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Banking Agencies Issue Final Guidance on Executive Compensation

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On June 21, the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, and the Federal Deposit Insurance Corporation (collectively, the Banking Agencies) issued final guidance regarding incentive compensation arrangements at financial organizations that are intended to be consistent with safe and sound practices (Guidance). The Guidance applies to all the banking organizations supervised by the Banking Agencies, including national banks; state member banks; state nonmember banks; savings associations; U.S. bank holding companies; savings and loan holding companies; the U.S. operations of foreign banks with a branch, agency or commercial lending company in the United States; and Edge and agreement corporations (each, a Covered Institution). With regard to scope within each Covered Institution, the Guidance applies to senior executives as well as employees who, either individually or as part of a group, have the ability to expose the banking organization to material amounts of risk.

The Guidance is the result of the Federal Reserve's analysis of incentive compensation practices at large, complex banking organizations. In conducting this review, the Federal Reserve noted the following deficient areas: (1) many firms need better ways to identify employees that expose banking organizations to material risk; (2) many firms are not fully capturing the risks involved in incentive compensation; (3) many firms are using deferral arrangements to adjust for risk, but are not tailoring such deferrals according to the type and duration of the risk; and (4) many firms do not have adequate mechanisms to evaluate whether established practices are successful in balancing risk.

Three key principles are identified in the Guidance: (1) incentive compensation arrangements at a banking organization should provide employees incentives that appropriately balance risk and financial results in a manner that does not encourage employees to expose their organizations to imprudent risk; (2) these arrangements should be compatible with effective controls and risk management; and (3) these arrangements should be supported by strong corporate governance, including active and effective oversight by the organization's board of directors.

The Guidance also states that the Federal Reserve will prepare a report in consultation with the other Banking Agencies at the conclusion of 2010 on trends and developments in compensation practices at banking organizations.

For more information, click here.

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