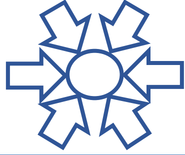

Financial Services Management

Failed-Bank Compensation, Resolution

Cite

S. 2190, Recovering Executive Compensation from Unaccountable Practices (RECOUP) Act of 2023

Recommended Distribution

Human Capital, Policy, Legal, Government Relations

Website

https://www.congress.gov/118/bills/s2190/BILLS-118s2190rs.pdf

Impact Assessment

- Incentive compensation for most senior officers of larger failed IDIs, parent companies could be clawed back either by the company or FDIC, with these officers also exposed to greater federal civil money penalties and re-employment prohibitions.
- GSIB acquisition of failed IDIs would be less likely.
- Senior officers at IDIs/ parent companies with less than $10 billion would be subject to less stringent penalties. This might protect very large nonbank parents.
- IDIs and parent companies would need to have internal governance standards mandating claw-backs.

Overview

The Senate Banking Committee has overwhelmingly approved bipartisan legislation to reform executive compensation following larger insured-depository institution (IDI) failures, with parent-company executive compensation also at risk in some circumstances. Unlike previous bipartisan claw-back legislation,[1] this measure is targeted to incentive compensation, not salary, expressly exempts "white knights," institution-affiliated persons and directors, and gives the FDIC discretion also to allow senior officers to retain affected compensation in certain other circumstances. Also unlike the prior bill, this measure would make it more difficult for the FDIC to resolve a failing IDI as it did for First Republic via an assisted acquisition by JPMorgan despite the overall prohibition on any U.S. institution holding more than ten percent of national deposits.[2] The Senate bill also mandates that IDIs and parent companies adopt governance standards that give the firm power to claw back compensation in the event of weak condition or poor management practice.

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[1] See **COMPENSATION36**, *Financial Services Management*, June 6, 2023.

[2] See **FHC19**, *Financial Services Management*, February 21, 2012.

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Impact

By virtue of its revisions, this bill now does not allow the FDIC to claw back compensation when it believes an IDI is trouble, limiting risk to employees of struggling banking organizations or the use of claw-backs as an enforcement tool ahead of a finding that an IDI is in danger of failing or it actually fails. The bill's other limitations also more directly target senior management with the most direct responsibility for safety and soundness and are thus unlikely to inhibit the ability of troubled banks to find new management or major shareholders interested in trying to rescue the IDI.

The new bill also allows both firms and federal regulators to reach parent companies, defining them in a way that reaches all such parents, not just BHCs or S&LHCs. As a result, nonbank parent companies of ILCs would be governed by these incentive-compensation enforcement actions if their assets are below $10 billion. Although it is clear that this exemption puts ILCs on par with smaller banks for purposes of this measure, parent companies could actually be surprisingly large if they are not balance-sheet oriented entities (i.e., if, as is often the case, they are fintech entities, payment companies, or loan securitizers).

The new bill also mandates that covered IDIs and parent companies adopt new governance standards designed to codify firm practice and incentives with safety and soundness. Among these are incentive-compensation claw-backs that could put executive or other insider compensation at greater risk of internal discipline that might prove particularly important given continuing challenges finalizing and then implementing the Dodd-Frank incentive-compensation restrictions mandated in 2010.[3]

As noted, the bill now gives large regional banks a better chance at bidding on failed IDIs even if a GSIB is interested in working with the FDIC. This is done in part by limiting the application of the least-cost test in such cases, a provision that might increase resolution costs subject to recapture via new special assessments in return for less consolidated, powerful competition.

What's Next

This bill was reported 21-2 by the Senate Banking Committee on June 21 and subsequently introduced by Chairman Brown (D-OH) in reported form to facilitate speedy action on the Senate floor. No companion bill sponsored by both parties has yet been proposed in the House, although HFSC Chairman McHenry (R-NC) has suggested he is open to legislation in this area and Ranking Member Waters (D-CA) strongly supports the Senate bill even though she would prefer it go farther in several areas.

[3] See **COMPENSATION30**, *Financial Services Management*, July 28, 2010.

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Analysis

A. Compensation

The FDIC has power and, as noted below, the bill would mandate new governance standards for IDIs and parent companies expressly authorizing the IDI or holding company and/or the FDIC to claw back many forms of compensation (but not salary) from senior officers deemed responsible for failure received during the two years preceding it. Profits from securities sales related to the IDI or parent company could also be retrieved. An exemption is provided for senior officers employed eighteen months prior to failure whose behavior did not contribute to the failure. All executives at IDIs or holding companies with less than $10 billion in assets are exempted.

B. Enforcement

The bill also strengthens the FDIC's ability to bar senior officers at failed banks or their parent BHCs from future banking employment and increases civil money penalties that may be imposed.

C. Additional Provisions

These would:

- require IDIs and their parent companies to establish governance and accountability standards in their bylaws promoting safety and soundness, supervisory responsiveness, and "responsible management." The bill includes specific content standards, including that the bank or parent company may claw back executive compensation and the FDIC may do the same (see above);
- bar sale of failed IDIs to the largest banking organizations if there are other qualifying pending bids to do so that meet either the least-cost test or avoid the systemic effects that would otherwise allow a waiver of the current prohibition on IDIs controlling more than ten percent of U.S. deposits. Similar restrictions would apply to FRB approval of an acquisition for the parent BHC;
- mandate a report from the appropriate federal regulator(s) assessing their supervision of a failed IDI within 180 days absent extenuating stress conditions. The Fed would also need to file a semiannual report to Congress on its supervision and regulation, current banking conditions, and internal changes made to the supervisory or regulatory "culture" in areas such as internal communications, relations with other federal and state regulators, an enhance public-input process, and the responsiveness of supervised institutions. Metrics for numerous criteria would also need to be developed and disclosed;
- mandate IG reports to Congress of regulators of failed IDIs and holding companies with more than $10 billion in assets identifying acts or

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omissions contributing to the failure as well as the failure's causes. These reports are generally due 180 days after a failure and are to be followed in thirty days with Congressional testimony; and

- enact a sense of Congress resolution that the U.S. banking system is strong and resilient, bank management should be good, and bank regulators should be diligent. The resolution also states that the bill's prohibitions should not be used to penalize senior officers at healthy institutions that are appropriately managed. It is unclear what this last provision is meant to do as any regulator seeking to use the bill's penalties against senior officers at operating banks would otherwise need to find the entity either unhealthy and/or ill-managed.

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