansion followed by Citigroup, Wells Fargo and Capital One who implemented an expansion this year by an agreement with New York City's comptroller.[78] Previously, their clawback only could be applied if the concerning executive committed intentional or gross misconduct. After the establishment of the agreement, boards can also recoup bonuses of executives whose (mis)conduct caused serious financial or reputational harm.[79]In addition, banks were pressed to enhance disclosure with regard to the claw back actions they take. Capital One implemented this enhanced disclosure rule and other banks are still in consideration.[80]

JP Morgan is one of the first banks in the United States that recouped bonuses from executives. JP Morgan is an American financial firm listed on the New York Stock Exchange and is highly ranked in the Fortune 100 companies. The bank was not the first company that clawed back remuneration: AIG was the first company that enforced its clawback provision. However, the biggest difference was that AIG's major shareholder was the government and at JP Morgan it was not. This makes JP Morgan the first public company that uses the clawback and media speculated that this could be a template for other banks and companies.[81] The next section will describe the clawback case of JP Morgan.

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[74] Equilar 2012, p. 4.
[75] Gilligan 2013.
[76] Park 2013.
[77] Park 2013.
[78] Tuttle 2013.
[79] Isidore 2013.
[80] Park 2013.
[81] Thompson 2012.

4.3 JP Morgan

The London Whale Trade Losses

"We are dead I tell You". These are the words that JP Morgan's trader, Bruno Iskil, who worked in the Chief Investment Office (CIO) in London, send to his lawyer in March 2012. What exactly made him writing this message?

Three days before his message, Iksil lost $44 million (€33 million) on corporate-credit bets which made him make more than $500 million (€374 million) losses that year. Together with junior trader Julien Grout he tried to hide the losses that would have a total amount of more than $6.2 billion (€4.6 billion). Moreover, the manager under who's supervision both traders worked exerted pressure on them to keep the losses secret, because of the huge scandal it would become.[82] CEO and Chairman Jamie Dimon, who had the reputation of being one of the best and smartest CEOs on Wall Street was also involved in the scandal. Dimon became known in Wall Street as a banker that let the bank survive the crisis without making losses. He was also known for investigating all affairs in and around the investment bank. However, this scandal changed this reputation. The firm engaged in different kinds of misconduct, like the misleading presentation of forecasts and the ignorance of risk limits more than 300 times in first quarter of 2012.

Based on an investigation report of the Senate panel, JP Morgan was accused for hiding trade losses, deceiving regulators and misinforming investors. Furthermore, JP Morgan was suspected to be guilty on failing to supervise traders, excessive risk taking and misleading disclosures. For instance, in April 2012 executives of JPMorgan would have made losses of more than $1 billion (€750 million) and when this became public, Dimon stated that this was just exaggerated and there was nothing to worry about. According to the Senate Panel, there is reasonable doubt that JP Morgan has violated the law. The case is now subject of investigation by the SEC and the Federal Bureau of Investigation (FBI). The scandal later became publicly known as the 'London whale trading losses', with Iksil as the 'London whale'.[83]

On 13 July 2012 JP Morgan published information about the trade losses of the CIO and announced that it would restate its financial findings of the first quarter of 2012. The result of the restatement was that the net income of JPMorgan of this first quarter would be diminished by $459 (€343 million).[84] In its 8-K form, filed on 13 July 2012, JPMorgan states that the information that was disclosed prior to the restatement leads to doubts about the 'integrity of the trader marks' and that it indicates that 'certain individuals' are guilty of hiding losses over

[82] Kopecki & Moore 2013.
[83] Kopecki & Moore 2013.
[84] 8-K, EX-99.1 filed July 13, 2012.

the first quarter. For that reason, JP Morgan was not sure whether the first quarter results that were reported corresponded with the real situation. Dimon later told the press that they were managing risks and hedging against losses in order to prevent a drop in the credit market and that there was nothing to be worried about.[85] New York City comptroller John Liu stated that JP Morgan should do everything to get every single dollar back from those executives who were held responsible for the whale trade losses. This should provide a clear statement to executives that they should not participate in excessive risk taking or gambling with money of shareholders.[86]

A whale with claws

In JP Morgan's proxy statement of 10 May 2013, the bank stated that the scandal finally resulted in a clawback of total annual compensation of the last two years from employees who were held primarily responsible.[87] Besides that, the board held senior management responsible for the trading losses of the CIO. These clawbacks contained a total amount of more than $100 million (€75 million). Ina Drew, former head of the CIO had to return an amount that equaled the amount that maximal could be clawed back. Because of a lack of supervision of the CIO, Dimon saw his compensation shrink with 19 percent to $18.7 million (€14 million. The Board argued it showed its independence through taking such stringent measures, while making a record profit in 2012 of $21 billion (€15.7 billion).[88]

Clawback policy JP Morgan

Until 2012, JP Morgan used in corporate governance policy as trigger for applying a clawback *'a material restatement of earnings by acts or omissions by employees'*. However, because banks are still not required to comply with the more stringent mandatory clawback provision of the Dodd-Frank Act, the New York Comptroller exerted pressure on JP Morgan in December 2011, which resulted in an adjustment of its clawback provision in 2012. The Comptroller proposed to strengthen the clawback provision on three elements:

1. Removing the word 'material'. The former clawback policy contained the requirement that the restatement had to cause material or financial reputational harm. The materiality standard would provide too many legal and financial issues to actually make a fair application of the clawback policy.
2. Extending the application to those executives that are responsible for managing and supervising for the employees that contributed to actions that lead to the restatement.

[85] 8-K filed July 13, 2012
[86] Braithwaite, Scannell & Alloway 2012.
[87] Thompson 2012.
[88] Form DEFA14A, Definitive Proxy Statement, Filed 10 May 2013.

3. Obligating disclosure in Form 8-K of the decision of the board or compensation committee whether to claw back compensation or not.[89]

As a result of the proposal, JP Morgan strengthened its clawback policy. In the recent policy, the board looks at the facts and circumstances that contributed to a financial restatement. The board considers the accountability of the persons who were responsible for the restatement and those who engaged in misconduct with regard to the events that resulted to the restatement. The clawback provision does not require 'misconduct', but nevertheless takes it into consideration when deciding if an employee is accountably responsible for the restatement.

The board can take appropriate actions with regard to recouping compensation. In making a clawback decision, the board has to take account of whether compensation was rewarded based on specific performance targets, the restatement was a (partial) consequence of misconduct and if the compensation would also be diminished if the financial results never were reported. JP Morgan uses the following definition of misconduct:

"*Misconduct includes violation of the Firm's Code of Conduct or policies or any act or failure to act that could reasonably be expected to cause financial or reputational harm to the Firm".*

If the board ascertains that the circumstances are sufficient, it can decide to take appropriate actions, which can exist of:

"*reducing compensation in the year the restatement was made, seeking repayment of any bonus received for the period restated or any gains realized as a result of exercising an option awarded for the period restated, or canceling any unvested equity compensation awarded for the period restated. Consideration may also be given to whether or not any one or more of such actions should be extended to employees who did not engage in misconduct that contributed to the restatement."*[90]

[89] New York City Comptroller 2011
[90] J.P. Morgan 2013.

Table 3: Clawback provision JP Morgan 2013

	JP Morgan
Trigger	• Material restatement of the firm's financial results • based on the relevant circumstances • Misconduct is not required but important factor
Subject to clawback	Any employee who can held responsible
Amount	• Bonus • Options • Other equity based compensation
Recovery Period	The period restated
Enforcement	Board of Directors

4.4 Conclusion

In the United States, there are different mandatory clawback provisions and the implementation, expansion and use of these provisions is increasing. However, since Section 954 of the Dodd-Frank Act still is not implemented by the SEC, there exists confusion in the implementation of the provision. It is important that the SEC gives guidelines with regard to the different elements of the Section 954. Although not required, a clawback provision is most of the times used in case of misconduct. The JP Morgan whale trade scandal is a good example of this. As we also see is that there is a possibility for JP Morgan to clawback bonuses from those employees who are not responsible for the restatement. That this might lead to legal issues has been shown in the RBS case in the United Kingdom.

The next chapter will describe the different provisions of the United Kingdom and uses the RBS case to illustrate the enforcement of a clawback provision.

5. The United Kingdom

As a result of a series of scandals in the banking sector, the use of clawback and malus provisions has increased considerably from 2012 in the United Kingdom. The FSA Remuneration Code requires banks to create a provision that makes it possible to clawback bonuses in case of executive misconduct or a financial misstatement. Although the need for a clawback provision started in the banking sector, other companies are affected more and more, partly because regulators and shareholders are pushing them to implement these provisions.[91] Nevertheless, the United Kingdom seems to be more cautious than the United States in creating clawback provisions. As a result of practical difficulties, especially with the vested variable remuneration, existing provisions are limited. In this chapter, the existing provisions in the United Kingdom will first be explained in Section 5.1. Section 5.2 discusses the actual use by banks of clawback provisions. Finally, the case of Royal Bank of Scotland (RBS) in which the bank clawed back £72 million (€85 million) deferred variable compensation of its executives will described to illustrate the enforcement of a clawback policy in the United Kingdom.

5.1 Clawback provisions

FSA Remuneration Code

The Financial Services Authority (FSA) first introduced a clawback provision in 2009 in the Remuneration Code which was revised on 17 December 2010. Under Policy Statement 10/20 (PS 10/20) the FSA amended the remuneration structure in the United Kingdom, thereby implementing the EU Capital Requirements Directive 3 (CRD3), which is applicable to all European financial institutions that fall under the scope of the Markets in Financial Instruments Directive (MiFID)[92] The Code is applicable to Code Staff, which contains all Significant Influence holders holding controlled Functions (SIFs). This term covers both executive directors and non-executive directors. However, non-executive directors are unlikely to obtain performance based remuneration, which makes the code not applicable form them most of the time.[93]

The FSA Remuneration Code is rule-based and thus the provisions are obligated for firms that fall under its scope. However, the principle of proportionality has to be considered in applying the rules. If a provision is not proportional with regard to the 'size, internal organization and the nature, the scope and the complexity of its services', then it is possible to diverge from the

[91] Osborne 2012.

[92] Directive 2004/39/EC. In Europe, the EU Capital Requirements Directive 3 (CRD3) requires financial institutions to award at least 50% of the variable remuneration in shares or at least 50% in deferred cash vehicles. The retention period has to be at least three years and can extend up to five years.

[93] Norton Rose 2011.

Code (SYSC 19A.3.3R(2)). Section 157(1) of the Financial Services & Markets Act 2000 (FSMA) requires all institutions to comply with the Code at the same level. Based on firm-specific characteristics, each firm can however decide to apply its own specific policy in which one firm requires a more stringent policy than the other. The FSA developed four tiers in which risks are divided. The tier to which a specific bank belongs depends on the capital of the concerning bank. For instance, if a bank has a capital between £50 million and £1 billion it falls under tier I, which implies the highest risk.

Principle 8 contains the ex-post risk adjustment and exists of a clawback and a malus provision. Under Principle 8, a firm has to choose the most appropriate adjustment mechanism that fits best to its characteristics. The firm has to implement mechanisms that make it possible to adjust unvested variable remuneration, especially in case of misconduct of an employee, financial downturn of the firm or material failure in risk management (SYSC 19A.3.23(2)).

After different scandals in the banking sector, Andrew Bailey, head of the FSA, stated in a letter written by him in 2012 that the FSA would put more emphasize on ex-post risk adjustment and the implementation of clawback provisions of banks. In their function to control banks, the FSA would focus mainly on the implementation of these provisions in 2012.[94]

UK Corporate Governance Code

The UK Corporate Governance Code (2012) of the Financial Reporting Council (FRC), which applies to all listed companies, is based on the 'comply-or-explain principle', just like its Dutch equivalent. This means that the provisions are not mandatory, but if a company decides not to imply a provision it has to explain the reason for non-complying. If good governance can be reached by other provisions, the non-complying will be allowed. The Listing Rules however, make the Main Principles of the code mandatory for listed companies. Schedule A of the Code states that the company should give 'consideration' to the use of mechanisms that make it possible for the company to clawback the variable part of the remuneration in 'exceptional circumstances of misstatement or misconduct'. This means a listed company is only required to 'consider' the implementation of a clawback provision according to the UK Corporate Governance Code, which makes the adoption of a clawback not mandatory. However, the government has asked support of the Financial Services Commission (FRC) in order to advice on an amendment to the Code to make it mandatory for large public companies to implement a clawback provision.[95]

ABI Guidance on Remuneration

In November 2012 the Association of British Insurers (ABI) introduced the newest version of their Principles of Remuneration. The principles are a reflection of the ideas of the ABI

[94] Osborne 2012.
[95] Pinsent Masons 2012, p. 2.

members on remuneration, most of the time being insurers that are big investors. The principles provide general guidelines and principles; these are not mandatory. Moreover, the ABI states that there is no exact prescription for a company on how to apply the principles and which scheme will be best for them. Companies should implement the principles by themselves, based on their specific characteristics and strategy.[96]

The ABI prefers a high degree of deferral and indicators that measure long-term performance. Besides that, the Principles state that shareholders expect that remuneration packages contain a malus or claw-back provision. This expectation should put more pressure on companies to adopt such provisions. According to the Principles, a bonus that is undeserved should be the trigger for clawing back. However, this is a very broad standard and leaves much space for interpretation. The question is what can be considered ‘undeserved’.

[96] Pinsent Masons 2012.

Table 4: UK clawback provisions

	FSA Remuneration Code	UK Corporate Governance Code	ABI Principles of Remuneration
Mandatory?	• Yes	• No: company should only give 'consideration'	• No
Companies covered	• Financial Services Firms	• Listed companies	• Listed companies • Non-listed companies
Trigger	Especially: • Misconduct • Financial downturn • Material failure in risk management	Exceptional circumstances of • Misstatement • Misconduct	• If a bonus is 'underserved' and if appropriate to enforce
Subject to clawback	Code Staff: • Executive directors • Non-executive directors	• Executive directors	• Executive directors
Amount	• All unvested variable remuneration	• Variable components of the remuneration	-
Recovery Period	-	-	-
Enforcement	• The company has to create and implement ex-post risk adjustment provisions under which clawback	• The company can reclaim	• Company

5.2 Actual use of clawback

The financial crisis and recent scandals in the banking sector led to public outrage about bonus payments in the financial sector in the United Kingdom. Although bonus payments fell from £11.6 billion (€13.7 billion) in 2008 to £1.6 billion (€1.9 billion) in 2012, the public consternation did not disappear. The call for stringent measures became even bigger. For that reason, different mechanisms that deal with excessive bonuses are developed and increasingly being used. Besides that, the manner in which bonuses are awarded is subjected to change: bonuses are awarded more often on deferred payments. Most clawback provisions contain also a provision to defer bonus payments and more bonuses are awarded as part of deferred schemes. On this moment, there is even a proposal in the United Kingdom to defer bonus payments up to ten years.[97] Deferral in combination with clawback mechanisms became considerable popular in the United Kingdom in the last few years. The warning of the FSA to check whether banks actually implement (and if necessary enforce) clawback provisions exerts only more pressure on banks and other firms to accurately implement such provisions.[98]

The national clawback provisions in the United Kingdom are formulated relative open and can be interpreted in all kinds of manners. A clawback is only triggered in 'exceptional circumstances'. Besides that, a clawback provision is not required for public companies, other than for financial institutions. However, a growing pressure of shareholders and regulators to implement and enforce clawback provisions can be observed. Research shows that around 20 percent of the FTSE100[99] firms has adopted a clawback provision. However, this is still far below the Fortune 100 companies in the United States with 86,5 percent in 2008. In most of these companies, the clawback-trigger is often a misstatement of financial results or gross misconduct of an executive.[100]

Although companies more often implement clawback provisions, the financial sector is most familiar with this topic. Especially banks are showing the results of the use of their clawback mechanisms now after a series of scandals. Lloyds Banking Group decided to clawback bonuses of its top-executives, due to an insurance payment scandal which led to the fact that bonuses in 2010 were awarded wrongfully.[101] Britain's biggest bank HSBC clawed back £2 million in bonuses from 13 directors as a consequence of misstatements with regard to the sale of payment protection insurance. The recent 'Libor Scandal' caused major clawbacks of several banks, like Barclays, UBS and RBS.

In contrast to these examples, Standard Chartered refrained from cutting bonuses after admitting responsibility for engaging in criminal conduct by violating sanctions of the United States in the period 2007-2011. This gave rise to clawback bonuses of Standards' top-executives who were directly responsible for these risks, like chairman John Peace. The bank based its decision not to claw back on the circumstances of the violation. These circumstances would not be appropriate to trigger a clawback, because the gains from the violations would have been 'immaterial' and therefore did not affect the bonus payments.[102]

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[97] Jenkins & Thompson 2013.
[98] Boyle 2013.
[99] FTSE100: Financial Times Stock Exchange Index 100, which is a list of 100 companies that represent the UK listed companies with the highest market value.
[100] BIS 2011, p. 35-36.
[101] Colchester 2012.
[102] Pratley 2013; RBS Group 2013, p. 27.

Where one bank refuses to clawback, the other uses a clawback in such an extent that it causes huge discussions and even legal actions. The RBS example seems to be a good example of the latter mentioned and will be discussed in the next section.

5.3 RBS

In March 2013, Royal Bank of Schotland (RBS) announced that it would abolish 2012 bonus payments and claw back bonuses from 21 employees for the engagement in the Libor Scandal. The amount to be clawed back consisted of £72 million (€85 million) (Figure 2)and the total reduction of variable compensation was more than 300 million.[103] RBS clawed back £4 million (€4,7) from John Hourican, CEO of markets and international banking.[104]

Figure 2: Clawback of variable compensation RBS 2011-2012

	Group			Markets		
	2012 £m	2011 £m	Change %	2012 £m	2011 £m	Change %
Non-deferred cash awards (2)	73	70	4	10	9	11
Non-deferred share awards	27	34	(21)	17	21	(19)
Total non-deferred variable compensation	100	104	(4)	27	30	(10)
Deferred bonds awards	497	589	(16)	212	264	(20)
Deferred share awards	82	96	(15)	48	66	(27)
Total deferred variable compensation	579	685	(15)	260	330	(21)
Total variable compensation pre clawback (3)	679	789	(14)	287	360	(20)
Clawback of prior year deferred awards (4)	(72)	—	—	(72)	—	—
Total variable compensation (3)	607	789	(23)	215	360	(40)

Source: RBS Group 2013.

Libor Scandal

"Amazing how Libor fixing can make you that much money", were the words of a RBS trader who was involved in the so called 'Libor Fixing Scandal', which refers to the London Interbank Offered Rate.[105]

On 6 February 2013, the now 82% state-owned bank RBS admitted that it was engaged in the Libor-fixing scandal and that it made a settlement with the FSA and authorities of the United States. In the investigation around the suspicion of RBS, 21 RBS employees in London, Singapore and Tokyo were held responsible for the manipulation of the Libor between 2006 and 2010. Libor is one of the most important interest rates in the world and can be best described as the average daily rate under which banks can borrow money from each other. Traders of different banks tried to manipulate these rates in order to boost the derivatives

[103] RBS Group 2013, p. 26.
[104] Butcher 2013.
[105] The Economist 2013.

profits.[106] Libor underlies at least $300 trillion (€224.3 trillion) of financial contracts and is therefore considered to be of essential importance. The scandal and the involvement of many banks caused a decrease of trust in the banking system. The investigation showed that RBS tried to fix the Libor a few hundred times for over four years. RBS took responsibility by admitting that the control and risk mechanisms were failing and that the 21 employees participated in misconduct.[107]

According to the settlement, RBS was required to pay fines to the United States authorities, worth $475 million (€554.8 million) and one of £87.5 million (€102.2 million) to the FSA. In order to avoid criminal liability in the United States, RBS agreed to terms with the United States authorities in a deferred prosecution agreement, thereby admitting the misconduct.[108] Compared to the other banks involved in the Libor scandal, the gravity of RBS' involvement seems to be average. For instance, UBS has to pay a fine of $1.5 billion (€1.12 billion), while accused for fixing the rate thousands of times and Barclays one of £290 million (€338.7 million).[109] In an attempt to lower the burden on the taxpayer, RBS decided to cut and claw back bonuses of its employees.

Clawback

In a letter to all shareholders from the chairman of the Group Performance and Remuneration Committee, Penny Hughes, states that RBS deeply regrets the involvement in the Libor scandal. The bank fired the 21 responsible employees after the scandal. The bank also cut their bonus payments for 2012 and clawed back the deferred bonuses. Because the firm also suffered reputational harm, the Committee decided also to clawback bonus payments from other employees across the Group, especially those in the Markets division.[110]

The Remuneration Committee agreed with the Board that the reduction of shareholders wealth due to harm resulting from the Libor scandal should be imposed on the employees who can be held responsible for these damages by clawing back their bonus payments. One of the main decisions taken by the Committee is a reduction of total variable compensation from 2011: 14% at Group level (23% after clawback) and 14% at Market level (40% after clawback).[111]

Under its Group-Wide Remuneration Policy regarding all its employees, RBS has established the possibility to clawback both short-term and long-term variable remuneration. To trigger a clawback, new information has to cause financial damage or reputational harm. Variable

[106] RBS Group 2013, p. 26.
[107] RBS Group 2013, p. 26.
[108] Scuffham & Ridley 2013.
[109] The Economist 2013.
[110] RBS Group 2013, p. 2.
[111] Butcher 2013.

remuneration can only become subject to the clawback provision, if this seems to be appropriate to do so.[112] The provision of RBS is a very broad standard, because the word 'appropriate' is a subjective term and can be interpreted differently.

Under its Group-Wide Remuneration Policy, RBS can only clawback all long-term variable remuneration , which is granted to specific senior employees.[113] Next to the Group-Wide Remuneration Policy, RBS established an Executive Remuneration Policy with regard to the remuneration of its executives. It differs from the Group-wide policy in underscoring pay-for-performance. Besides that, performance-based remuneration is for a greater part awarded in shares. The short-term bonus is paid out in shares, which have a six month holding period after vesting. A clawback can be applied to this bonus before the vesting of the shares. The long-term variable remuneration is also awarded in shares, which vest after three years if the pre-determined targets are met and have a holding period of six months after vesting. Until the moment of vesting, this remuneration can also be subjected to the clawback provision.

The maximum amount that can be clawed back cannot exceed 400% of the annual salary. For the year 2013, this amount has a cap of 300%. The four performance indicators can lead to bonuses of a maximum of 100% of the base salary. If vesting is planned at the same time, there is also a cap of 300%. The performance indicators are: core bank economic profit, total shareholder return, balance sheet and risk and strategic scorecard. These four elements contribute each for 25%. Prior to vesting of the awards, the Remuneration Committee of RBS will look at the Strategic plan and risk performance, thereby obtaining information of the Board Risk Committee. For instance, if the Risk Committee concludes that the performance indicators are fulfilled but by excessive risk taking of an executive, it can advice to reduce awarding. RBS can clawback 100% of the deferred unvested awards and may be used with or without previous action with regard to discipline the concerning employee.[114]

The discussion

The decision to claw back bonuses caused a lot of criticisms. Although the bank stated that it would cut and clawback bonuses of the 21 direct responsible RBS employees, the bank also decided to clawback bonuses from employees across the market division, who received bonuses of more than £25.000. The decision was made in order to deal with the reputational harm that the bank suffered from the Libor Scandal.[115] However, these employees could not be held responsible for the scandal. In the Remuneration Disclosures 2013 of the bank, RBS states:

[112] RBS Group 2013, p.3.
[113] RBS Group 2013, p. 7.
[114] RBS Group 2013, p. 11.
[115] Butcher 2013.

"Supervisors with accountability for the business but no knowledge or involvement in the wrongdoing have received zero variable compensation awards for 2012 and a range of clawback from prior years depending on specific findings. Reduction of variable compensation awards and long term incentive awards an prior year clawback has been made across RBS and particularly in the markets division to account for the reputational damage for these events and the risk of additional outstanding legal and regulatory action."[116]

With regard to the clawback of bonuses of those employees who cannot be held directly responsible, lawyers argue that RBS has no legal ground to do this. The intention of a clawback is to return money awarded to an employee based on wrongful information or that resulted in higher revenues due to misconduct and led to a restatement. However, if someone cannot be held responsible, the clawback mechanism would be used as a punishment rather than reflecting the damage caused by an employee. Therefore different law firms argue that the clawbacks of RBS are legally suspicious.

5.4 Conclusion

In the United Kingdom, clawback provisions are most often used in combination with the deferral of bonuses. The FSA Remuneration Code requires banks to adopt a post-risk adjustment scheme under which a clawback rule belongs. Different scandals in the banking sector in the United Kingdom caused an increase in the use of clawback provisions. However, the relative open standard causes different problems with the implementation of such a provision. RBS seems to be a good example of this. The bank used its clawback provision not only for those executives that were responsible for the Libor scandal, but also to clawback from employees that could not be held responsible. This causes legal actions of employees and it is therefore recommendable for banks to establish clear provisions and become well informed about all the potential consequences of enforcing a clawback. For that reason, there are made some recommendations in the next chapter of this thesis.

[116] RBS Group 2013, p. 27.

6. Recommendations

Based on the comparing of the different clawback provisions and clawback cases in the Netherlands, United States and the United Kingdom some recommendations can be made. First of all, it will be argued in section 6.1 that there is a need for a mandatory clawback provision on national level for banks. Especially when banks obtain government support, a mandatory provision seems to be justified. Secondly, in section 6.2, already discussed elements of a clawback provision applicable to banks (trigger, subject, amount, recovery period, enforcement) will be discussed and there will be given some recommendations for drafting a clawback provision for banks. The last section will give some general recommendations with regard to clawback provisions.

6.1 Mandatory clawback provision

Because of the critical role of the banking sector in economy and society, banks have to be treated different than 'normal companies', also when it comes to remuneration. In times of financial crisis in which many banks are failing, we strongly need the best bankers as possible. For that reason, pay-for-performance is a good mechanism to attract these bankers. Bonuses have to reflect the risks that executives take and correspond with performance. However, in a bail-out situation, a banker becomes nothing more than a state official and for that reason its seems unjustified that he will get away with high bonuses, while the taxpayer has to pay for his mistakes. For that reason, the asymmetric nature of the bonus has to be removed. Next to the incentive for success, there has to be a corresponding disincentive for failure. A clawback provision provides a good mechanism to arrange this.

In my opinion, each country needs a mandatory clawback provision with regard to banks, especially with regard to banks that are on the brink of a collapse and need to be bailed out by the government. Notwithstanding the fact that codes are efficient, in the banking sector we need more than just a code based on the comply-or-explain principle. Therefore its necessary to implement a mandatory clawback provision on national level, which mandates banks to implement a clawback rule into their corporate governance provisions, but can also be enforced directly if a bank does not have its own provision. The FSA Remuneration Code of the United Kingdom has such a mandatory provision. However, the provision is very broad, which gives banks a lot of discretion - in my opinion even too much discretion. Standard Chartered is an example of a bank that refused to clawback while the provision was triggered and RBS gives an opposite example. The intent of the bank to clawback bonuses of executives that were not responsible for the restatement but solely based on reputational harm will result in legal actions. The United States have different mandatory options. However, the provision under the

Dodd-Frank Act is still not implemented by the SEC. The specific requirements and elements still have to be explained by the SEC in order to create certainty and clearness. Nevertheless, the United States do have regulation for banks that participate in TARP, in which banks become automatically subject of a clawback provision. The Netherlands still do not have any required clawback provision with regard to banks and it is unclear when or if the Clawback Bill will be approved by the Senate. The SNS case shows that there is an actual need of such a provision, because the recent applicable Banking Code is not sufficient to recoup the concerning remuneration. However, the total amount that can be clawed back in the end if the bill is adopted, is relative low. That does not mean that other banks might possibly profit from the provision in the future.

For banks it is important to become well-informed about the discretion and limits of the mandatory provision. This is the moment where the lawyer has to step in. Lawyers should inform banks on how to implement the clawback provision conform the national legislation into their corporate governance policy and how to draft these provisions into contracts with employees. The next paragraph will give some general recommendations with regard to the different elements of a clawback provision that a bank should take into account when implementing or enforcing such a provision.

6.2 Drafting a clawback provision

Trigger

The trigger for the use of a clawback provision is one of the most important elements and can vary considerably among different countries. On this moment one is tended towards adopting national provisions that only require a 'restatement' as a trigger for clawback, instead of 'misconduct' or 'materiality'. The questions that should be asked is:

- Is there new information?;
- That leads to a financial restatement?;
- Was the bonus based on this wrongful information that led to a restatement?

If these three question can be answered with 'yes' the clawback provision will be triggered.

However, in practice banks are tended to clawback if there is misconduct or breach of codes of conduct. I think it is important that there is at least some form of responsibility. This can be a direct contribution to the restatement of the employee as well as the responsibility for the acts or omissions that contributed to the restatement from other employees. The question is also whether 'reputational harm' is a good trigger for a clawback. Off course, reputational harm damages a bank as well. If reputational harm can be linked in some way to certain performance indicators, then a clawback will be a logical result. However, the link between the performance and the bonus is harder to establish. For that reason, a bank should be able to prove how the reputational harm has affected the bonus payment. The question that should be asked is, would the bonus be different in case the bank did not suffer reputational harm?

Subject

The question who can be subjected to a clawback scheme is also of great importance. In most formal clawback regulations, the provision is specifically mentioned for executive directors. However, what we see is that the provisions as implemented by banks often reach further than the national provisions at this point. Both JP Morgan and RBS made other employees potential clawback subjects. JP Morgan makes it possible to clawback from all employees who can be held responsible for the financial restatement. RBS goes even further, by making all current and former employees subject to a clawback. However, as we have seen, this broad extension of subject might lead to some issues. If any current or former employee is at risk of losing his bonus without even being responsible for the acts or omissions that led to the financial restatement, it seems to be unfair to clawback his remuneration. A bonus has to be linked to performance and if this performance seems to be based on inaccurate data, then the clawback should make it possible to recoup (part of) the bonus. I will argue that both executives and other employees that received bonuses should be subjected to a clawback provision. However, the provision with regard to normal employees should be much stricter. Executives can be subject if a clawback provision is triggered, for instance in case of a financial restatement. The bonus of normal employees should only be recouped in case of the concerning employee can be held responsible for the act or omission that caused the restatement.

Amount

Another element that might lead to different problems is the amount that can be clawed back. In order to retain the link between pay and performance, the part of the bonus that should be recouped is that amount that would have been awarded under the restatement. In other words, the remuneration that is paid *in excess* of what would have been awarded can be revoked. In all countries there are legal and practical issues with the clawback of that part of the incentive remuneration that is already vested. For that reason, the Netherlands, the United States and the United Kingdom prefer clawback of the unvested deferred part of the variable remuneration. Banks should follow these provisions, because if they choose to claw back remuneration that is already awarded in cash or vested, this might lead to different problems with the applicable labor and tax laws for example. For instance, in the United States state-wage deduction laws limit the option to clawback 'wages' of employees. What type remuneration exactly is considered to be a 'wage' depends on the state in which the bank is situated. If a bank is spread through the entire United States, the implementation of a common clawback provision is even harder.[117]

For that reason, a deferral of the variable remuneration is recommended. Banks should specially combine the clawback elements with deferral of payments, will it be an effective mechanism. In Europe, the EU Capital Requirements Directive 3 (CRD3) requires financial institutions to award at least 50% of the variable remuneration in shares or at least 50% in deferred cash vehicles. The retention period has to be at least three years and can extend up to five years. However, the United Kingdom is intending to defer the bonuses up to ten years.
In my opinion a period of ten years is too long and this will diminish the pay-for-performance sensitivity. A lot can happen in ten years and with clawback rules that are very extensive, executives can become very uncertain about their promised bonuses.

Period
The period of time over which the money can be recovered is also a point of discussion. The Netherlands and the United Kingdom are not very clear about this period. The United States extended in the Dodd-Frank provision the period from one to three years previously to the date on which the restatement was made.
I think the period has to be limited at least to a certain period. An infinite period seems attractive, but has negative effects. Just like deferring variable remuneration for a too long period, if the clawback period becomes too long, the problem is that it creates uncertainty for the concerning executive. It will remain uncertain whether an executive actually gets his bonus awarded for period of time that is too long. Too much uncertainty might cause a decreasing of pay-for-performance sensitivity. Therefore I would advice banks to keep the period relative short, for instance 3 till 5 years. In case of a bank bail-out this period should be extended. This makes the situation totally different and does in no way justify awarded bonuses anymore. Thus, an exception should be made with regard to banks that are bailed-out. The recovery period should in this situation be 'the period over which the restatement had to be made'.

Enforcement
It has to be clear who has the power to enforce a clawback. Off course this will depend on the structure within the bank. In Anglo-American countries there is a one tier board most of the time. Therefore it is best if non-executive directors are in charge of the clawback decision. Although in the Netherlands is also recently introduced the option of a one tier board structure, most companies still have a two tier board structure. The Supervisory Board has the authority to enforce the clawback provision. It is important that it's clearly defined who is in charge of the enforcement. In the United States, it's defined that the Remuneration Committee decides about a clawback, but the

[117] Lilienfeld & O'Connell 2010.

United Kingdoms' provision solely states that the 'company' has to create and implement ex-post risk adjustment provisions under which a clawback.

6.3 Miscellaneous recommendations

Overregulation has a reversed effect

The clawback provision cannot be regarded as an instrument that stands alone. Instead, it has to be considered in interaction with other instruments. Andrew Baily, head of the UK FSA argued that the introduced European bonus cap undermines clawback provisions. The introduction of the bonus cap will considerably increase the chance of higher fixed salaries to executives in order to compensate with the decreased variable salary. As a consequence, overall salary will be equal, but the amount that can be clawed back becomes much lower. The pay-for-performance sensitivity decreases if one knows the fixed salary is already high and bonuses are lower. Too much regulation with regard to bonuses will have a reversed effect and lead to banks are looking for other options to mitigate the stringent bonus rules.[118] The bonus cap will – next to other side effects – undermine the clawback provision.

Disclosure

On this moment, some provisions require disclosure in case of a bank uses its clawback provision. Most of the time at least the amount of the clawback needs to be disclosed. However, in my opinion the disclosure has to be extended. There is a huge lack in additional information of the clawbacks. RBS disclosed more than JP Morgan, but from both we do not know the exact amount of which employee was clawed back, the exact contribution of these employees and the grounds on which the clawback was based. Because a clawback is a relative new instrument, disclosure is very important. For instance, other banks, lawyers and judges could learn from the enforcement of clawbacks of other banks. They can look at all the different elements of al clawback, as also discussed in this thesis and possibly learn from the mistakes banks made. But other banks can also learn from the positive results of a clawback. In this way, a clawback policy of a bank could serve as a template for others. For that reason I would strongly recommend that banks disclose more details of their applied clawback.

[118] Masters 2013.

7. Conclusion

This thesis has focused on the implementation and enforcing of clawback provisions in the Netherlands, the United States and the United Kingdom. We have seen that in order to mitigate the asymmetric nature of bonuses and reducing the gambling element of remuneration, a clawback provision is a desired instrument. As a consequence of different scandals in the banking sector and banks that were bailed-out by the government, the provision has increasingly been used by banks the last several years. The main reason for comparing the clawback provisions was that it is a relative new provision that causes different legal and practical issues it implementation and enforcing.

In the Netherlands the long waited mandatory clawback provision still needs approval of the Senate. For that reason, banks only rely on the best practice provisions of codes with regard to clawback provisions. We saw that the SNS Reaal case asked for the accelerated implementation of the Clawback Bill. On the contrast, the United States already have adopted mandatory provisions in the SOX Act, the Dodd-Frank Act and the TARP provision. However, the Dodd-Frank provision, which forms a considerable improvement to the SOX-provision is still not implemented by the SEC. Consequently, the different elements of the Dodd-Frank provision are not clear and leave much space for interpretation. As also discussed, TARP recipients become automatically subject to a clawback provision. If we consider the clawback provision in a period in which many banks have to be bailed-out by the government we understand the usefulness of such a provision. For that reason, I would encourage countries to adopt a mandatory provision. Especially for banks that are bailed-out by the government, a mandatory clawback provision should apply automatically .

Still, as we have seen in the different examples of banks that used their own clawback, there are different legal and practical problems in enforcing a clawback provision. National legislation leaves considerable discretion for a bank to implement a clawback provision into its corporate governance provision and contracts with employees. The result is that a clawback sometimes is enforced while triggered on wrong grounds and sometimes is not enforced although triggered. For instance, in the RBS case we saw that claims of employees might arise when they are punished, while they are in no way responsible for the restatement. Reputational harm can be used as a trigger for clawback, but if a bank wants to punish employees other than executives, responsibility seems to be a good criteria.

This thesis points out that is of great importance that national clawback provisions give a clear definition or are provided with guidelines on how to implement them. Besides that, I would emphasize the importance of lawyers in supporting banks in translating mandatory provisions on national level into their corporate governance provisions and contracts with employees. The result will be that banks have the possibility to clawback bonuses, but still act within the boundaries of national regulations, such as tax laws and labor laws.

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