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AN OVERVIEW OF THE USE OF CLAWBACK AS A GOVERNANCE MECHANISM ON EXECUTIVE REMUNERATION IN SOUTH AFRICA

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ABSTRACT. The use of malus and clawback provisions has increased in recent years due to the demand for tighter controls on incentive-based compensation. The alignment between executive pay and individual performance creates a culture of responsible decision-making and accountability within an organisation. This paper seeks to evaluate the current state of governance legislation on the clawback of remuneration in the South African context. A systematic literature review was conducted to provide descriptive insight on the technical and procedural approach applied to the clawback of remuneration. These findings were then compared to other countries so that similarities, differences, and areas of further research could be identified. Through detailed content analysis, it was found that the South African governance regime lags behind its international counterparts regarding remuneration clawback. Due to the absence of relevant statutory guidelines, discretion is frequently applied, leading to inconsistent treatment of clawback amongst listed companies. The use of clawback as a risk-mitigation mechanism is also relatively new in South Africa and comparative studies provide useful insight on the technicalities and administration processes applied abroad. The lessons learnt and strategies applied internationally serve as a benchmark for the development of clawback legislation in South Africa.

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BACKGROUND AND INTRODUCTION

The global financial crisis experienced in 2008 drew attention to weaknesses in the governance of remuneration as misalignment was found to exist between pay and performance. Excessive incentive-based compensation, inadequate risk-taking and a focus on short-term results also played a significant role contributing to the global economic instability (Melone, 2009). As shareholders lost confidence in the accuracy of financial reporting, the need to institute measures to hold executives accountable for unsubstantiated risk-taking arose (Hirsch *et al.*, 2017).

According to Bhagat & Romani (2010), effective management over executive remuneration results in reduced levels of risk and improved shareholder value in the long term. The alignment of incentives to actual performance ensures that rewards are only granted for contributions that drive business growth and strategy Bussin & Ncube (2017). This inspires accountability on the part of executives whilst also restoring confidence in the market (Madlela, 2018). El Mahdy (2019) explains that the structure of remuneration packages and the establishment of appropriate performance criteria becomes vital in streamlining pay to performance. Studies have also shown that the incorporation of risk-mitigating mechanisms such as malus and clawback in remuneration contracts encourages a long-term business outlook, whilst also creating a culture of responsibility within an organization (Ronald & Gulbenkian, 2022).

Moolman & Giliam (2019) explain that malus and clawback are used as mechanisms to manage risk exposure and to control the self-serving behaviours of individuals. Malus provisions permit the adjustment of the value of an award prior to vesting, whilst clawback allows the recovery of awards subsequent to vesting (Franklin, 2016). In this way, management is afforded the opportunity to re-evaluate the adequacy of variable remuneration, so that any modifications or recoveries are made, if necessary, upon the occurrence of certain pre-agreed events (Moolman & Giliam, 2019).

Chen & Vann (2017) explain that clawback is an effective governance mechanism that serves a dual purpose. Clawback is punitive as it aims to invalidate unjust benefits received by creating adverse consequences for the individual concerned, whilst also serving as a remedial measure as companies are reimbursed for any unwarranted losses incurred (Melone, 2009). Clawback permits the employer to recoup excessive amounts paid to employees in error, or alternatively, it discharges the employer from an obligation to pay an employee if the employee did not rightfully earn the amount (Melone, 2009). Fried & Shilon (2011a) add that clawbacks are commonly used to control the reckless conduct of senior executives as this has a detrimental impact on the risk exposure of companies.

Velte (2020) explains that effective management on executive remuneration impacts on shareholder satisfaction, and therefore it is imperative to institute mitigating controls when executive performance falls below standard. Jensen & Murphy (1990) add that incentive-based compensation in many companies is influenced by appropriate decision-making, transparency and accuracy in financial reporting. The inclusion of clawback provisions in the remuneration structure not only ensures better control over remuneration, but also promotes an ethos of ethical leadership in the business (El Mahdy, 2019).

According to Chan *et al.* (2012) the incentive exists for executives to manipulate results to obtain personal benefit, and with the inclusion of clawback, the actions of executives are confined to certain limits (Chen & Vann, 2017). Clawback imposes a monetary penalty on executives for the misrepresentation of financial results Chan *et al.* (2012). Studies have shown that senior executives perceive clawback to add value as it augments internal controls as opposed to substituting other forms of internal controls (Chan *et al.*, 2012; Chen & Vann, 2017).

Better quality in financial reporting was also noted amongst various institutions that include clawback in the remuneration (Chen & Vann, 2017). Finnemore *et al*. (2022) explain that clawback improves credibility of the financial results which enhances investor confidence. Chan *et al.* (2012) agrees as the number of financial restatements are found to reduce with the enforceability of clawback. Mahoney (2019) also supports this view as the existence of clawback tends to keep executives focussed on accuracy in financial reporting.

Walker (2021) explains that the use of clawback as a risk mitigation mechanism contributes positively to value creation in listed companies, as the increased use of clawback in executive compensation inspires behavioural change in leadership. In this way, an ethical culture is created as transparency and commitment to principled governance becomes a priority (Walker, 2021). Walker (2021) explains that the concept of unjust enrichment is also controlled through the process of recovering amounts erroneously paid out.

Velte (2020) also argues that the inclusion of clawback provisions in executive compensation results in better alignment between executive responsibility and stakeholder interests. Clawback assists in creating accountability for decision-making, which results in more robust reasoning and justification processes within the business (Hirsch *et al*., 2017). Denis (2012) adds that by creating monetary consequences for unethical conduct, the incentive to disclose accurate financial information is compounded.

On the contrary however, the enforceability of clawback provisions may deter the use of judgment in decision-making as serious consequences may arise if an error is subsequently detected (Securities and Exchange Commission, 2015). Executives may choose to abstain from risky projects where the outcomes are uncertain in an effort to ensure the accuracy of financial reporting (Securities and Exchange Commission, 2015). Decisions may be taken with a view to maximize short-term benefits rather than long-term performance, which in turn, has an adverse operational impact on the business (Securities and Exchange Commission, 2015). Walker (2021) adds that companies may opt for higher base salaries as opposed to issuing variable compensation that is subject to forfeiture.

In studies conducted by the OECD, it was found that the use of clawback has increased in various jurisdictions globally, particularly in listed companies (Cormann, 2021). Within the South African context, an increased tendency to use malus and clawback provisions by listed companies is also evident (van Zyl & Mans-Kemp, 2022). As the enforceability of clawback provisions has both financial and legal consequences, Moolman & Giliam (2019) explain that policies and processes applied by companies need to be robust and clearly defined.

In light of the increased use of clawback by locally listed companies, it is not clear whether any regulatory guidance on remuneration clawback exists in the South African context, and whether such regulation is sufficient in addressing the issues posed by clawback. The purpose of this paper therefore is to determine how existing legislation and governance codes deal with clawback of remuneration locally in South Africa, and to contrast this to other jurisdictions so that improvement areas can be identified. This paper aims to provide a broad understanding of the governance codes applicable to the clawback of remuneration to identify any similarities, differences, and improvement areas. In achieving this goal, the South African governance regime on remuneration is compared to that of the USA and UK which represent developed economies, and which were at the forefront of the global recession experienced a few decades ago. Through this comparison, the approach to remuneration clawback may be standardized across jurisdictions so that best practice can be applied coherently amongst companies. Furthermore, details on how to enforce a clawback on current and former employees may be determined.

This paper comprises of four sections. The first section provides the background and introduction and explains the purpose of the study. The next section elaborates on the methodology applied, after which section three includes a detailed discussion and analysis on the findings. Lastly, section four provides concluding remarks and recommendations for further research.

OBJECTIVES AND METHODOLOGY

This paper seeks to provide descriptive insight on the clawback of remuneration to better understand the technicalities and procedural approach applied in various jurisdictions. Grant & Booth (2009) explain that narrative descriptions are commonly used to examine the current literature available on a topic. An overview of literature describes the relevant characteristics so that conceptual or thematic analysis may be performed Grant & Booth (2009). The presentation of such findings may occur in a narrative or tabular format Grant & Booth (2009).

Through a systematic review, the integration of data occurs across various independent data sets so that the current state of literature is understood (Nowell et al., 2017; Thorne, 2000).

Common themes, similarities and differences are also identified so that recommendations can be made for further research (Grant & Booth, 2009; Kim *et al*., 2017). Booth (2006) explains that a qualitative systematic review is not merely an aggregation of existing knowledge. Instead, it aims to interpret the data and to isolate themes and constructs so that a comprehensive understanding of the data can be obtained (Booth, 2006). Snyder (2019) adds that systematic reviews are commonly used to inform existing policy on a particular matter.

Systematic reviews focus on a particular research question so that information sought from the literature is relevant in addressing a specific issue. The research question formulated should be understandable, free of ambiguity and clearly formulated (Tawfik *et al.*, 2019). In terms of data eligibility and identification, Tawfik *et al.* (2019) suggest that appropriate scoping criteria be applied to exclude unrelated and duplicated information from the literature surveyed. Scrutiny of the reference lists of relevant articles or citation tracking assists in identifying similar literature (Tawfik *et al.*, 2019).

Snyder (2019) explains that the aim of a systematic literature review is to identify data that meets specific inclusion requirements with the intention to answer the research question. In this way, consistency in findings across various data sets can be identified (Sydner, 2019).

Yang & Tate (2012) explain that systematic reviews entail a structured method in terms of searching, filtering and categorising the data. Clear documentation of the process followed in identifying, analysing and synthesizing the literature improves the credibility of the findings documented in the study (Liberati *et al.*, 2009).

Once appropriate data has been sourced, King & He (2005) suggest that the researcher identify trends and common themes amongst the various data sets so that inferences may be drawn. Nowell *et al.* (2017) explain that thematic analysis enables the researcher to capture important aspects that link the data together. In this way, the current state of literature on the research question is brought to the fore (Yang & Tate, 2012).

In the context of this paper, the systematic review comprises of both data selection and content analysis. Data was sourced through a search of relevant legislation, governance frameworks, journal articles, legal interpretations and through the use of keywords. References to remuneration clawback assisted in isolating the most applicable information. The titles and abstracts were surveyed for suitability in addressing the research question. No limits were applied in determining the quantity of data to include. As this is a qualitative review, information was sourced until saturation was reached. Snyder (2019) explains that the search strategy applied in a systematic review enables the researcher to identify and categorise pertinent information so that reliable findings can be obtained.

Thereafter, the content was analysed through a narrative overview commencing with a broad synopsis of applicable governance principles and narrowing down to the technical detail applied to remuneration clawback. This enabled the researcher to evaluate the current state of legislation in a particular jurisdiction. Lastly, findings from each jurisdiction were integrated to identify similarities and differences, and to identify areas where development or further research is required.

A diagram representation of the research methodology applied to this study is included below:

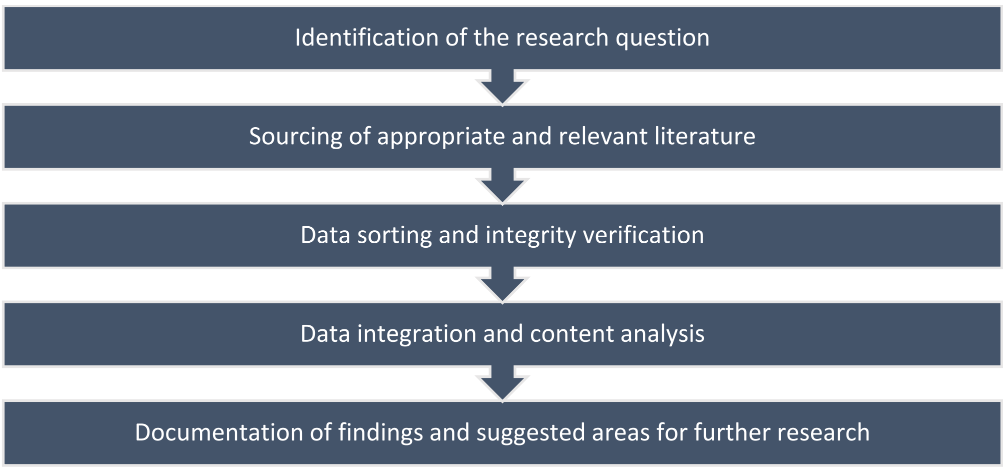

Figure 1. Illustration of the research methodology
Source: Authors' compilation

A similar approach was adopted in studies conducted by Aleti *et al.* (2013), Auler *et al.* (2017), Colosia *et al.* (2013), Kitchenham *et al.* (2009) and Santisteban *et al.* (2016) in which relevant data was sourced to address a specific research question. Explicit criteria were then applied to isolate the most pertinent information after which comparative analysis with independent data sets was carried out to identify any trends and anomalies. Inferences were drawn on the findings and suggestions were made for further research.

DISCUSSION AND ANALYSIS

South African overview

Governance legislation on remuneration clawback in South Africa is informed primarily by the King IV Report on Corporate Governance for South Africa ('King IV') and the Companies Act 71 of 2008. The former advocates for the application of good governance principles, whilst the latter deals with the reporting requirements and fiduciary duties of executives. The Basic Conditions of Employment Act 75 of 1997 alludes to the concept of procedural fairness in relation to remuneration clawback. Lastly, the Banks Act 94 of 1990 expands upon specific remuneration clawback guidelines for companies operating in the banking sector. A comprehensive overview on the status of current legislation is provided below.

King IV Report on Corporate Governance for South Africa

King IV advocates for responsible governance over remuneration. This includes transparency and close alignment between remuneration and the fulfilment of the organization's strategic objectives (IOSDA, 2016). Responsible governance also requires senior management to implement measures to mitigate risk exposure (IOSDA, 2016). Moolman & Giliam (2019) explain that clawback allows the opportunity to re-evaluate the adequacy of variable remuneration and adjust if necessary.

King IV also advocates for better accountability on remuneration. The 'apply and explain' principle required by King IV allows companies and other stakeholders the opportunity to evaluate the extent to which the principles and recommendations of King IV are being adhered to. The remuneration committee is tasked with the oversight on the adequacy of remuneration in terms of the policies of the company (IODSA, 2016).

Sufficient disclosure on remuneration is also required which includes detail on the reasons behind particular transactions and the manner of implementation (IODSA, 2016). Whilst remuneration should motivate and reward employees for contributions made to the business; King IV requires that transparency, ethics and adherence to the business strategy form the foundation of any payment made to employees (IODSA, 2016). For variable remuneration, adequate reasoning needs to be provided in justification for the award of short and long-term incentives, as well as any assumptions used in determining these amounts (IODSA, 2016).

Individual performance is scrutinized against pre-agreed targets in determining the amounts to be awarded (IODSA, 2016).

In terms of clawback, the Guide to the Application of King IV encourages the use of clawback as a mechanism to control unjust enrichment (SARA & IODSA, 2017). Excessive risk taking in pursuit of incentive targets is dissuaded, and instead behaviour that concurs with the company's strategy, objectives and risk management approach is encouraged (SARA & IODSA, 2017).

King IV however does not prescribe the manner in which clawback is to be implemented, and instead leaves this responsibility to the board of directors to deliberate (IOSDA, 2016; SARA & IODSA, 2017). The report does however require detailed disclosure on the circumstances, conditions and process applied to the enforceability of clawback (IOSDA, 2016; SARA & IODSA, 2017). The disclosure thereof should also adhere to applicable regulations and international best-practice (SARA & IODSA, 2017). King IV supports this as benchmarking of remuneration against other companies both locally and abroad ensures that remuneration is fair in relation to the services rendered (IOSDA, 2016).

The appointment of a King IV compliant remuneration committee is mandatory for listed companies in South Africa. Madlela (2018) does however point out that whilst the application of King IV is mandatory for listed companies, the report itself is not legislated and merely provides a set of recommendations for companies. Consequently, companies apply discretion which leaves room for inconsistency in application.

In a study conducted by van Zyl & Mans-Kemp (2022), it was found that the use of clawback by listed companies has increased in South Africa over the past decade, however the disclosures relating to clawback were found to be inconsistent between companies. The link between pay and performance was not clearly articulated, and in many instances, a high-level overview on the application of clawback was provided without sufficient detail on the mechanics (van Zyl & Mans-Kemp, 2022). In light of this, there exists a need to benchmark the current local governance approach to international best-practice so that coherence can be created amongst companies.

In terms of the JSE listings requirements, clawback is regarded as a corporate action for which specific principles apply (JSE,2017). Prior to the execution of a clawback, part 1.1 of the Corporate Action Timetable requires a Stock Exchange News Service ('SENS') announcement to be made (JSE, 2021). Disclosure is also required on the method, formulas and assumptions applied in determining the amounts clawed back (JSE, 2021). The JSE however does not prescribe the mechanics around the clawback transaction from a legislative perspective, and instead leaves this aspect to the board to determine.

Companies Act 71 of 2008

The Companies Act 71 of 2008 elaborates on corporate responsibility and the fiduciary duties of directors. From a remuneration governance perspective, this Act focuses on the reporting requirements and the conduct of directors. Clawback is not dealt with directly. In terms of reporting, sections 28 and 29 of the Companies Act 71 of 2008 emphasize the need for accuracy and completeness of the accounting records and financial statements. Section 30 of the Companies Act 71 of 2008 demands that all categories of remuneration be disclosed separately to enable users to distinguish between the fixed and variable components.

Section 76 of the Companies Act 71 of 2008 discourages self-serving behaviours on the part of directors and instead emphasizes the importance of clear communication and transparency. This section requires that directors act in good faith and in the best interest of the company whilst displaying the knowledge, skill and care expected of a person in such a role. Directors may also incur liability for breach of fiduciary duties in terms of section 77 of the Companies Act 71 of 2008. Furthermore, section 214 of the Companies Act 71 of 2008 remands directors for any false statements, reckless conduct and non-compliance. Certain actions are specified in section 214 of the Companies Act 71 of 2008 and include falsification of accounting records, providing false or misleading information, misstatement or omission of amounts with fraudulent intent and providing untrue statements. These actions are analogous to the contingent events used to enforce a clawback, and by inference therefore, the enforcement of a clawback would result in a breach of fiduciary duties on the part of directors, yet legislation does not explicitly state this.

The Companies Act 71 of 2008 does however preserve the integrity of directors when honest mistakes are made in that fiduciary duties are not breached if the director acted in the best interest of the company. An evaluation of the circumstances is therefore essential. To encourage exposure of misconduct, section 159 of the Companies Act 71 of 2008 safeguards whistle blowers from all forms of civil, criminal and administrative liability.

Basic Conditions of Employment Act 75 of 1997

Moolman & Giliam (2019) explains that existing employment law also prevents employers from enforcing clawback in the absence of a written contractual right. Section 34(1) of the Basic Conditions of Employment Act 75 of 1997 only permits employers to recoup amounts from the remuneration of an employee in specific instances provided a written agreement exists between both parties. Whilst overpayments resulting from mathematical error may be recovered in terms of section 34(5) of the Basic Conditions of Employment Act 75 of 1997, this Act remains silent on the recovery of funds due to misconduct, fraud or other forms of misrepresentation.

Banks Act 94 of 1990

In addition to the regulations above, companies in the banking sector are subject to the Banks Act 94 of 1990 ('Banks Act'). Regulation 43 of the Banks Act 94 of 1990 requires banks to disclose the details surrounding malus and clawback in the remuneration report (SARB, 2012). Detail should be provided on the processes and procedures followed and should incorporate both quantitative and qualitative information (SARB, 2012). The performance criteria impacted by the clawback needs to be disclosed as well as the approach adopted by the bank in adjusting remuneration through the use of clawback (SARB, 2012). At present, the Banks Act does not stipulate exactly what the policies should contain, and neither is the preferred approach to clawback prescribed.

Whilst the South African Reserve Bank ('SARB') retains the power to issue direction to banks on how to clawback variable remuneration, the process applied remains unclear (SARB, 2015). The Basel Committee on Banking Supervision (2015) emphasizes that remuneration structures within a bank concur to the business's risk strategy, its long-term interest, value and objectives. Remuneration should reflect a balance between risk taking and risk outcomes (Basel Committee on Banking Supervision, 2015). Risk outcomes should be measured over a number of years so that remuneration pay-outs are aligned to results (Basel Committee on Banking Supervision, 2015). The inclusion of malus and clawback provisions in remuneration plans enable the bank to defer payments until risk outcomes are more certain (Basel Committee on Banking Supervision, 2015). Consequently, the use of these provisions is strongly encouraged in the banking sector so that recovery can occur without unnecessary delay.

In light of the above, explicit guidance on how to execute the clawback is not presently available in South Africa. The absence of distinct guidelines on remuneration clawback leaves companies with no option but to apply discretion on the most suitable approach. Further research is therefore required to specify the mechanics surrounding clawback for both current and former employees.

USA overview

Various legislation exists in the USA that refer to the clawback of remuneration. Since the onset of the financial crisis, regulatory authorities proposed several reforms to legislation to ensure better oversight on remuneration. The Model Business Corporation Act of 2016 governs the conduct of companies and directors. This Act is supported by various doctrines applied in the common law. The mechanics on the application of clawback is expanded upon in other legislation, such as the Sarbanes-

Oxley Act of 2002, the Dodd-Frank Wall Street Consumer Reform and Protection Act of 2010 and the Securities Exchange Act of 1934, all of which are discussed in detail below.

Model Business Corporation Act (2016) and common law doctrines

The Model Business Corporation Act (2016) exists in the USA and clarifies the fiduciary duties of directors. Section 8.30 of the Model Business Corporation Act (2016) requires directors to act with reasonable care, in good faith and in the best interest of the business. This section also expects directors to possess a general awareness of the business activities and its financial affairs. Whilst directors may rely on the inputs from colleagues, the responsibility to ensure that competent individuals are allocated to tasks remains the responsibility of the board in terms of Section 8.30(d) of the Model Business Corporation Act (2016). In this way, the accountability of the board is tied to actual involvement (Sparks & Hamermesh, 1992).

Section 8.31 of the Model Business Corporation Act (2016) also holds directors liable for decisions that are not in good faith and not in the best interest of the business. Decisions resulting from a lack of objectivity or self-serving behaviours, or those displaying a lack of oversight or resulting in financial benefits also fall withing the scope of section 8.31 of the Model Business Corporation Act (2016). In terms of this section, directors may be held liable for both reputational and monetary damages and any clauses pertaining to recovery of compensation or disgorgement may be instituted (American Bar Association, 2016).

Melone (2009) explains that any material misstatement of financial information results in a breach of the duties of good faith and loyalty, and therefore further action may be instituted from a legal perspective. Sparks & Hamermesh (1992) add that directors may be held personally liable where gross negligence is proven to exist. Whilst section 8.31 of the Model Business Corporation Act (2016) describes the consequences resulting from a transgression, the business judgement rule is applied in the common law and provides refuge for individuals that act with reasonable care, in good faith and for the best interest of the company (Sparks & Hamermesh, 1992). This rule protects executives that were not directly involved in perpetrating the misstatement and presumes that sound judgement is applied by the board if decisions taken conform to a rational purpose that is in line with the business strategy (American Bar Association, 2016).

Sparks & Hamermesh (1992) explain that the corporate opportunity doctrine is commonly applied in the USA. This doctrine strives to direct business pursuits so that there is no conflict between professional duties and self-serving behaviours (Sparks & Hamermesh, 1992). As directors have a fiduciary duty of loyalty to the business, opportunities aligned to the business interest should be pursued, as opposed to those that provide personal gain to the executives involved (Sparks & Hamermesh, 1992). In terms of subsection F of the Model Business Corporation Act (2016), a breach of fiduciary duties is deemed to occur when directors pursue self-interests that are not aligned to business interests.

Non-disclosure of financial interests may also result in the transaction being considered unfair. Fairness in the context of section 8.61 of the Model Business Corporation Act (2016) refers to whether the transaction is beneficial to the business and whether it is comparable to an independent arms-length transaction. Walker (2021) explains that the doctrine of equitable restitution is also applied in common law. This doctrine aims to bridge the gap between the amount of compensation granted to executives and the level of responsibility undertaken by executives (Warren, 2010). Any failure on the part of the executive to fulfil corporate responsibilities results in the employer possessing a right to recover or withhold compensation for those services (Warren, 2010). As clawback strives to prevent unfairness resulting from unjust enrichment, the doctrine of equitable restitution may be invoked to ensure this.

In addition to the above, Caywood (2010) explains that the corporate waste doctrine is applied which demands that directors be held accountable for the use of corporate resources. Directors are accountable to shareholders for any excessive or unjustified expenditure (Caywood, 2010). The concept of corporate waste encapsulates the disregard to act in the best interest of the business (American Bar Association, 2016), and any action that constitutes a waste of corporate resources carries consequences for the executive involved in terms of section 8.31 of the Model Business Corporation Act (2016).

Melone (2009) adds that if the terms and conditions attached to executive compensation are found to be too favourable to executives, the issue of corporate waste is commonly brought to the fore. Caywood (2010) mentions that this doctrine places the onus on proof on shareholders and in many cases, insufficient factual evidence is available to successfully prosecute a director, which leads to high litigation costs. As this doctrine on its own is ineffective in holding directors accountable for unwarranted expenditure, clawback was expanded upon in other legislation to create consequences for performance that is incoherent to business strategy.

Various other legislation also exists in the USA in which detail is provided on how to design and implement clawback policies on remuneration. Such legislation includes the Sarbanes-Oxley Act of 2002, the Dodd-Frank Wall Street Consumer Reform and Protection Act of 2010 and the Securities Exchange Act of 1934. The clawback provisions in these acts is discussed in further detail below.

Sarbanes-Oxley Act of 2002

Section 34 the Sarbanes-Oxley Act of 2002 provides specifically for the clawback of compensation from the chief executive officer ('CEO') and chief financial officer ('CFO') of public interest entities. Schwartz (2008) explains that section 34(2) of the Sarbanes-Oxley Act of 2002 holds the CEO and CFO accountable for creating an internal control environment that promptly responds to identified misconduct. Section 34 of the Sarbanes-Oxley Act (2002) is however only applicable if the misstatement resulted from an act of misconduct and if the company is required to restate results due to non-compliance with financial reporting requirements (Fried & Shilon, 2011a). This section also requires executives to forfeit any bonuses or incentive-based compensation received within 12-months prior to an earnings restatement (Brown *et al.*, 2015). Melone (2009) adds that section 34 of the Sarbanes-Oxley Act of 2002 is punitive in that it requires the reimbursement of the full amount of the award.

Brown *et al.* (2015) explain that the absence of misconduct impedes on the application of section 34 of the Sarbanes-Oxley Act of 2002, as the existence thereof is mandatory. Judgement is required in identifying misconduct and the intention of the offender becomes paramount (Fried & Shilon, 2011a). Mahoney (2019) adds that in many cases an admission of guilt does not occur and that makes recovery of compensation an arduous exercise. Studies have also shown that many listed companies failed to adopt robust clawback policies as the enforceability of section 34 of the Sarbanes-Oxley Act of 2002 was oftentimes very costly and inefficient (Fried and Shilon, 2011b).

Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010

A few years later, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 was introduced. Brown *et al.* (2015) explain that this act required all public companies to include clawback as part of executive remuneration. Section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 permits employers to recover excess compensation from employees if financial results were misstated within a 3-year period prior to the restatement. According to Chan *et al.* (2012), this clawback applies irrespective of whether an act of misconduct has occurred, and places the responsibility of enforcement on the employer, rather than on the regulatory authorities. In this way, section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 expands upon section 34 of the Sarbanes-Oxley Act (2002) as the latter only permitted a recovery from executives in the case of identified misconduct or fraud (Brown *et al.*, 2015).

Section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 allowed the recoupment of the excess amount paid out, as opposed to section 34 of the Sarbanes-Oxley Act of 2002 which requires the recovery of the full amount (Fried & Shilon, 2011b). One of the shortfalls of section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 however, is that it limits the application of a clawback to cases of misrepresentation of financial results that necessitate an accounting restatement, whilst overlooking other types of non-financial misconduct (Fried & Shilon, 2011b).

Securities Exchange Act of 1934

In 2015, the Securities Exchange Commission ('SEC') introduced section 10D as part of the Securities Exchange Act of 1934. This section is applicable to listed companies and expands upon section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. Section 10D(a) of the Securities Exchange Act of 1934 requires listed companies to adopt, disclose and enforce policies relating to the clawback of incentive awards, or the companies could face delisting. Board (2015) explains that this section brought the concept of 'earning' into incentive awards. Where an accounting restatement occurs, it should be determined whether or not the executives involved earned their compensation prior to the restatement. If compensation was not earned, then it may be recouped from current or former executives (SEC, 2015).

The Listing Standards for Recovery of Erroneously Awarded Compensation (SEC, 2015) explain that incentive-based compensation in the context of section 10D of the Securities Exchange Act of 1934 includes both cash and equity awards that are 'granted, earned or vested based wholly or in part upon the attainment of a financial reporting measure'. Financial reporting measures refer to the correct application of accounting principles, as well any other financial metrics derived from reported financial information (Kesner *et al.*, 2015; SEC, 2015).

In cases where an award is subject to several conditions, all conditions need not be met before the executive obtains a 'non-forfeitable' interest in the award (SEC, 2015). According to the Listing Standards for Recovery of Erroneously Awarded Compensation (SEC, 2015), the fulfilment of financial criteria is sufficient to create an obligation on the part of the company to pay the award and a contingent right on the part of the executive to receive the award. Non-financial metrics and performance criteria are ignored when determining whether a non-forfeitable interest in an award has been obtained (SEC, 2015). Once the contingent right to the award is established, the amounts is deemed to be earned and is therefore subject to clawback in accordance with section 10D of the Securities Exchange Act of 1934 (SEC, 2015). This occurs despite the non-satisfaction of other conditions attached to the award (SEC, 2015). Bachelder (2015) adds that awards may only be recouped after receipt, and deemed receipt occurs on the earlier of the date on which the award became earned by the executive and the date of actual payment (SEC, 2015).

Bachelder (2015) and Kesner *et al.* (2015) explain that cash or equity awards linked to time, strategic, operational or service measures are excluded from the definition of incentive-based compensation and therefore the clawback of such amounts would not be subject to section 10D of the Securities Exchange Act of 1934. Kesner *et al.* (2015) also add that discretionary and retention bonuses are also excluded from the scope of section 10D of the Securities Exchange Act of 1934. The clawback of non-incentive awards would therefore be subject to section 304 of the Sarbanes-Oxley Act of 2002 provided an action of misconduct is found to exist. In the absence of misconduct, section 304 of the Sarbanes-Oxley Act of 2002 will not apply, and therefore the rules and doctrines applicable in the common law may be enforced.

The concept of materiality also plays an important role in determining whether or not to enforce a clawback. The use of judgement is necessary in determining materiality as all relevant facts need to be considered (SEC, 2015). A series of immaterial errors may aggregate to a material amount, and therefore sound judgement should be exercised in determining what to report. Unnecessary delays in reporting material accounting errors, whether intentional or not may result in criminal liability on the part of the executive and the company involved (SEC, 2015).

Therefore, to apply section 10D of the Securities Exchange Act of 1934, the restatement must result from an accounting error or material financial blunder that was used initially in determining the amount of compensation paid to executives (SEC, 2015). Fuerst & Sengar (2016) explain that the date of enforcement of section 10D of the Securities Exchange Act of 1934 is the date on which the company is required to make an accounting restatement. This date is the earlier of the date on which the board of directors have resolved that a material error exists, or the date on which a court concludes that the financial results require a restatement.

Upon identification of an accounting restatement, section 10D(b) of the Securities Exchange Act of 1934 advises that executive compensation be recalculated for a period of 3-years prior to the restatement to determine any excess amounts paid out (SEC, 2015). Bachelder (2015) explains that the 3-year period is referred to as a ‘look-back period’, the purpose of which is to determine the surplus amounts that should be recouped from current or former executives (SEC, 2015). The Listing Standards for Recovery of Erroneously Awarded Compensation (SEC, 2015) clarify that the restatement must be to correct material inaccuracies in previously issued financial results. If financial results were not incorrectly represented initially, section 10D of the Securities Exchange Act of 1934 will not apply, and instead relief should be sought from section 304 of the Sarbanes-Oxley Act of 2002 or through the rules and doctrines applicable in the common law.

Bachelder (2015) adds that section 10D of the Securities Exchange Act of 1934 applies whether or not the executive was responsible for the restatement. This concept is referred to as 'no fault recovery' (Kesner *et al.,* 2015; SEC, 2015), and the amount clawed back would be the gross amount, pre-tax (SEC, 2015). Kesner *et al.* (2015) explain that the purpose of this is to ensure that the company is fully reimbursed for the excess amounts initially paid out in error.

All individuals in key management or finance roles as well as those tasked with the responsibility of policy-making are regarded as executives in the company and are subject to the clawback rules per section 10D of the Securities Exchange Act of 1934 (SEC, 2015). Furthermore, companies are not permitted to indemnify executives from the enforcement of a clawback in terms of section 29(a) of the Securities Exchange Act of 1934 (Bachelder, 2015; SEC, 2015).

The Listing Standards for Recovery of Erroneously Awarded Compensation (SEC, 2015) emphasize that the use of discretion by the board is also limited when it comes to enforcing section 10D of the Securities Exchange Act of 1934. Non-application of section 10D of the Securities Exchange Act of 1934 is only permitted in cases where the amount to be recovered exceeds the cost of recovery, or where recoupment contravenes the law (Bachelder, 2015). The manner of recovery however is left to the discretion of the company issuing the award. Several mechanisms are available such as cancelling unvested awards, forfeiting awards and deduction from future remuneration amongst others (SEC, 2015).

There may be situations where both section 10D of the Securities Exchange Act of 1934 and section 304 of the Sarbanes-Oxley Act of 2002 apply to the same amount. In such cases, Kesner *et al.* (2015) explain that section 304 of the Sarbanes-Oxley Act of 2002 will be applied first, after which the amount recovered will be deducted in determining the clawback per section 10D of the Securities Exchange Act of 1934 (SEC, 2015). In contrast to section 304 of the Sarbanes-Oxley Act of 2002, section 10D of the Securities Exchange Act of 1934 refers to non-fulfilment by the company with the prerequisites in financial reporting, for which misconduct need not exist (SEC, 2015.)

Warren (2010) does however point out that existing clawback legislation in the USA does not directly address compensation that is not incentive-based, and neither is non-adherence to performance metrics that do not result in gross misconduct. Whilst the doctrine of equitable restitution discussed above may be invoked in this instance, it remains an area where further research is required.

UK overview

The repercussions of the financial crisis in the USA had a ripple effect on the UK and on various other jurisdictions globally. In response to the public concern on the appropriateness of remuneration and the adequacy of bonuses paid to senior executives, regulatory authorities in the UK legislated guidelines on remuneration clawback. The Greenbury Report on Directors Remuneration and the UK Corporate Governance Code defined the acceptable principles of good governance. The Companies Act of 2006 expanded upon the roles and responsibilities of directors and companies in achieving common goals, whilst the Employment Rights Act of 1996 sought to protect the interests of employees upon the enforcement of clawback. The technicalities on the process applied to clawback amounts is described in various policy statements issued by the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA).

Greenbury Report on Directors Remuneration

In 1995, the Greenbury Report on Directors Remuneration was introduced to propose governance standards pertaining to the responsibility and accountability of directors. The Greenbury Report on Directors Remuneration highlights that it is crucially important to align the remuneration of directors to performance, so that better accountability and responsibility can be obtained over remuneration (Greenbury, 1995). Price (2016) explains that the Greenbury Report attempted to address concerns resulting from inadequate financial reporting and the lack of accountability that resulted during the financial crisis. The Greenbury Report also supports restrictions on earnings for senior executives so that remuneration is aligned to market practice (House of Commons of the United Kingdom, 1995).

Price (2016) explains that the Greenbury Report proposed that remuneration committees comprise solely of non-executive directors so that independent supervision can occur over remuneration. These committees were tasked with the responsibility to oversee the fairness of directors remuneration and should evaluate the adequacy of key performance measures applied in the business (Greenbury, 1995). The Greenbury Report also favoured the adoption of longer-term incentives at senior executive level to better align director interests to shareholder interests (Price, 2016).

Whilst performance measures should adequately compensate directors for services rendered to the business, performance metrics should be designed to reward improvements made to the business (Greenbury, 1995). Price (2016) explains that remuneration committees were also encouraged to adopt a firm line with respect to discretionary bonuses so that that the financial position of companies is appropriately evaluated before any rewards are paid out. The link between pay and performance was emphasized (Price, 2016).

UK Corporate Governance Code

The UK Corporate Governance code was drafted subsequently to expand upon the basic principles of good governance. This code focussed on building onto the principles of remuneration addressed in the Greenbury Report, and elaborated on issues arising from the financial crisis including misconduct and inadequate governance (Financial Reporting Council, 2018a). The UK Corporate Governance Code requires that policies on directors remuneration be designed to incorporate the values, purpose and the strategy of the business, whilst also reflecting the commitment and responsibilities assigned to the role in question (Financial Reporting Council, 2018a). Den Exter (2013) explains that adherence to the UK Corporate Governance Code is mandatory for listed companies, and therefore all provisions of the Code need to be applied on a 'comply or explain' basis. In this way, stakeholders hold management accountable for decisions taken Price, (2016).

In designing remuneration policies, the UK Corporate Governance Code suggests that the remuneration structure be kept simple, transparent, and fair in relation to the level of risk undertaken and the outcomes delivered (Financial Reporting Council, 2018a). For incentive-based awards, authority to exercise discretion on the payment of amounts vests with the remuneration committee (Financial Reporting Council, 2018a). This committee is permitted to override formulaic outcomes that may be perceived as being too excessive (Financial Reporting Council, 2018a). The Guidance on Board Effectiveness (Financial Reporting Council, 2018b) explains that the remuneration committee may adjust the value of awards due to unforeseen circumstances, if results have not been achieved, or if outcomes differ to what was initially intended. This ensures that amounts eventually paid to directors is aligned to the contribution made to the business (Financial Reporting Council, 2018b).

Furthermore, provisions to recover previously issued compensation may also be included in the remuneration policies of companies (Financial Reporting Council, 2018a). Whilst the remuneration committee is permitted to set limits on what is considers reasonable, clawback and malus provisions may also be included in remuneration policies (Financial Reporting Council, 2010; (Financial Reporting Council, 2018b). Detail is required on the circumstances for which such provisions may be invoked. Such circumstances include misleading information or misstatement of accounts, misconduct, reputational damage or corporate failure (Financial Reporting Council, 2018b).

Price (2016) explains that the increased disclosure requirements proposed by the UK Corporate Governance Code aims to improve transparency in reporting, as better transparency contributes to better accountability over remuneration. If accountability is established, corrective action can be taken by management (Price, 2016). The Financial Reporting Council (FRC) also suggest that disclosures on remuneration focus on the substance of transactions as opposed to the legal form (Price, 2016). In addition, improvement in stakeholder relationships was encouraged particularly between directors and shareholders. The purpose of this was to ensure alignment between remuneration and shareholder needs (Price, 2016).

Companies Act of 2006

Further guidelines on the factors that contribute to the efficient and responsible management of directors and companies is outlined in the Companies Act (House of Commons of the United Kingdom, 2006a). This act protects directors that act within the best business interest, whilst also creating consequences for those that deviate from acceptable norms. The Companies Act (House of Commons of the United Kingdom, 2006a) also explains the role of stakeholders in approving the remuneration policies of companies. Chapter 2 of the Companies Act (House of Commons of the United Kingdom, 2006a) details the fiduciary duties of directors. Section 172 of the Companies Act (House of Commons of the United Kingdom, 2006a) indicates that directors are obliged to act within good faith and to promote the best interests of the company. This section also requires directors to maintain a high standard of conduct and to promote the long-term success of the company in all business pursuits. Directors are also required to exercise independent judgement in terms of section 173 of the Companies Act (2006a) and should carry out daily activities with reasonable care, skill and diligence.

Section 176 of the Companies Act (House of Commons of the United Kingdom, 2006a) stipulates that directors should not accept benefits from third parties. The Explanatory Notes (House of Commons of the United Kingdom, 2006b) to this section indicate that the purpose of this is to encourage directors to refrain from pursuing personal interests which may conflict with business interests. Disclosure is also required for any interests held in terms of sections 177 and 182 of the Companies Act (House of Commons of the United Kingdom, 2006a).

From a remuneration perspective, section 226B of the Companies Act (House of Commons of the United Kingdom, 2006a) states that remuneration may only be paid to directors in terms of the remuneration policy, or a pre-approved directors' resolution. If the latter option of chosen, a memorandum should accompany the submission detailing deviations from the remuneration policy in terms of section 226D of the Companies Act (House of Commons of the United Kingdom, 2006a). Any payments made to directors without the necessary approval carry civil consequences in terms of section 226E of the Companies Act (House of Commons of the United Kingdom, 2006a). In terms of this section, directors that wrongfully approved a payment are obliged to indemnify the company for any losses incurred.

Furthermore, section 232 of the Companies Act (House of Commons of the United Kingdom, 2006a) nullifies any arrangement that may exempt directors from liability for breach of fiduciary duties. A breach of fiduciary duties includes negligence, breach of trust and the non-fulfilment of corporate duties (House of Commons of the United Kingdom, 2006b).

The non-disclosure of directors remuneration, or the disclosure of false or misleading information amounts to reckless conduct in terms of sections 418 and 422 of the Companies Act (House of Commons of the United Kingdom, 2006a) for which directors are liable for an offence, indictment, a fine or imprisonment.

In discharging the fiduciary duty of directors to report material information to shareholders, section 234B of the Companies Act (House of Commons of the United Kingdom, 2006a) mandates directors of listed companies to prepare a remuneration report. The Directors Remuneration Report Regulations 2002 (House of Commons of the United Kingdom, 2002) were drafted to provide guidelines on the type of information to include, pertaining specifically to emoluments earned by directors. The Auditing Practices Board (2002) explains that detailed information relating to remuneration committees, performance-related remuneration and liabilities incurred by directors should be disclosed to shareholders in the directors remuneration report. Section 8 of the Directors Remuneration Report Regulations (House of Commons of the United Kingdom, 2002) legislates the provision of financial statements to shareholders which include adequate disclosure on directors remuneration.

Section 3 of Schedule 7A of the Directors Remuneration Report Regulations (House of Commons of the United Kingdom, 2002) stipulates that remuneration policy should include detailed information on the performance conditions attached to remuneration. This information includes benchmarking to comparative companies, an explanation on the assumptions used, as well as a summary of the performance conditions and explanations on why such conditions were chosen. Any variation to the terms attached to performance conditions also require disclosure in terms of section 9 of Schedule 7A of the Directors Remuneration Report Regulations (House of Commons of the United Kingdom, 2002). If, for any reason, performance criteria are not attached to incentive awards, explanation is also required in terms of section 3 of Schedule 7A of the Directors Remuneration Report Regulations (House of Commons of the United Kingdom, 2002).

Disclosure is also required for any significant awards or lumpsums paid to past directors in terms of section 14 of Schedule 7A of the Directors Remuneration Report Regulations (House of Commons of the United

Kingdom, 2002). Shutkever (2002) explains that remuneration policies should also explain the rationale behind the length of contracts granted to directors as well as justification for the categories of remuneration offered. Malus and clawback arrangements should also be disclosed in the directors' remuneration report indicating the criteria of enforceability for each category of remuneration. Disclosure is also required when such provisions have been invoked during the period.

Employment Rights Act of 1996

Section 13 of the Employment Rights Act (House of Commons of the United Kingdom, 1996) prohibits employers from deducting any amounts from the remuneration of employees except if permitted through a statutory provision or if the employee has provided written consent to such a deduction. Furthermore, adequate notice needs to be provided by the employer to the employee in writing in terms of section 13(2) of the Employment Rights Act of 1996, detailing the areas of concern so that remedial action may be taken by the employee prior to any deductions from remuneration. The Financial Services Authority (FSA) also emphasizes that the terms and conditions included in contracts need to be fair, and should adequately explain the rights and obligations of both parties (Financial Services Authority, 2010). Detailed explanations should be provided by employers when the intention is to reclaim amounts from employees (Financial Services Authority, 2010).

Section 13(4) of the Employment Rights Act of 1996 does however permit employers to adjust for computation errors made in determining the value of remuneration payable. In addition, section 14 of the Employment Rights Act of 1996 permits employers to deduct any overpayment of remuneration as well any amounts accruing to regulatory authorities in terms of statutory provisions. The Employment Rights Act of 1996 seeks to defend the employee from unfair practice on the part of the employer. Employers are not permitted to clawback amounts except in cases of mathematical inaccuracy, provided adequate notice was given to the employee. Other circumstances warranting the enforcement of clawback are not addressed, and therefore the principle of fairness outlined in this act should be considered in conjunction with other relevant legislation.

PRA and FCA guidelines

The Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) have also issued various guidelines on remuneration to curb short-termism and excessive risk-taking by directors (Prudential Regulation Authority and the Financial Conduct Authority, 2015). Clause 19C.3.6 of the FCA Handbook (Financial Conduct Authority, 2017) specifies that the remuneration policies adopted by companies should conform to the business strategy and values. Remuneration policies should also promote effective risk management in terms of clause 19C.3.7 of the FCA Handbook (Financial Conduct Authority, 2017). In addition, performance of employees should be aligned to the long-term interests of the business, and measures should be place to avoid conflicts of interest in accordance with clause 19C.3.9 of the FCA Handbook (Financial Conduct Authority, 2017).

Furthermore, clause 19C.3.13 of the FCA Handbook (Financial Conduct Authority, 2017) requires companies to demonstrate that remuneration decisions have considered both the current and future financial position of the company. The determination of remuneration should also be done independently by the remuneration committee to prevent any undue influence in accordance with clause 19C.3.17 of the FCA Handbook (Financial Conduct Authority, 2017). Clause 19C.3.4 of the FCA Handbook (Financial Conduct Authority, 2017) also specifies that employees should be categorised depending on seniority and the level of risk imposed on the business. Employees should be made aware of the categories and should understand the implication of the status allocated to them in terms of clause 19C.3.5 of the FCA Handbook (Financial Conduct Authority, 2017).

Policy statement PS 7/14 (Prudential Regulation Authority, 2014) explains that by exposing variable remuneration to the risk of forfeiture, a safety net is created in which management can exercise better control over the amounts eventually paid. In determining the value of variable remuneration, the PRA and FCA are in agreement that both financial and non-financial metrics should be considered (Prudential Regulation Authority and the Financial Conduct Authority, 2015). Clause 15.4 of the PRA Rulebook (Prudential Regulation Authority, 2020) also specifies that the award of variable remuneration should be tied to individual performance, as well as the performance of the relevant business unit and the firm as a whole.

Furthermore, clause 15.9 of PRA 2015/53 (Prudential Regulation Authority and the Financial Conduct Authority, 2015) specifies that fixed remuneration should comprise a major component of total remuneration so that companies may exercise discretion in determining whether or not to issue variable remuneration. Clause 19D.3.61 of FCA 2015/27 (Prudential Regulation Authority and the Financial Conduct Authority, 2015) and clause 19A.3.51 of PRA 2014/22 (Prudential Regulation Authority, 2014) emphasize that variable remuneration should only be paid if permitted by the financial performance of the business as a whole. Furthermore, the contingent nature of such remuneration should be made known to employees in terms of clause 4.6 of the Remuneration Supervisory Statement SS2/17 (Prudential Regulation Authority, 2014).

From a risk mitigation perspective, policy statements PRA PS12/15 and FCA PS15/16 (Prudential Regulation Authority and the Financial Conduct Authority, 2015) explain that both malus and clawback are seen as effective risk management tools on variable remuneration.

Hoffmann *et al.* (2019) explain that inclusion of malus and clawback impacts on the likelihood of the pay-out. Clawback may be enforced upon agreement by the employee to refund certain amounts in particular circumstances (Prudential Regulation Authority and the Financial Conduct Authority, 2015). Alternatively, companies may opt to extend the length of time between date of award and the date of vesting (Prudential Regulation Authority and the Financial Conduct Authority, 2015). This represents a malus condition in which the company retains control over the unvested amounts for a longer period. The PRA and FCA (Prudential Regulation Authority and the Financial Conduct Authority, 2015) explain that this is known as a deferral period and should essentially incorporate the estimated timeframe in which the results from poor performance, misconduct or excessive risk taking are expected to surface. Studies have also shown that the application of moderate deferral periods assists in improving risk management within companies (Hoffmann *et al.,* 2019).

In determining the length of the deferral period however, factors such as the level of responsibility, strategic influence and seniority of the position should be considered, in addition to the nature of the business, its risks and activities (Prudential Regulation Authority and the Financial Conduct Authority, 2015; Prudential Regulation Authority, 2020). Whilst the PRA and FCA retain authority to adjudicate on the duration of the deferral period, an extended period is proposed to ensure effective risk management over the long term (Prudential Regulation Authority and the Financial Conduct Authority, 2015).

Rule 15.21 of the PRA Rulebook (Prudential Regulation Authority, 2020), clause 15.21 of PRA 2015/53 and clause 19D.3.62 of FCA 2015/27 (Prudential Regulation Authority and the Financial Conduct Authority, 2015) explain that the criteria for the application of both malus and clawback need to be clearly specified and should include situations where the conduct of employees resulted in financial loss or fell short of acceptable standards. Green & Pierson (2018) explain that at present, only financial loss and unacceptable conduct are currently prescribed for the enforcement of clawback. The criteria for clawback is therefore very limited and hinders on the ability of the board to enforce clawback in the case of corporate failure (Green & Pierson, 2018). Clause 19A.3.51B of PRA 2014/22 (Prudential Regulation Authority, 2014) explains that relevant factors together with the employee's level of responsibility in perpetuating the exposure to risk should be considered in determining the amount to clawback. Rule 15.22 of the PRA Rulebook and clause 15.22 of PRA 2015/53 (Prudential Regulation Authority and the Financial Conduct Authority, 2015; Prudential Regulation Authority, 2020) specifies that adjustment should be made to variable remuneration if material error, employee misconduct, material failures in risk management or a material downturn in financial performance is found to exist.

Clause 4.8 of the Remuneration Supervisory Statement SS2/17 (Prudential Regulation Authority, 2014) specifies that in cases of misconduct or material failures in risk management, employees directly and indirectly involved may be held accountable. By virtue of seniority of a position, employees are expected to be aware of business activities and are responsible for effective implementation of internal controls. Employees may therefore be implicated for the failure to identify and address issues timeously.

From a timing perspective, clawback may be applied within a period of seven years from the date on which variable remuneration was granted if misconduct or a failure in risk management is identified in terms of clause 15.2 of PRA 2015/53 (Prudential Regulation Authority and the Financial Conduct Authority, 2015). The PRA and FCA (Prudential

Regulation Authority and the Financial Conduct Authority, 2015) explain that this period may be extended to ten years if investigations have commenced that are likely to result in an adjustment to remuneration.

Companies are also encouraged to apply fairness and consistency in the enforcement of clawback policies (Prudential Regulation Authority, 2021). While criteria for enforcement should be specified, remuneration committees retain the right to exercise discretion on the suitability thereof in accordance with clause 4.13 of the Remuneration Supervisory Statement SS2/17 (Prudential Regulation Authority, 2021). Remuneration policies should clearly define the approach followed in determining the amount to be reimbursed as required by clause 4.14 of the Remuneration Supervisory Statement SS2/17 (Prudential Regulation Authority, 2021). Furthermore, if performance measures are used in determining the value of variable remuneration, clause 19C.3.22 of the FCA Handbook (Financial Conduct Authority, 2017) specifies that both current and future business risks are considered.

In determining the amount to be clawed back, clause 19C.3.37 of the FCA Handbook (Financial Conduct Authority, 2017) emphasizes that non-financial metrics form a major component of the performance assessment process. Clause 4.19 of the Remuneration Supervisory Statement SS2/17 (Prudential Regulation Authority, 2021) also advises companies to adopt a comprehensive approach in that a numeric value should be assigned to both the qualitative and quantitative implications of the action. Qualitative implications are described in clause 4.19 of the Remuneration Supervisory Statement SS2/17 (Prudential Regulation Authority, 2021) and include the adverse financial impact resulting from reputational damage, tainted stakeholder relations, loss of customer support and duration of the unfavourable repercussions of the wrongdoing amongst others. The damage resulting from these aspects should be estimated and included together with financial loss, fines and other regulatory costs in determining the value of the clawback (Prudential Regulation Authority, 2021).

Clause 4.22 of the Remuneration Supervisory Statement SS2/17 (Prudential Regulation Authority, 2021) also provides authority to the remuneration committee to evaluate the amount of the clawback if information subsequently comes to light that impacts on the value initially determined. Furthermore, companies are expected to justify how remuneration has been adjusted to incorporate risks undertaken in accordance with clause 5.16 of the Remuneration Supervisory Statement SS2/17 (Prudential Regulation Authority, 2021) Clause 5.17 of the Remuneration Supervisory Statement SS2/17 (Prudential Regulation Authority, 2021) stipulates that both long-term risk factors as well as unexpected future losses be incorporated into the performance measures so that a combination of financial and non-financial criteria are used in determining the amounts eventually paid. Clause 15.20 of the PRA Rulebook (Prudential Regulation Authority, 2020) also emphasizes that company sustainability is critical in deciding whether or not to pay variable remuneration.

Clawback legislation in the UK is quite comprehensive and in many instances, replicates the approach adopted by the USA. From the literature above, it appears as though the focus of regulatory authorities is to recover amounts erroneously paid out, whilst also creating punitive consequences for the offender. The alignment between performance and remuneration is frequently emphasized in both the UK and USA. Legislation in these jurisdictions also clarifies the stance to be adopted by companies in enforcing clawback. South African legislation on the other hand is silent on the mechanics to be applied to remuneration clawback. Furthermore, the approach adopted locally differs drastically to comparative jurisdictions. A summary of the key findings is included below:

Table 1. Summary of the key findings. Tabular representation of the treatment of remuneration clawback across various jurisdictions

	South Africa	**USA**	**UK**
1	Limited clawback focus due to the absence of clear guidelines.	Focus on restitution mechanisms to curtail unjust enrichment.	Focus on restitution to align personal and business interests.
2	Trigger events limited to computational error.	Trigger events include misconduct, financial restatement, fraud, or any other contractually agreed condition.	Trigger events include misconduct, financial restatement, fraud, or any other contractually agreed condition.
3	Inadequate statutory/ legislative guidance.	Developed legislation on clawback.	Developed legislation on clawback.
4	Focus on procedural fairness and employee rights.	Focus on procedural fairness and employee rights.	Focus on procedural fairness and employee rights.

	South Africa	**USA**	**UK**
5	Discretion is frequently applied due to the absence of clear guidelines.	Discretion is infrequently applied.	Discretion applied to reduce the payment of excessive incentive awards.
6	Inconsistency in application between companies.	Homogenous application between companies due to the prevalence of appropriate guidelines.	Homogenous application between companies due to the prevalence of appropriate guidelines.
7	No specific guidance on the approach clawback in later years.	Guidance is provided on clawback in later years. A 3-year look back period is applied.	Guidance is provided on clawback in later years. A 7-year look back period is applied.
8	No guidance on clawback from former employees.	Guidance is provided on clawback from former employees.	Guidance is provided on clawback from former employees.
9	Lack of clear administrative and procedural guidelines.	Administrative and procedural guidelines exist.	Administrative and procedural guidelines exist.
10	Common law principles not applied to remuneration.	Culture of responsible decision-making is encouraged through doctrines applied in the common law.	Common law principles not applied to remuneration.
11	Limited use of clawback in aligning pay to performance.	Clawback used to align pay to performance.	Clawback used to align pay to performance.
12	Limited enforcement of clawback as a method to inspire behavioural change.	Clawback is a punitive and remedial measure to inspire ethical conduct.	Clawback is a punitive and remedial measure to inspire ethical conduct.
13	Existing remuneration policies favour malus as clawback legislation is non-existent.	No preference is noted. Legislation is developed to support both.	Malus provides better control over remuneration over a longer period.
14	Deferral of vesting periods not applied.	Deferral of vesting periods not applied.	Deferral of vesting periods is applied.
15	No clear directive on the exposure of variable remuneration to clawback.	Variable remuneration partially exposed to risk of forfeiture.	Variable remuneration exposed to risk of forfeiture in full.

Source: Authors' compilation

CONCLUSIONS

In this paper we discussed the current state of governance legislation on clawback in South African. The findings were benchmarked against other jurisdictions to determine how well South Africa fares in relation to its global counterparts with the aim of facilitating policy change locally. The following aspects are noted as improvement areas with the South African context.

Despite the increased use of clawback amongst listed companies in South Africa, inadequate governance procedures are found to exist. Whilst King IV advocates for good governance and encourages adherence to international best-practice, further research is needed on how to develop existing laws to effectively deal with clawback on remuneration.

The governance structures implemented by companies and other regulatory bodies in South Africa tend to focus more on the operational aspects surrounding clawback. If companies decide to enforce a clawback, the internal reporting requirements are made clear, yet no guidance is given on how to enforce clawback from a statutory perspective. The rights and responsibilities of employers and employees remain vague, despite clawback having huge financial and reputational consequences.

Currently, in terms of South African employment law, the enforceability of a clawback provision will require the employer to have a contractual right against the employee. Procedural fairness is an aspect emphasized in labour law, particularly when deducting amounts from remuneration. As clawback policies applied by listed companies currently incorporate the use of board discretion, employees should ideally be afforded the opportunity to make counter representations to reduce the value proposed as a clawback. Consistency needs to be applied in the implementation of the policies and therefore formalisation of the legislation and processes around clawback is imperative.

Furthermore, the trigger events for the enforceability of a clawback need to be clearly articulated so employees are aware of the actions to avoid. Key performance measures also need to incorporate clearly defined criteria. Transparency and disclosure are also necessary on the process followed by companies prior to the recoupment of awards. Technicalities such as clawback in the later years, as well as clawback from current and former employees are not dealt with in South

African legislation at present. Consequently, the reporting requirements and administrative processes fall short. Further research on these aspects is required.

The overview of the comparative jurisdictions evidences the commitment of regulatory authorities to exercise better control over executive compensation. Whilst certain laws may emphasize specific requirements, such as the existence of misconduct or a financial restatement, various other doctrines and rules exist within the common law that inspire a culture of responsible decision-making at senior levels of management. The alignment between the personal interests of executives and the fiduciary duty to act within the business interest is a common focus in both the USA and the UK. Clawback is used as a mechanism in these jurisdictions to align executive remuneration to individual performance.

The exposure of variable remuneration to the risk of forfeiture also enables remuneration committees to exercise full control over the amounts in question. Management is afforded the opportunity to consider various factors, including long-term sustainability of the business before committing to any payment. The incorporation of both financial and non-financial performance metrics also incentivizes employees to excel as incentive awards are not guaranteed.

The coherence in the approach adopted by the USA and the UK creates harmony as companies are subject to a similar set of standards. Performance can be gauged across international borders and in this way, areas of concern can be timeously identified and addressed. The approach to administration and reporting can also be standardized so that the process functions optimally. Jurisdictions such as South Africa that do not have an established regulatory regime on clawback can therefore definitely consider the approach adopted in these jurisdictions as a basis from which to build on existing law. Through the sharing of knowledge and collaboration, efficiencies on remuneration clawback can be maximised.

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