Clawback: A global guide

Variable pay has long been viewed as the best way to align employee and shareholder interests on the basis that it encourages the individual to perform and to contribute to an increase in business value. But attitudes to variable pay changed after the global financial crisis of 2007-8. Variable pay structures were blamed by many for contributing to the financial crisis because they (allegedly) encouraged employees in the financial sector to focus on the short term and to take excessive risks.

One of the criticisms was that most variable pay structures historically did not include mechanisms to allow companies to hold employees (or their managers) to account for the long term consequences of their actions. To correct this, regulators across the globe have put in place measures aimed at strengthening individual accountability through changes to variable pay structures.

One of the most popular of these measures has been the introduction by many regulators of a requirement that, in certain circumstances, businesses adjust variable pay after it has been awarded and potentially ask for it to be repaid after it has vested or even where it has been received by the employee, ie to make an ex-post risk adjustment to the award. The circumstances in which this power might be operated usually include where it becomes apparent that the individual’s performance (on the basis of which the award was made) has been misjudged or the financial performance upon which the award was calculated was inaccurate. There are two types of ex-post risk adjustment – clawback and malus.

**Clawback** refers to a contractual arrangement under which an employee is required, in certain circumstances, to return an amount of variable remuneration (cash, shares or other assets) which has already been paid or which has already vested (and on which tax has generally been paid).

**Malus** (or soft clawback) is the reduction (sometimes to zero) of variable remuneration amounts which have not yet vested and/or been paid or delivered. The term ‘clawback’ is often used inaccurately to describe what is, in fact, ‘malus’ – some companies have claimed to have ‘clawed back’ bonuses when what they have, in fact, done is cause the deferred, unvested part of those bonuses to lapse. For this reason, malus is sometimes termed ‘soft clawback’. When this guide refers to ‘clawback’, it means hard clawback, not malus.

Clawback requires an individual to return the value of an incentive award which they have already received or to return shares which have already been transferred to them. As such, it is an aggressive remedy - whether a clawback provision will be enforceable depends on the law applicable to the award and on the facts of the individual case. Clawback may be completely prohibited or it may be permissible but only in limited circumstances. Alternatively, as is the case in some countries, clawback may be compulsory. The recent, rapid developments in this area have made it increasingly difficult for multinationals to know whether their pay arrangements, and more specifically the clawback provisions in their incentive schemes, comply with national law.

This guide looks at how enforceable clawback is in over 20 jurisdictions.
Clawback: How enforceable is it?

Malus is applied before the award vests and so does not generally give rise to the enforceability issues associated with clawback.

That said, in a number of jurisdictions it is becoming increasingly common (both in the financial services sector and beyond) for clawback arrangements to be put in place and applied despite there being questions in that jurisdiction as to whether clawback is enforceable. In practice, some senior executives have resisted bringing claims based on the enforceability of clawback arrangements, preferring to settle any claim rather than risk tarnishing their reputations with a court claim and its associated disclosures.

Following the 2007-8 financial crisis, the Financial Stability Forum (now the Financial Stability Board) was the first body to propose the use of clawback in the financial services sector as a means of ensuring that financial services remuneration is risk aligned. Its 2009 Principles for Sound Compensation Practices and their Implementation Standards (produced in response to representations by the G20) provided that subdued or negative financial performance should generally lead to a considerable contraction of the firm’s total variable compensation, including through the application of malus or clawback arrangements.

This global proposal has since been implemented both regionally and locally. In the EU, CRD4\(^1\) has introduced a range of constraints on pay arrangements within the financial sector, including clawback. CRD4 prescribes that up to 100 per cent of total variable remuneration must be subject to malus and clawback arrangements. AIFMD\(^2\) and the UCITS Directive\(^3\) also refer to the application of clawback arrangements.

Further guidance on the circumstances in which financial services employers are expected to apply clawback is provided by the European Banking Authority’s (EBA) guidelines on sound remuneration policies (EBA Guidelines), which came into force on 1 January 2017. According to the EBA Guidelines, clawback ‘should in particular be applied when the identified staff member contributed significantly to the subdued or negative financial performance and in cases of fraud or other conduct with intent or severe negligence which led to significant losses.’ This, does not, however, necessarily mean that financial services employers in all EU Member States will be able to enforce clawback provisions, as the EBA Guidelines also confirm that clawback remains subject to the general principles of national contract or labour law.

‘Up to 100 per cent’ within the meaning of CRD4 could therefore still mean ‘zero’ if the applicable national law does not allow for any form of clawback at all. The question of whether clawback is enforceable is, for employers based within the EU, dependent on national law just as it is for employers based outside of Europe.

In the US, a number of legislative measures have been put in place which require listed companies to put in place a clawback policy, with such policies generally receiving strong shareholder support. In Asia, a number of jurisdictions, most notably China and Hong Kong, have introduced guidelines applicable to the financial services sector which feature clawback and forfeiture.

This guide summarises how enforceable clawback is in the following jurisdictions overleaf.

\(^1\) The Capital Requirements Directive 2013/36/EU of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms.


Basic principles

There are no statutory provisions in Brazil which require businesses to put in place clawback arrangements or which regulate clawback.

The enforcement of clawback arrangements is allowed by the courts in relation to some benefits and incentives which are provided voluntarily by the employer (ie which do not arise from mandatory rights) — for example, bonuses, stock options, restricted stock units, golden parachutes, sign-on bonuses, payments for non-competes, training expenses - provided that the employee is given notice of the clawback arrangement. There is also a legal clawback mechanism which applies to sales people who are paid on a commission only basis — this allows an employer to claw back sales commission in respect of a particular sale where the buyer becomes insolvent and does not pay the relevant invoice.

It will not be possible to claw back any amounts paid in respect of mandatory labour rights (eg salary, 13th salaries, holiday pay, Unemployment Savings Fund, notice pay) because employees cannot waive their entitlement to these rights, unless there has been a mistaken overpayment.

In order to be enforceable, a clawback arrangement must have been agreed to by the employee — it will usually be a term in the employment agreement or be set out in the incentive plan rules under which the variable pay award is granted. The arrangement will have more chance of being enforced in the case of senior employees. Clawback arrangements should be carefully drafted and should make clear (i) whether the employee will be required to pay back the gross or net amount; (ii) whether any interest might be payable on the clawed back amount; (iii) the circumstances in which clawback may be applied; and (iv) that the employee must acknowledge and agree to the clawback arrangement.

Clawback conditions should not be abusive as otherwise they could become null and void — in order to reduce this risk, the clawback provision should not be too widely drafted and should be precise about when it might be triggered.

Is the award paid back gross or net of tax?

The employer should seek to claw back the gross amount of the award but the courts can still rule that the employee is only required to pay back the award net of tax. In general, the individual would be able to claim back the tax paid on the clawed back amount from the tax authorities.

The employer may also claim back any social security contributions which it paid in respect of the clawed back amount from the authorities.
Basic principles

The enforceability of clawback provisions in Mexico is questionable because the Mexican Federal Labor Law (FLL) prohibits salary deductions. If the variable remuneration (whether cash or shares) is granted as an employment benefit, it is unlikely that the employer will be entitled to claw it back, as it will be treated as an acquired right under the FLL. If the clawback arrangement falls outside the scope of the FLL (which might be the case if it is granted by a non-Mexican parent company), it might be possible to enforce it.

Any contractual provision which provides for a full or partial repayment of any award by an employee to the employer when specific events occur (eg termination of employment, misconduct, breach of a non-compete obligation) might be void, even if agreed by the parties, on the basis that it constitutes a waiver of an acquired right (contrary to the FLL). In practice, the application of the FLL makes it very difficult to enforce clawback in Mexico.

In the financial services sector, clawback arrangements can be put in place in respect of senior executives' variable remuneration but the enforceability of these provisions will again depend on whether they comply with the requirements of the FLL.

Is the award paid back gross or net of tax?

The employer would claw back the award on a net basis. In order to recover the overpaid income tax on the clawed back amount, both the employer and the employee would have to follow an administratively burdensome procedure before the tax authorities. There is no legislative mechanism that regulates the recovery of social security contributions.

The employer would also need to cancel the initial payroll receipt and issue a fresh payroll receipt to the employee setting out the correct amount of variable remuneration (after the clawback).
**Basic principles**

Section 304 of Sarbanes-Oxley Act of 2002. This grants the Securities and Exchange Commission the power to claw back certain CEO and CFO incentive compensation and profits from the sale of securities in the preceding twelve months in the event of a required restatement of financial statements due to an issuer’s material non-compliance as a result of misconduct with financial reporting requirements under applicable securities laws.

Section 954 of Dodd-Frank Wall Street Reform and Consumer Protection Act (2010). This requires listed companies to adopt a policy governing the recovery of excess incentive-based compensation paid due to a material error in an issuer’s financial statements. The clawback of incentive compensation under this rule would apply to compensation received during the previous three years by current and former executive officers in the event of a required restatement of financial statements regardless of fault. Foreign private issuers generally would also be subject to this clawback regime unless it violates home country laws. A proposed rule implementing this mandate under Dodd-Frank has been issued by the Securities and Exchange Commission, but a final rule is not expected to be adopted in the near term. However, clawback policies generally receive strong shareholder support, and many companies, including financial institutions already covered by the EU rules, have adopted clawback policies typically linked to a finding of fault.

Section 956 of Dodd-Frank Wall Street Reform and Consumer Protection Act (2010). This requires inter-agency rules to be adopted designed to (i) prohibit incentive-based payment arrangements determined to encourage inappropriate risks by certain financial institutions by providing excessive compensation or that could lead to material financial loss, and (ii) require those financial institutions to disclose information concerning incentive-based compensation arrangements to the appropriate federal regulators. A proposed set of highly intricate rules (some of which broadly track the CRD4 framework) have been adopted, but they are not expected to be finalised in the near term. However, financial institutions regulated by the Federal Reserve, the Federal Deposit Insurance Corporation and/or the Office of the Comptroller of the Currency remain subject to the safety and soundness standards regarding incentive compensation, which have resulted in a common market practice of voluntary deferrals and clawbacks at financial institutions.

**Enforceability of Clawback.** Clawback provisions and clawback policies generally should be enforceable, but there can be significant limitations under pre-existing contractual arrangements or the requirements of local wage laws that must be carefully considered. In addition, since the proposed rules under Dodd-Frank described above have not been finalised, enforceability in the context of those specific rules remains an untested and uncertain area of the law. Finally, there are practical concerns relating to the enforcement of clawback provisions, including the cost of potential court action to recover the amounts claimed, concerns over attracting and retaining staff, questions as to whether the employee will have the funds available to repay the award, and the tax impact on the employee and the employer.

**Is the award paid back gross or net of tax?**

Under the rules described above, the amount of excess compensation that is to be recovered generally is expected to be calculated on a pre-tax basis (i.e., the clawback applies on a gross, rather than net, basis). Tax advice should be sought in connection with any clawback to evaluate any potential complexity associated with tax reporting and the availability of tax deductions/credits with respect to the clawed-back compensation.

**Financial CHOICE Act.** This proposed bill is under consideration in Congress. It would roll back many of the protections of Dodd-Frank, including the proposed Dodd-Frank clawback rules described above.
Basic principles

Clawback is required/recommended in Austria as follows:

- Clawback agreements are market practice for listed stock corporations in Austria. The Austrian Governance Code recommends that listed and (where reasonable) non-listed, stock corporations put in place clawback arrangements with their board members which provide (at the very least) that variable remuneration which was paid on the basis of evidently incorrect data can be reclaimed by the company. This requirement operates on a comply or explain basis, however, and is not compulsory.

- Clawback agreements are compulsory for certain financial institutions where the EBA Guidelines require this, due to §69(5) of the Austrian Banking Act.

It is our view that if (i) the clawback and (ii) the circumstances in which clawback will be applied are expressly agreed between employer and employee before the remuneration to which the clawback relates is earned, vested or paid out, clawback will be enforceable under Austrian law. This view applies to both hard clawback and malus. There is, however, no Austrian case law yet on the enforceability of clawback provisions.

There is a potential difficulty with the enforceability of clawback in Austrian law because there is a strict pro-rating principle which applies to remuneration already earned for periods worked. This would not prevent the application of a malus provision which seeks to recover remuneration which has not yet vested if there is a prior written agreement which provides that the remuneration will not be earned until fully vested. Nor, in our view, should it stop a carefully drafted hard clawback provision from operating effectively provided it is agreed before the remuneration is earned, vested or paid out and it is clear in what circumstances it would operate.

Is the award paid back gross or net of tax?

The award would generally be paid back gross by the employee. This is because, under Austrian law, except for in very limited cases, only the employee can reclaim tax and social security contributions which are no longer owed.

Austria
Basic principles

It is not clear to what extent clawback provisions are enforceable in Belgium. Belgian legislation does not give any clear guidance on the issue and, in fact, the Banking Act (which implements CRD4 into Belgian law and governs clawback within the financial services sector) explicitly states that any clawback provisions are without prejudice to the general rules of contract and employment law.

The Corporate Governance Act requires any listed company which has contractual clawback arrangements in place to include details of these in their remuneration report. The Corporate Governance Act, however, does not deal with the potential conflict with employment law provisions or the question as to whether clawback is enforceable.

Clawback provisions are not common in Belgium but, given these legislative provisions, it is expected that the use of clawback provisions by listed companies and financial institutions will increase, notwithstanding the uncertainty surrounding their enforceability.

Is the award paid back gross or net of tax?

Income tax

- If clawback is enforced in the financial year in which the award was received by the employee, the employee will only need to return to the employer the value of the award net of income tax.
- If clawback is enforced in a different financial year, the gross taxable amount should be repaid. In this case, the employee will be able to recover the income tax paid on the award from the tax authorities.

Social security contributions

There is no provision governing whether an employee who is required to return a clawed back award would also have to pay back an amount equal to the social security contributions that were previously withheld by the employer, but it seems unlikely. The employer should, however, be able to ask for a return of the contributions from the Social Security Authorities.
Basic principles

The French clawback regime is limited to the financial sector only and is based on CRD4. While therefore there are provisions on clawback, such arrangements are generally thought to be unenforceable under French law for the following reasons:

- The French Labour Code prohibits pecuniary sanctions against employees, and clawback provisions, especially those which involve clawback related to individual performance, would generally be in breach of the Code.

- French case law suggests that a deferred bonus cannot be withheld because the employee leaves the company if they do so after the end of the performance period for which the bonus was awarded.

It may be that French case law will evolve in light of regulatory developments, especially at EU level. This, however, remains to be seen. Given the issues with enforceability, it is very rare to encounter a French company which has clawback arrangements in place. Instead companies rely on the use of deferred bonuses which allows them not to release the bonus to the employee if there is a performance issue during the deferral period.

Is the award paid back gross or net of tax?

French legislation does not give guidance as to whether clawback could operate on a pre-tax or post-tax basis, but it is unlikely that a French court would enforce an obligation placed on an employee to ‘reimburse’ to the employer employee social security charges previously withheld by the employer.
Basic principles

Clawback is difficult to enforce in Germany. Courts have been, and still are, reluctant to allow employers to claim back bonus payments on the basis that the employee has breached their duties except where the bonus payment was ill-founded in the first place (eg in case of fraud).

Until August 2017 there was no obligation on employers in Germany to introduce clawback arrangements.

This changed when the new pay regulations for financial institutions (Institutsvergütungsverordnung/ Pay Regulations) entered into force on 4 August 2017. ‘Important’ financial institutions (principally systemically important institutions and institutions with an average balance sheet of €15bn over a period of three financial years) will now have to introduce clawback for their EU identified staff (‘risk takers’) as of the next remuneration cycle, typically during the calendar year 2018.

Under the Pay Regulations, clawback must be applied in the following circumstances:

- the risk taker has been substantially involved, or has been responsible for, any action which has led to the institution sustaining a significant loss or it receiving a considerable regulatory sanction; or
- the risk taker has committed a serious breach of internal or external rules relating to suitability and behaviour.

The employer may choose to apply additional clawback triggers but should bear in mind the difficulties in enforcing them — see below).

The minimum clawback period is five to seven years depending on the applicable minimum deferral period (which is either three or five years). The clawback period starts to run on the date non-deferred variable remuneration is paid and ends two years after the end of the deferral period.

Whether clawback arrangements are now enforceable, at least in those circumstances that are described as compulsory clawback trigger events in the new Pay Regulations, remains questionable. Although there is no judgment on the subject by a court of last instance, the general presumption remains that an employer would find it difficult to enforce a clawback arrangement on grounds that earned income cannot be claimed back retroactively.

As noted above, the German courts have only allowed employers to claim back bonus payments in circumstances where the bonus payment was ill-founded in the first place, eg where the employee’s bonus payment was based on the fraudulent behaviour or illegal business practices of the employee. By contrast, where an employee breaches their duties in another way (eg by harassing their co-workers) or is the cause of financial loss without having acted improperly, any claim to claw back a bonus payment is generally thought unlikely to succeed.

Since ‘important’ financial institutions will need to include clawback arrangements in their remuneration policies, employment contracts and other arrangements relating to material risk takers on the basis of the Pay Regulations, we expect there to be case law on this subject relatively soon which will hopefully shed some light on the enforceability of clawback in Germany.

Is the award paid back gross or net of tax?

In Germany, it should be possible to claw back an award on a gross basis — ie including income tax and social security contributions — where this is based on the remedy of unjust enrichment. It remains to be seen on which basis (ie gross or net) an award can be clawed back in other circumstances (if at all).
Basic principles

Financial institutions which are subject to CRD4 are required to have clawback arrangements in place in respect of the variable pay arrangements of their ‘material risk takers’. Companies listed on the main securities market of the Irish Stock Exchange are also required to include clawback provisions in all performance related remuneration arrangements for executive directors.

In order for clawback provisions to be enforceable, there must be an express contractual right to effect the clawback or the employee must have consented to the clawback in question. Otherwise an employee could assert that the clawback constitutes an unlawful deduction from wages, which is prohibited by the Payment of Wages Act 1991.

It is important that the clawback provision is carefully worded to minimise the risk of it being found to be a penal damages clause. In practice this is achieved by the clawback triggers being drafted by reference to the positive acts of the employee (that have resulted in negative consequences for the firm) rather than the employee's breach.

It is also important that a firm acts reasonably in effecting clawback and has regard to all relevant factors in determining the percentage of variable remuneration to be clawed back. Relevant factors include (i) the degree of culpability of the employee and (ii) the length of time between the payment of the variable remuneration and its proposed clawback.

If a firm acts unreasonably in effecting clawback, it could potentially face a constructive unfair dismissal claim based on an alleged breach of the implied term to maintain trust and confidence in the employment relationship.

Is the award paid back gross or net of tax?

Market practice is to claw back the award net of tax, universal social charge and social insurance contributions. However, an employer could claw back the gross amount if the clawback provision provided for this or the employee agreed. If the gross amount was clawed back, the employee would need to seek the agreement of the Revenue Commissioners to the excess tax being credited as against tax liabilities relating to future employment income. There is no statutory basis for an employer to reclaim tax paid on a clawed back payment.
Basic principles

There are several clawback regimes in Italy — one governing credit institutions (which implements CRD4), one governing insurance companies, one governing alternative investment funds, one governing harmonised funds and another applicable to listed companies.

These regimes provide that clawback should apply in certain prescribed circumstances, which are generally limited to circumstances related to mistakes or misconduct by the individual who received the award. For credit institutions subject to CRD4, the EBA Guidelines provide for a wider set of clawback events which are not only related to mistake or misconduct but also to objective events, such as a significant downturn in the financial performance of the institution and/or business unit. These additional clawback events have not yet been included within Italian legislation and, on this basis, it is not clear what force the EBA guidelines have in Italy on this point.

None of the regimes gives much guidance as to what would be an appropriate clawback period. Given this lack of guidance, it is worth noting that, as a matter of general principle, an employer would be time-barred from clawing back an award 5 or 10 years (depending on the circumstances) after the payment of the award. In any event, the regulators would expect an employer to try to claw back the monies as soon as they become aware that a clawback event has occurred.

To date there has been no case law precedent nor any regulator’s decision concerning the enforcement of clawback.

Is the award paid back gross or net of tax?

There is no regulatory framework in Italy and no clear market practice as to whether awards should be clawed back before or after tax. Employers are theoretically free to adopt both approaches.

In any case, it would be in the interests of the employer to clawback the gross (rather than the net) amount. If it did so the employer would immediately obtain the gross amount back and the employee (and not the employer) would have the burden of claiming a repayment from the Italian Tax Agency of the withholdings applied on the clawed back amount — this process may take years.

Social security contributions cannot be clawed back by the employer from the relevant employee. Rather, the employer can claim a repayment of these monies from the Italian public social security authorities.
Basic principles

The EBA Guidelines have been transposed into Luxembourg law, including the clawback requirements. The administrative circular which achieved this was adopted on 16 June 2017 and provides that the clawback requirements are subject to the general principles of Luxembourg contract and employment law. The new law applies to all credit institutions and CRR investment firms and Luxembourg branches of non-EEA credit institutions and investment firms.

In Luxembourg, the Labour Code does not regulate the situation where an employer requests repayment of money already paid out to an employee. When assessing whether a contractual clawback provision is enforceable, the employment courts will have to decide whether the provision conflicts with any employment protection guaranteed under Luxembourg employment law – in this context it is likely that a court would, in the absence of a clear contractual provision to the contrary, hold that any amounts subject to the proposed clawback are ‘acquired rights’ which have been awarded by reference to past performance and that it is not possible lawfully to apply clawback to those acquired rights. For this reason it is unlikely that a Luxembourg court would allow a clawback claim to succeed unless there is a contractual provision allowing the clawback and the circumstances of the proposed clawback are clearly envisaged in that provision.

Is the award paid back gross or net of tax?

Luxembourg legislation does not specifically address the question of whether awards should be clawed back before or after tax. Since employers are generally required to withhold income tax from gross salary (including awards), market practice in Luxembourg would generally be to claw back an award on a net basis. The employer could only potentially claim back the full gross amount of the award if (i) the employee files a regularisation request with the tax authorities, and (ii) the tax authorities effectively reimburse the related taxes to the employee.

There is no legal provision governing the recoverability of social security contributions paid on any clawed back amounts. It is unlikely that the employer would be able to recover these from the employee but it is possible that the employer might be able to recover the overpaid contributions from the relevant social security authorities.
**Basic principles**

The Dutch clawback regime applies to Dutch financial institutions and three groups of companies: (i) Dutch companies with public liability (naamloze vennootschappen), (ii) Dutch limited liability companies and Dutch cooperative associations (coöperaties) which operate as banks, and (iii) Dutch mutual benefit associations (onderlinge waarborgmaatschappijen) which operate as insurance companies.

The Act applicable to certain but not all Dutch financial institutions (Wet beloningsbeleid financiële ondernemingen) provides that the financial institution must recover an appropriate amount of variable remuneration to the extent the relevant individual working for it (i) has not complied with appropriate standards in relation to competence and correct behaviour, or (ii) was responsible for actions which have led to a substantial deterioration in the financial position of the institution. This requirement applies to all individuals working for the financial institution.

In addition, there is a requirement for Dutch listed companies to claw back any increase in value realised by managing directors on share based incentive arrangements as a result of certain corporate transactions regarding the company (eg public bid, merger). This clawback requirement is not related to the managing director’s performance but is triggered solely by the corporate transaction.

Save for these provisions, clawback is not compulsory in The Netherlands but a company may nevertheless decide to put in place contractual clawback arrangements. In practice, where there is no legal requirement to apply clawback, clawback provisions are only commonly used at board/management level within listed companies.

Clawback is generally considered enforceable under Dutch law where contractually agreed between employer and employee, unless exercising the contractual clawback right would be contrary to the principle of ‘reasonableness and fairness’.

The statutory clawback provisions do not state what might be an appropriate period of clawback, so the regular statutes of limitation apply, ie claims in principle lapse five years after the company has become aware of the facts which form the basis of the right to exercise clawback.

An employer could insert into the employment contract a clause providing that it is able to apply clawback for a period exceeding the five year limitation period but, in practice, it is very rare to find such a provision as (i) such an arrangement could more easily be considered contrary to the principle of ‘reasonableness and fairness’ and (ii) it would make it more difficult for the company to attract and retain highly skilled directors and employees.

**Is the award paid back gross or net of tax?**

Under Dutch law, employers are able to recover the gross amount of the award subject to clawback. The individual will be able to include the amount that was clawed back as negative wages in their tax return.
Basic principles

Clawback is generally prohibited under Russian law. The only situation in which it would be enforceable is if the circumstances giving rise to the clawback fall within an exhaustive list set out in the Russian Federation Labour Code (the Labour Code) which permits an employer to recover certain amounts that have been paid to an employee. For example, an employer may recover sums overpaid to the employee due to their wrongful actions as determined by a court.

In these limited circumstances, the Labour Code allows the employer to recover the amounts due from the employee by withholding each month up to 20% of the employee’s monthly salary, provided that (i) the employee does not dispute the amount of and ground for such withholding, and (ii) the employer adopts a formal decision to withhold the due amounts within one month from the date the indebtedness occurred. If any of these conditions cannot be met, the employer may only recover the overpayment by filing a lawsuit.

It will only be possible for the employer to withhold the due amounts from the employee’s future salary while the individual is in employment. Where the individual is no longer employed, the employer would need to bring a claim in court if it wished to claim back any amount of pay from the individual and this, again, would only be permissible if the reason for the clawback fell within the limited list of reasons set out in the Labour Code, such as that the employee’s wrongful actions as determined by a court caused the overpayment of salary (eg the employee made false entries in the time recording sheet or other document used for calculating the employee’s salary and this fact has been confirmed with a court ruling).

Any contractual agreement which provides for other circumstances in which remuneration can be recovered is void.

Is the award paid back gross or net of tax?

Any clawback can only operate on a net salary basis.
Basic principles

Clawback arrangements are regulated for financial institutions and listed companies but there is no firm framework relating to these arrangements. The appropriate scope and duration of a clawback provision remains unclear, partly because of a lack of case law on the subject. That said, clawback arrangements for employees at financial institutions are generally expected to be enforceable. Outside the financial sector, the presumption would be that they are not enforceable. To improve the likelihood of enforceability the clawback period should generally not be longer than the limitation period applicable to the claim the employer would need to bring to enforce the clawback. The length of the limitation period depends on the nature of the relationship — for executive directors (mercantile relationship) it is five years and for other employees (labour relationship) it is one year.

Is the award paid back gross or net of tax?

As a matter of market practice, the amount recovered by way of clawback is calculated on a pre-tax basis (ie gross amount), unless otherwise agreed. The amount of tax and social security contributions which were previously withheld by the company may be claimed by the employee at the time of filing their personal income tax return.
Basic principles

Under the Swiss Banking Act, where a systematically relevant bank receives state aid the Swiss government can request an adjustment of the bank’s remuneration packages, which could include clawback. In order to ensure that clawback is enforceable in these circumstances, systematically relevant banks are required to include a provision in their remuneration plans which provides that, where the bank is the recipient of state aid, variable remuneration may be subject to clawback or other restrictions.

In other situations, clawback is a matter for contract law in Switzerland. In 2010, the Swiss Financial Market Supervisory Authority (FINMA) issued a set of rules on compensation (FINMA Circular on Remuneration Schemes), which encourage deferred compensation and malus provisions. FINMA also suggested that it might require the use of clawback provisions but there were fierce objections to this and ultimately this requirement was not included in the guidelines.

When it comes to the enforcement of clawback provisions, employers encounter several hurdles:

- Under Swiss law, awards qualify either as salary or gratuity. Restrictions on the payment of salary are generally unenforceable - a clawback provision will only therefore be potentially enforceable if the award qualifies as a gratuity. Whether an award forms part of salary or is a gratuity can be difficult to establish and depends on the particular facts of the case. Relevant factors include (i) the wording of the agreement between the employer and the employee, (ii) the ratio between salary and gratuity, (iii) whether the amount is clearly determined or objectively ascertainable, and (iv) the total amount of remuneration and the frequency of the payments.

- As a general rule, clawback becomes much more difficult to enforce when five or more years have lapsed since the event which triggered the clawback, although the precise limitation period applicable to clawback has not yet been determined by the courts.

- The employer might have forfeited its right to clawback even earlier if the employment has terminated and at the end of the employment relationship the employer knew about its clawback right but had not taken steps to enforce it.

Is the award paid back gross or net of tax?

Income tax

The employee will be able to claim a deduction equal to the clawed back amount in their tax return for the year in which the clawback was enforced. The employer must issue a statement to the employee confirming the clawback amount.

Social security

As a general rule, employees have a right to ask for a refund of social security contributions which were not due for payment.
Basic principles

There are two clawback regimes in the UK. Financial institutions are required to make variable remuneration awarded to material risk takers subject to clawback for a minimum period of seven years from the date of award (ten years for senior managers in certain circumstances) if (i) there is reasonable evidence of misbehaviour or material error or (ii) the firm or business unit suffers a material failure of risk management. This requirement applies to firms in proportionality levels one and two. UK listed companies are required to include clawback in all performance-related incentive schemes for executive directors.

Clawback arrangements are potentially enforceable in the UK provided they are carefully structured. The following key points should be borne in mind.

Consent – The individual must have consented to the clawback either in their contract of employment or by giving prior written consent in some other form. This is because section 15 of the Employment Rights Act 1996 makes it unlawful for an employer to receive a payment from a worker unless (i) the payment is required/authorised by statute or the employment contract or (ii) the individual has given their prior written consent to the payment being made. It is advisable to obtain the employee’s consent in writing to the clawback arrangement at the time it is put into place.

Penalty doctrine – The clawback provision must be carefully drafted to ensure that it does not engage the penalty doctrine. If it provides for repayment of a specified sum by the employee in the event of a breach of contract by the employee it is likely to be classified as unenforceable penalty. It is advisable for the clawback trigger to be the employee’s ‘positive’ misbehaviour rather than a failure by him to comply with his obligations.

Reasonableness – Clawback provisions are subject to the general principle of reasonableness. Financial institutions should take into account all relevant factors when deciding whether to apply clawback and to what extent - eg they should take into account the proximity of the employee to the risk management failure and their level of responsibility if the ground for clawback was that the business unit had suffered a material failure of risk management. Outside financial services we would also expect the courts to apply a reasonableness test when deciding on enforceability.

In financial services, the prescribed period of clawback (of seven or ten years) starts from the date of the award (not the date on which the award vests). The parties could potentially agree a longer clawback period, subject to the reasonableness test described above, although in practice employers tend not to go beyond what is required.

Is the award paid back gross or net of tax?

Market practice is to claw back the award net of tax and National Insurance Contributions (NICs). However, if the employer sought to claw back the gross amount, the individual may be able to obtain income tax relief for the amount repaid on the grounds that this constitutes negative taxable earnings. This would not be the case in relation to employer or employee NICs, however, which would not be recoverable.
Basic principles

The majority of the UAE (including the free zones) are subject to the UAE Federal Law No. 8 of 1980, as amended (the UAE Labour Law), with the exception of the Dubai International Financial Centre (the DIFC) and Abu Dhabi Global Marketplace (the ADGM) free zones which are subject to the DIFC Law No.4 of 2005 (as amended) (the DIFC Employment Law) and the ADGM Employment Regulations 2015 (as applicable).

The UAE Labour Law does not contain any specific provisions regulating clawback. However, where an employer seeks to recover sums paid to an employee (under a contractual clawback mechanism), the UAE Labour Law restricts the circumstances in which employers can lawfully make deductions from an employee’s salary or severance payments. These restrictions operate to limit the enforceability of clawback in practice.

The UAE Labour Law does offer an unrestricted right for the employer to deduct from an employee’s statutory end-of-service gratuity payment any amounts owed by the employee to the employer, offering a legitimate (albeit limited) means of clawback. In practice, the benefits of this will largely depend on whether the employee is eligible for the gratuity in the first place (as it is a service-linked benefit) and if so, whether the gratuity pot is sufficient to claw back in full the amounts owing to the employer. A clawback arrangement which demands repayment of the award amount rather than making a deduction is unlikely to be commercially attractive - it would need to be enforced through the civil courts and parties in the UAE bear their own litigation costs irrespective of outcome – in practice, the cost of bringing the claim would usually quickly outstrip its value.

The DIFC Employment Law and ADGM Employment Regulations also do not contain any provisions regulating clawback. However, both regimes broadly mirror the laws of England and Wales (and its litigation costs approach) and therefore clawback arrangements should be permitted provided they are properly documented. In order for a clawback provision to be lawful under the DIFC Employment Law and ADGM Employment Regulations, the individual must have consented to the clawback either in their contract of employment or by giving prior written consent in some other form. It is therefore advisable to obtain the employee’s consent in writing to the clawback arrangements at the time they are put in place. Additionally, the clawback provision must be carefully drafted to ensure that it does not engage the penalty doctrine and therefore be considered unenforceable. Clawback provisions are also subject to general common law principle of reasonableness.

Is the award paid back gross or net of tax?

In the UAE, DIFC and ADGM, there is no personal income tax levied and so any amounts clawed back would be gross.
Basic principles

Clawback is not yet mandated under Australian law or regulation but is increasingly being adopted in Australia as a matter of corporate governance.

Institutions regulated by the Australian Prudential Regulation Authority must have a remuneration policy that enables the employer to adjust performance-based remuneration downwards, potentially to zero, in relation to specified persons if it is necessary:

- to protect the financial soundness of the institution; or
- to respond to significant, unexpected or unintended consequences that were not foreseen by the employer.

Draft legislation has also been proposed that would apply deferral to variable remuneration paid to bank executives, with such remuneration being subject to reduction, potentially to zero, if the executive breaches their statutory accountability obligations.

Even where carefully drafted clawback provisions are included in relevant plans, it can be difficult to enforce them in Australia because:

- any deduction from remuneration will breach section 324 of the Fair Work Act 2009 unless (i) it is authorised in writing by the employee and principally for the employee’s benefit and (ii) the authorisation specifies the amount of the deduction (unlikely for future clawbacks);
- a clawback arrangement may be rendered invalid by section 326 of the Fair Work Act — this provides that a term of an employment contract will have no effect if it requires an employee to pay an amount to an employer and the requirement is unreasonable in the circumstances;
- a clawback provision could be challenged as being an unenforceable penalty or, if it is triggered by a breach of a post-termination restriction, as being an unenforceable restraint of trade.

As a result, Australian employers usually try to retain control over performance-based payments through the use of deferral and malus.

Is the award paid back gross or net of tax?

Income tax

If the award is cash-based:

- the employee will have to repay the gross amount if the clawback is enforced in a tax year after the year of grant - the employee may be able to claim tax relief; and
- the employee will only need to repay the net amount if the clawback is enforced in the year of grant.

For share-based awards, the employee would return the gross number of shares/options.

Social security

There is no employer social security payable on share-based awards. If an award is cash-based, it is unlikely that employer social security ('superannuation guarantee contributions') paid into a complying fund could be recovered by the employer following any clawback.
Basic principles

In China, clawback arrangements are only found in the financial services sector.

Financial institutions which are regulated by the China Banking Regulatory Commission must establish policies which give the institution the power (but not the obligation) in certain limited circumstances to claw back performance-based incentive awards from its senior executives and staff who have a material impact on its risk profile. This requirement is set out in the Supervisory Guidelines on Sound Compensation in Commercial Banks and provides for a minimum deferral and clawback period of three years. The Guidelines are not legally binding, however, and it remains to be seen whether the courts would enforce a clawback arrangement.

Is the award paid back gross or net of tax?

According to the Guidelines, when a commercial bank’s senior executives and staff cause any unusual risk exposure, the bank is entitled to claw back the total amount of the relevant performance-based incentive awards it has paid out. Our understanding is that ‘total amount’ here includes all the taxes and social security contributions withheld/paid by the bank. However, in practice, it is unclear how and from whom (the employee or the authorities) the bank should collect the overpaid taxes and social security contributions — we are not aware of any case or precedent on this point.
Basic principles

There is no legislation on clawback in Hong Kong, but guidelines have been introduced by the Hong Kong Monetary Authority (the HKMA), which governs financial institutions, that feature clawback and forfeiture.

When trying to enforce clawback on the basis of these guidelines or otherwise, employers should take into account the following constraints.

Unlawful deductions under the Employment Ordinance

The Employment Ordinance prohibits employers from making deductions from employees’ wages except in specific circumstances. To the extent that the relevant incentive payments constitute ‘wages’ under the Employment Ordinance, there is a risk that malus/clawback could be viewed as an unlawful deduction of wages. That said, it is debatable whether a clawback is a ‘deduction’ of wages if the employer asks the employee to repay the payments made to them and the employer does not offset such payments against the employee’s wages.

Restrictive Covenants

If the trigger event for clawback is the breach of a restrictive covenant, then the clawback may be challenged if the employee claims that the restrictive covenant is unenforceable as being an unenforceable restraint of trade. The same approach will be taken to evaluating clawback provisions as is taken when looking at standard restrictive covenants in employment contracts, ie the court will consider factors such as whether the provision is necessary to protect the legitimate business interests of the employer and whether the provision is reasonable.

Penalty doctrine

The clawback provision must be carefully drafted to ensure that it does not engage the penalty doctrine. If it provides for repayment of a specified sum by the employee in the event of a breach of contract by the employee it is likely to be classified as unenforceable penalty. It is advisable for the clawback trigger to be the employee’s ‘positive’ misbehaviour rather than a failure by him to comply with his obligations.

Is the award paid gross or net?

It is likely to be a challenge to recover tax on an award which has already been paid out to an employee. Given this, any attempted clawback in practice would be made on a net basis. There is no concept of social security contributions in Hong Kong.
Basic principles

Clawback is not regulated in Japan nor is it commonly relied upon by employers in practice. Notwithstanding the absence of a clawback regime, as a legal matter, employers could contractually agree clawback provisions with directors (as opposed to employees), but Japanese companies still rarely make use of such arrangements because, as a general matter, directors are engaged on long term contracts and receive comparatively low remuneration. The number of companies introducing performance-based remuneration is increasing, however, so clawback may become more important in practice in Japan in the near future.

The situation is different for employees in that Japanese legislation prohibits any arrangement which predetermines either the sum payable to the employer for breach of contract or the amount of compensation payable by way of damages. While it has not been tested specifically in court, clawback arrangements could be considered as falling under this regime and therefore be prohibited for employees – there is a court decision that the obligation to return a sign-on bonus in certain circumstances is in breach of this legislation.

Is the award paid back gross or net of tax?

As clawback is not common in Japan, there is no established tax standard for clawbacks. Therefore, the tax approach in relation to clawbacks would need to be considered on a case by case basis.
Basic principles

There is no statutory or regulatory framework which governs the imposition or enforcement of clawback in Singapore.

However, the Monetary Authority of Singapore (the MAS) has issued guidelines to encourage the use of such provisions under certain circumstances. The Code of Corporate Governance in 2012 (CCG) encourages companies to consider the use of contractual clawback provisions in respect of executive directors and key management in exceptional circumstances where there has been a misstatement of financial results or misconduct resulting in a financial loss to the company. While the CCG is non-binding and only applies to companies listed on the Singapore Stock Exchange, it has been recognised as a best practice guide that should generally be adopted by public companies in Singapore. The MAS has also published guidelines specifically encouraging financial holding companies, banks, insurers, reinsurers and captive insurers incorporated in Singapore to adopt clawback arrangements in line with the CCG.

The right to claw back variable compensation is generally dependent on there being an express contractual agreement between employer and employee. If this is the case, the clawback provision should be enforceable unless:

- it is prohibited by statute (e.g. on grounds that the clawback constitutes an unauthorised deduction under the Employment Act — this could be the case if the clawback relates to a financial loss which is not directly attributable to the employee's neglect or default).
- the clawback provision is found to constitute a penalty clause in which case it will be unenforceable. Whether this is the case will depend on the way the provision is drafted and the circumstances giving rise to the clawback. The provision should be drafted as a clawback of a sum of money reflecting a genuine pre-estimate of loss, as opposed to being a disproportionate penalty for breach of the employment contract.
- it is against public policy — in the context of post-termination restrictive covenants a contractual provision which operates to restrain an employee from joining a competitor through the forfeiture of a vested award may be unenforceable on grounds of public policy for being an unreasonable restraint of trade.

Is the award paid back gross or net of tax?

There are currently no established Singapore tax standards specifically applicable to clawback — the approach would need to be considered on a case-by-case basis.
Contacts (1)

Austria
Karin Buzanich-Sommerger
Partner
T +43 699 18 910 125
E karin.sommeregger@freshfields.com

Belgium
Satya Staes Polet
Principal Associate
T +32 2 504 7594
E satya.staespolet@freshfields.com

China/Hong Kong
Laura Chapman
Counsel
T +852 2846 3496
E laura.chapman@freshfields.com

France
Gwen Senlanne
Partner
T +33 1 44 56 55 13
E gwen.senlanne@freshfields.com

Germany
Rene Döring
Partner
T +49 69 27 30 82 87
E rene.doering@freshfields.com

Germany
Boris Dzida
Partner
T +49 40 36 90 61 39
E boris.dzida@freshfields.com

Germany
Timon Grau
Partner
T +49 69 27 30 86 70
E timon.grau@freshfields.com

Germany
Klaus-Stefan Hohenstatt
Partner
T +49 40 36 90 61 08
E ks.hohenstatt@freshfields.com

Germany
Elmar Schnitker
Partner
T +49 211 49 79 222
E elmar.schnitker@freshfields.com

Germany
Thomas Müller-Bonanni
Partner
T +49 211 49 79 164
E thomas.mueller-bonanni@freshfields.com
Contacts (2)

Italy
- Luca Capone
  Partner
  T +39 02 625 30401
  E luca.capone
  @freshfields.com

The Netherlands
- Brechje Nollen
  Partner
  T +31 20 485 7626
  E brechje.nollen
  @freshfields.com

Russia
- Olga Chislova
  Counsel
  T +7 495 785 3032
  E olga.chislova
  @freshfields.com

Spain
- Raquel Flórez
  Partner
  T +34 91 700 3722
  E raquel.florez
  @freshfields.com

UK
- Kathleen Healy
  Partner
  T +44 20 7832 7689
  E kathleen.healy
  @freshfields.com

- Nicholas Squire
  Partner
  T +44 20 7832 7419
  E nicholas.squire
  @freshfields.com

- Caroline Stroud
  Partner
  T +44 20 7832 7602
  E caroline.stroud
  @freshfields.com

UK
- Howard Klein
  Partner
  T +1 212 277 4047
  E howard.klein
  @freshfields.com

- Jean-Francois Gerard
  Global Practice Development
  T +32 2 504 7697
  E jean-francois.gerard
  @freshfields.com

UK/Belgium
- Alice Greenwell
  Partner
  T +44 20 7716 4729
  E alice.greenwell
  @freshfields.com

Clawback: A global guide
Contacts (3)

Australia
Gordon Williams
MinterEllison
Partner
T +61 2 9921 4479
E gordon.williams@minterellison.com

Brazil
Rafael Bispo de Filippis
Mattos Filho, Veiga Filho, Marrey Jr. e Quiroga Advogados
Senior Associate
T +55 21 3231 8232
E rafael.filippis@mattosfilho.com.br

Ireland
Michael Doyle
A&L Goodbody
Senior Associate
T +353 1 649 2729
E mvdoyle@algoodbody.com

Japan
Akiko Yamakawa
Vanguard Lawyers Tokyo
T +813 6868 0413
E akiko.yamakawa@vl-tokyo.co.jp

Luxembourg
Philippe Schmitt
Arendt & Medernach
Partner
T +352 40 78 78 240
E philippe.schmitt@arendt.com

Mexico
Francisco Peniche Beguerisse
Cree principal
Partner
T +52 (55) 4748-0670
E francisco.peniche@creel.mx

Singapore
Ian Lim
TSMP Law Corporation
Partner
T +65 6216 9473
E ian.lim@tsmp.com.sg

Switzerland
Balz Gross
Homburger
Partner
T +41 43 222 15 00
E balz.gross@homburger.ch

UAE
Samir Kantaria
Al Tamimi & Company
Partner
T +971 (0)4 364 1641
E s.kantaria@tamimi.com