



Incentive-Compensation Restrictions

Cite

OCC, FDIC, NCUA, FHFA: Notice of Proposed Rulemaking,
Incentive-Based Compensation

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Website

https://www.fdic.gov/sites/default/files/2024-05/2024-05-03-fed-reg-incentive-based-compensation-agreements_0.pdf

Impact Assessment

- Revised incentive-compensation rules could provide slightly more latitude than initially proposed, particularly for smaller financial institutions.
- Many provisions deemed problematic could remain or become more stringent, especially for larger banks.
- Near-term final action is unlikely unless individual agencies issue guidance within the parameters of applicable law.

Overview

The OCC, FDIC, FHFA, and NCUA have revived what was in 2016 a proposal issued also by the FRB and SEC to revise incentive compensation at financial institutions in hopes of better alignment between compensation and safety and soundness. Rules or formal guidelines were required by the 2010 Dodd-Frank Act to take effect nine months after enactment,¹ but agreement has been hard to achieve as evidenced by a renewed proposal almost fourteen years after the law was passed to which key agencies have yet to consent even in proposed form. The new proposal reissues the 2016 inter-agency agreement for another round of public comment in concert with asking questions about a few specific alternatives and many aspects of the prior approach. The next step if agreement is reached is unclear unless the FRB and SEC join in the inter-agency process also mandated by the Dodd-Frank Act although each of the agencies that reach agreement could issue freestanding guidelines or perhaps even a formal rule binding the entities over which they have jurisdiction, a process the FDIC in fact initiated in 2011.²

¹ See **COMPENSATION30**, *Financial Services Management*, July 28, 2010.

² See **COMPENSATION33**, *Financial Services Management*, March 2, 2011.

Impact

This third try at an incentive-compensation rule notes at its outset that supervisory experience since 2016 warrants both reevaluation of the earlier proposal and a new final rule even though this latest release in fact re-proposes that approach. The plan appears to be to seek comment on questions asked in the preamble (see below) so that a basis under applicable administrative procedure is laid for substantive change to the 2016 proposal in a final rule. Should the agencies reach a consensus about what this final rule should look like, the new, limited approach could propel a new final rule without additional proposals.

However, this will be challenging. Chair Powell has questioned the need for any sort of compensation restraints despite his vote in favor of the 2016 proposal.

One of the most controversial issues highlighted in comments on the 2016 proposal was the need for a binding rule rather than guidelines. The Dodd-Frank Act calls for a rule or guidelines, but the guidelines are in other places required to be issued as a rule. Despite Mr. Powell's concerns, Congress clearly calls for some form of action and it is thus possible that a final compromise might involve the more principles-based guidelines favored by FDIC Vice Chair Hill when he voted against the FDIC's proposal. Doing so would, however, require a new proposal as moving forward with so different an approach likely could not be done following only this new proposal even if the FRB and SEC concurred.

Although the thrust of the new proposal is to retain the old one, the questions on which comment is sought encompass all aspects of the earlier proposal. Several suggest substantive changes in areas such as additional covered persons, new data and reporting requirements, and alternative approaches to the compensation considered to be incentive-based and the extent to which such compensation could be recaptured or forfeited. The questions also raise new ideas such as more exemptions for smaller banking organizations and new definitions of covered individuals at larger firms. However, it does not appear that the agencies are open to revising one of the most controversial aspects of the 2016 proposal, which set limits on what could be considered "excessive" or "unreasonable" compensation and that provided after employment rather than targeting its provisions only to incentive-based compensation as industry comment argued was the extent to which Congress authorized regulatory intervention in compensation decisions.

What's Next

These agencies released the NPR on May 6, with the SEC then saying only that it had the matter on its regulatory agenda. The SEC may or may not come to agree with this approach, but it must conduct an economic analysis of the proposal not required by the other agencies to do so. If it has not yet begun this analysis, it will take considerable time before the joint proposal necessary for *Federal Register* publication could be released and, even then, this could only occur if the FRB comes to agree to do so.

Until publication, the OCC, FDIC, FHFA, and NCUA invite comment directly to each agency; after publication, should it come, comments would be due in sixty

days. Even if more falls into line, finalization seems most unlikely in 2024 and subsequent action will depend on this year's election outcome.

Analysis

This analysis does not include an in-depth assessment of the 2016 proposal as reiterated in this release. However, perhaps in anticipation of a final rule, the new proposal includes a detailed analysis of comments received on the 2016 proposal, noting for example strong opposition to the definitions of covered persons repeated here, especially when it came to the definition of a "significant risk-taker" who might come under the rule's restrictions even if not otherwise a senior officer or highly-compensated person or one with the ability to affect a defined percentage of a bank's risk exposure. The definition of incentive-based compensation and proposed restrictions were also highly controversial.

In addition to new comments on the 2016 proposal, views are now also expressly solicited on:

- the compliance schedule;
- the scope of consolidation and how it affects BHC risk management, implications for small subsidiaries of large BHCs, and the potential for evasion;
- targeting along with how best to bring federal branches and agencies into this construct;
- the scope of covered individuals and the definition of key positions or characteristics. The new approach contemplates adding positions not in the 2016 NPR such as chief technology or information-security officers;
- how to define the level of compensation that is covered as incentive-based, with views also sought on how best to define compensation for "significant risk-takers;"
- whether the definition of "deferral" comports with current practice;
- how best to define claw-back, forfeiture, and other compensation penalties and the events that warrant them. Comment is also sought on whether claw-backs should be allowed and the minimum deferral period and related requirements, with particular focus on the impact of this period on the ability of covered institutions to attract quality recruits;
- performance measures and periods;
- record-keeping and -retention requirements and if these should be heightened for larger institutions;
- tax, accounting, or state-law considerations, with comment also sought on compensation covering future taxation on unrealized income;
- when payment acceleration should be allowed;
- whether compensation structures (e.g., debt or equity) influence behavior and, if alternatives are allowed, how they should be structured and if options should be allowed;
- whether incentive-compensation decisions should be made by a formal review committee and, if so, if it should include control personnel;
- the need to cover all incentive compensation;

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- the need for express incentive-based compensation limits at the largest firms for senior executive officers and risk-takers;
 - circumstances in which only revenue or volume goals are appropriate for incentives;
 - how best to craft governance and reporting requirements; and
 - how best to set the implementation and compliance deadlines.