DEPARTMENT OF THE TREASURY
Office of the Comptroller of the Currency
12 CFR Part 42
Docket No. OCC-2011-0001
RIN 1557-AD39

FEDERAL RESERVE SYSTEM
12 CFR Part 236
Docket No. 2011 -____
RIN _______

FEDERAL DEPOSIT INSURANCE CORPORATION
12 CFR Part 372
Docket No. 2011 -____
RIN 3064 – AD56

DEPARTMENT OF THE TREASURY
Office of Thrift Supervision
12 CFR Part 563h
Docket No. OTS-2011-0037
RIN 1550-AC49

NATIONAL CREDIT UNION ADMINISTRATION
12 CFR Parts 741 and 751
RIN 3133-AD88

U.S. SECURITIES AND EXCHANGE COMMISSION
17 CFR Part ____
Docket No. 2011 -_____
RIN _________

FEDERAL HOUSING FINANCE AGENCY
12 CFR Part 1232
Docket No. 2011 -_____
RIN 2590 – AA42

Incentive-Based Compensation Arrangements

AGENCIES: Office of the Comptroller of the Currency, Treasury (OCC); Board of Governors of the Federal Reserve System (Board); Federal Deposit Insurance Corporation (FDIC); Office of Thrift Supervision, Treasury (OTS); National Credit Union Administration (NCUA); U.S. Securities and Exchange Commission (SEC); and Federal Housing Finance Agency (FHFA).

ACTION: Proposed Rule.

SUMMARY: The OCC, Board, FDIC, OTS, NCUA, SEC, and FHFA (the Agencies) are proposing rules to implement section 956 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The proposed rule would require the reporting of incentive-based compensation arrangements by a covered financial institution and prohibit incentive-based compensation arrangements at a covered financial institution that provide excessive compensation or that could expose the institution to inappropriate risks that could lead to a material financial loss.

DATES: Comments must be received by [INSERT DATE 45 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

ADDRESSES: Although the Agencies will jointly review all the comments submitted, it would facilitate review of the comments if interested parties send comments to the Agency that is the appropriate Federal regulator, as defined in section 956(e) of the Dodd-Frank Act for the type of covered financial institution addressed in the comments. Commenters are encouraged to use the title "Incentive-Based Compensation Arrangements" to facilitate the organization and distribution of comments among the Agencies. Interested parties are invited to submit written comments to:

Office of the Comptroller of the Currency: Because paper mail in the Washington, DC area and at the OCC is subject to delay, commenters are encouraged to submit comments by the Federal eRulemaking Portal or e-mail, if possible. Please use the title "Incentive-based Compensation Arrangements" to facilitate the organization and distribution of the comments. You may submit comments by any of the following methods:

- **Federal eRulemaking Portal – "Regulations.gov":** Go to http://www.regulations.gov. Select "Document Type" of "Proposed Rule," and in "Enter Keyword or ID Box," enter Docket ID "OCC-2011-0001," and click "Search." On "View By Relevance" tab at bottom of screen, in the "Agency" column, locate the proposed rule for OCC, in the "Action" column, click on "Submit a Comment" or "Open Docket Folder" to submit or view public comments and to view supporting and related materials for this Proposed Rule.
- **E-mail:** regs.comments@occ.treas.gov.
- **Mail:** Office of the Comptroller of the Currency, 250 E Street, SW., Mail Stop 2-3, Washington, DC 20219.
- **Fax:** (202) 874-5274.
- **Hand Delivery/Courier:** 250 E Street, SW., Mail Stop 2-3, Washington, DC 20219.

Instructions: You must include "OCC" as the agency name and "Docket Number OCC-2011-0001" in your comment. In general, OCC will enter all comments received into the docket and publish them on the Regulations.gov Web site without change, including any business or personal information that you provide such as name and address information, e-mail addresses, or phone numbers. Comments received, including attachments and other supporting materials, are part of the public record and subject to public disclosure. Do not enclose any information in your comment or supporting materials that you consider confidential or inappropriate for public disclosure.

You may review comments and other related materials that pertain to this Proposed Rule by any of the following methods:

- **Viewing Comments Electronically:** Go to http://www.regulations.gov. Select "Document Type" of "Public Submission," in "Enter Keyword or ID Box," enter Docker ID "OCC-2011-0001," and click "Search." Comments will be listed under "View By Relevance" tab at the bottom of the screen. If comments from more than one agency are listed, the "Agency" column will indicate which comments were received by the OCC.

- **Viewing Comments Personally:** You may personally inspect and photocopy comments at the OCC, 250 E Street, SW., Washington, DC. For security reasons, the OCC requires that visitors make an appointment to inspect comments. You may do so by calling (202) 874-4700. Upon arrival, visitors will be required to present valid government-issued photo identification and submit to security screening in order to inspect and photocopy comments.

- **Docket:** You may also view or request available background documents and project summaries using the methods described above.

Board of Governors of the Federal Reserve System:

You may submit comments, identified by Docket No. R- ____, by any of the following methods:

- Agency Web Site: http://www.federalreserve.gov. Follow the instructions for submitting comments at http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm.
- Federal eRulemaking Portal: http://www.regulations.gov. Follow the instructions for submitting comments.
- E-mail: regs.comments@federalreserve.gov. Include the docket number in the subject line of the message.
- Fax: (202) 452-3819 or (202) 452-3102.
- Mail: Address to Jennifer J. Johnson, Secretary, Board of Governors of the Federal

Reserve System, 20th Street and Constitution Avenue, NW., Washington, DC 20551.

All public comments will be made available on the Board's web site at http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm as submitted, unless modified for technical reasons. Accordingly, comments will not be edited to remove any identifying or contact information. Public comments may also be viewed electronically or in paper in Room MP-500 of the Board's Martin Building (20th and C Streets, N.W.) between 9:00 a.m. and 5:00 p.m. on weekdays.

Federal Deposit Insurance Corporation: You may submit comments, identified by RIN number, by any of the following methods:

- Agency Web Site: http://www.FDIC.gov/regulations/laws/federal/notices.html. Follow instructions for submitting comments on the Agency Web Site.
- E-mail**:** Comments@FDIC.gov. Include the RIN number on the subject line of the message.
- Mail**:** Robert E. Feldman, Executive Secretary, Attention: Comments, Federal Deposit Insurance Corporation, 550 17th Street, NW., Washington, DC 20429.
- Hand Delivery**:** Comments may be hand delivered to the guard station at the rear of the 550 17th Street Building (located on F Street) on business days between 7:00 a.m. and 5:00 p.m.

Instructions: All comments received must include the agency name and RIN for this rulemaking and will be posted without change to http://www.fdic.gov/regulations/laws/federal/propose.html, including any personal information provided.

Office of Thrift Supervision: You may submit comments, identified by OTS–2011–0037, by any of the following methods:

- Federal eRulemaking Portal – Regulations.gov: Go to http://www.regulations.gov and follow the directions.
- E-mail: regs.comments@ots.treas.gov. Please include OTS–2011–0037 in the subject line of the message and include your name and telephone number in the message.
- Mail: Regulation Comments, Chief Counsel's Office, Office of Thrift Supervision, 1700 G Street, NW., Washington, DC 20552, Attention: OTS–2011–0037.
- Facsimile: (202) 906–6518.
- Hand Delivery/Courier: Guard's Desk, East Lobby Entrance, 1700 G Street, NW., from 9 a.m. to 4 p.m. on business days, Attention: Regulation Comments, Chief Counsel's Office, Attention: OTS–2011–0037.
- Instructions: All submissions received must include the agency name and docket number for this rulemaking. All comments received will be entered into the docket and posted on Regulations.gov without change, including any personal information provided. Comments, including attachments and other supporting materials received, are part of the public record and subject to public disclosure. Do not enclose any information in your comment or supporting materials that you consider confidential or inappropriate for public disclosure.
- Viewing Comments On-Site: You may inspect comments at the Public Reading Room, 1700 G Street, NW., by appointment. To make an appointment for access, call (202) 906–5922, send an e-mail to public.info@ots.treas.gov, or send a facsimile transmission to (202) 906–6518. (Prior notice identifying the materials you will be requesting will assist us in serving you.) We schedule appointments on business days between 10:00 a.m.

and 4:00 p.m. In most cases, appointments will be available the next business day following the date we receive a request.

National Credit Union Administration: You may submit comments by any of the following methods (please send comments by one method only): Federal eRulemaking Portal: http://www.regulations.gov. Follow the instructions for submitting comments.

- NCUA Web site: http://www.ncua.gov/Resources/RegulationsOpinionsLaws/ProposedRegulations.aspx. Follow the instructions for submitting comments.
- E-mail: Address to regcomments@ncua.gov. Include ''[Your name] Comments on ''Notice of Proposed Rulemaking for Incentive-Based Compensation Arrangements'' in the e-mail subject line.
- Fax: (703) 518–6319. Use the subject line described above for e-mail.
- Mail: Address to Mary Rupp, Secretary of the Board, National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314–3428.
- Hand Delivery/Courier: Same as mail address.
- Public Inspection: All public comments are available on the agency's Web site at http://www.ncua.gov/Resources/RegulationsOpinionsLaws/ProposedRegulations.aspx as submitted, except when not possible for technical reasons. Public comments will not be edited to remove any identifying or contact information. Paper copies of comments may be inspected in NCUA's law library at 1775 Duke Street, Alexandria, Virginia 22314, by appointment weekdays between 9:00 a.m. and 3:00 p.m. To make an appointment, call (703) 518–6546 or send an e-mail to OGCMail@ncua.gov.

Securities and Exchange Commission: You may submit comments by the following method:

Electronic Comments

- Use the Commission's Internet comment form (http://www.sec.gov/rules/exorders.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-__-10 on the subject line; or
- Use the Federal eRulemaking Portal (http://www.regulations.gov). Follow the instructions for submitting comments.

Paper Comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100F Street, NE., Washington, DC 20549

Federal Housing Finance Agency: You may submit your written comments on the proposed rulemaking, identified by RIN number 2590-AA42, by any of the following methods:

- E-mail: Comments to Alfred M. Pollard, General Counsel, may be sent by e-mail at RegComments@fhfa.gov. Please include "RIN 2590-AA42" in the subject line of the message.
- Federal eRulemaking Portal: http://www.regulations.gov. Follow the instructions for submitting comments. If you submit your comment to the Federal eRulemaking Portal, please also send it by e-mail to FHFA at RegComments@fhfa.gov to ensure timely receipt by the Agency. Please include ''RIN 2590–AA42'' in the subject line of the message.
- U.S. Mail, United Parcel Service, Federal Express, or Other Mail Service: The mailing address for comments is: Alfred M. Pollard, General Counsel, Attention:

Comments/RIN 2590-AA42, Federal Housing Finance Agency, Fourth Floor, 1700 G Street, NW., Washington, DC 20552.

- Hand Delivery/Courier: The hand delivery address is: Alfred M. Pollard, General Counsel, Attention: Comments/RIN 2590-AA42, Federal Housing Finance Agency, Fourth Floor, 1700 G Street, NW., Washington, DC 20552. A hand-delivered package should be logged at the Guard Desk, First Floor, on business days between 9:00 a.m. and 5:00 p.m.

All comments received by the deadline will be posted for public inspection on FHFA website at http://www.fhfa.gov. Copies of all comments timely received will be available for public inspection and copying at the address above on government-business days between the hours of 10:00 a.m. and 3:00 p.m. To make an appointment to inspect comments please call the Office of General Counsel at (202) 414-6924.

FOR FURTHER INFORMATION CONTACT:

OCC: Michele Meyer, Assistant Director, and Patrick Tierney, Counsel, Legislative and Regulatory Activities, (202) 874-5090, and Karen Kwilosz, Director, Operational Risk Policy, (202) 874-5350, Office of the Comptroller of the Currency, 250 E Street SW., Washington, DC 20219.

BOARD: Michael Waldron, Counsel, (202) 452-2798, or Amanda Allexon, Counsel, (202) 452-3818, Legal Division; William F. Treacy, Advisor, (202) 452-3859, or Meg Donovan, Supervisory Financial Analyst, (202) 452-7542, Division of Banking Supervision and Regulation; Board of Governors of the Federal Reserve System, 20th and C Streets, NW., Washington , D.C. 20551.

FDIC: Steven D. Fritts, Associate Director, Risk Management Policy Branch, DSC, (202) 898-3723; Melinda West, Chief, Policy & Program Development, DSC, (202) 898-7221, George Parkerson, Senior Policy Analyst, DSC, (202) 898-3648; (202) 898-3618, Rose Kushmeider, Senior Financial Economist, DIR, (202) 898-3861; Daniel Lonergan, Counsel, Legal Division, (202) 898-6791, Rodney Ray, Counsel, Legal Division, (202) 898-3556, Federal Deposit Insurance Corporation, 550 17th Street, NW., Washington, DC 20429.

OTS: Mary Jo Johnson, Senior Project Manager, Examination Programs, (202) 906-5739, Richard Bennett, Senior Compliance Counsel, Regulations and Legislation Division, (202) 906–7409; Robyn Dennis, Director, Examination Programs, (202) 906-5751; James Caton, Managing Director, Economic and Industry Analysis, (202) 906-5680, Office of Thrift Supervision, 1700 G Street, NW., Washington, DC 20552.

NCUA: Regina Metz, Staff Attorney, Office of General Counsel, (703) 518-6561; or Vickie Apperson, Program Officer, Office of Examination & Insurance, (703) 518-6385, National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314.

SEC: Raymond A. Lombardo, Branch Chief, Division of Trading & Markets, (202) 551-5755; Timothy C. Fox, Special Counsel, Division of Trading & Markets, (202) 551-5687; Nadya B. Roytblat, Assistant Chief Counsel, Division of Investment Management, (202) 551-6823; or Jennifer R. Porter, Attorney-Advisor, Division of Investment Management, (202) 551-6787, United States Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549.

FHFA: Alfred M. Pollard, General Counsel, (202) 414-3788 or Patrick J. Lawler, Associate Director and Chief Economist (202) 414-3746, Federal Housing Finance Agency, Fourth Floor, 1700 G Street NW., Washington, DC 20552. The telephone number of the Telecommunications Device for the Deaf is (800) 877-8339.

SUPPLEMENTARY INFORMATION:

I. BACKGROUND

Dodd-Frank Act

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act" or the "Act") (Pub. L. No. 111-203, § 956, 124 Stat. 1376, 2011-2018 (2010)), which was signed into law on July 21, 2010, requires the Agencies to jointly prescribe regulations or guidelines with respect to incentive-based compensation practices at covered financial institutions. Specifically, section 956 of the Dodd-Frank Act (codified at 12 U.S.C. 5641) requires that the Agencies prohibit incentive-based payment arrangements, or any feature of any such arrangement, at a covered financial institution that the Agencies determine encourage inappropriate risks by a financial institution by providing excessive compensation or that could lead to a material financial loss. Under the Act, a covered financial institution also must disclose to its appropriate Federal regulator the structure of its incentive-based compensation arrangements sufficient to determine whether the structure provides "excessive compensation, fees, or benefits" or "could lead to material financial loss" to the institution. The Dodd-Frank Act does not require a covered financial institution to report the actual compensation of particular individuals as part of this requirement.

The Act defines "covered financial institution" to include any of the following types of institutions that have $1 billion or more in assets: (A) a depository institution or depository institution holding company, as such terms are defined in section 3 of the Federal Deposit Insurance Act ("FDIA")(12 U.S.C. 1813); (B) a broker-dealer registered under section 15 of the

Securities Exchange Act of 1934 (15 U.S.C. 78o); (C) a credit union, as described in section 19(b)(1)(A)(iv) of the Federal Reserve Act; (D) an investment adviser, as such term is defined in section 202(a)(11) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-2(a)(11)); (E) the Federal National Mortgage Association (Fannie Mae); (F) the Federal Home Loan Mortgage Corporation (Freddie Mac); and (G) any other financial institution that the appropriate Federal regulators, jointly, by rule, determine should be treated as a covered financial institution for these purposes.

The Act also requires the Agencies to ensure that any standards adopted with regard to excessive compensation under section 956 of the Act are comparable to the compensation-related safety and soundness standards applicable to insured depository institutions under section 39 of the FDIA (12 U.S.C. 1831p-1(c)),[1] and to take the compensation standards described in section 39 of the FDIA into consideration in establishing compensation standards under section 956 of the Act.

Compensation arrangements are critical tools in the successful management of financial institutions. These arrangements serve several important objectives, including attracting and retaining skilled staff, promoting better organizational and individual employee performance, and providing retirement security to employees.

At the same time, improperly structured compensation arrangements can provide executives and employees with incentives to take imprudent risks that are not consistent with the long-term health of the organization. The Agencies believe that flawed incentive compensation practices in the financial industry were one of many factors contributing to the financial crisis that began in 2007.

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[1] The Federal banking agencies each have adopted guidelines implementing the compensation-related and other safety and soundness standards in section 39 of the FDIA. See 12 CFR part 30, Appendix A (OCC); 12 CFR part 208, Appendix D-1 (Board); 12 CFR part 364, Appendix A (FDIC); 12 CFR part 570, Appendix A (OTS).

Shareholders and, for a credit union, members of a covered financial institution have an interest in aligning the interests of managers and other employees of the institution with its long-term health. Aligning the interests of shareholders or members and employees, however, is not always sufficient to protect the safety and soundness of an organization, deter excessive compensation, or disincent behavior that could lead to a material financial loss at the organization. Managers and employees of a covered financial institution may be willing to tolerate a degree of risk that is inconsistent with broader public policy goals. In addition, particularly at larger institutions, shareholders or members may have difficulty effectively monitoring and controlling the incentive-based compensation arrangements throughout the institution that may materially affect the institution's risk profile, even with increased disclosure provisions. As a result, supervision and regulation of incentive compensation, as with other aspects of financial oversight, can play an important role in helping ensure that incentive compensation practices at covered financial institutions do not threaten their safety and soundness, are not excessive, or do not lead to material financial loss.

II. OVERVIEW OF THE PROPOSED RULE

The Agencies have elected to propose rules, rather than guidelines, in order to establish general requirements applicable to the incentive-based compensation arrangements of all covered financial institutions ("Proposed Rule"). The Proposed Rule would supplement existing rules, guidance, and ongoing supervisory efforts of the Agencies.

The Proposed Rule has the following components:

- The Proposed Rule would prohibit incentive-based compensation arrangements at a covered financial institution that encourage executive officers, employees, directors, or principal shareholders ("covered persons") to expose the institution to inappropriate risks by providing the covered person excessive compensation. As described further below, consistent with the directive of section 956, the Agencies propose to use standards comparable to those developed under section 39 of the FDIA for purposes of determining whether incentive-based compensation is "excessive" in a particular case.

- The Proposed Rule would prohibit a covered financial institution from establishing or maintaining any incentive-based compensation arrangements for covered persons that encourage inappropriate risks by the covered financial institution that could lead to a material financial loss. The Agencies propose to adopt standards for determining whether an incentive-based compensation arrangement may encourage inappropriate risk-taking that are consistent with the key principles established for incentive compensation in the Interagency Guidance on Sound Incentive Compensation Policies ("Banking Agency Guidance") adopted by the Federal banking agencies.[2] The Proposed Rule would also require deferral of a portion of incentive-based compensation for executive officers of larger covered financial institutions. The Proposed Rule would also require that, at larger covered financial institutions, the board of directors or a committee of such board identify those covered persons (other than executive officers) that have the ability to expose the institution to possible losses that are substantial in relation to the institution's size, capital, or overall risk tolerance. The Proposed Rule would require that the board of directors, or a committee thereof, of the institution approve the incentive-based compensation arrangement

[2] Guidance on Sound Incentive Compensation Policies, 75 FR 36395 (Jun. 25, 2010), adopted by the Federal banking agencies, meaning the OCC, Board, FDIC, and OTS.

for such individuals, and maintain documentation of such approval. The term "larger covered financial institution" for the Federal banking agencies and the SEC means those covered financial institutions with total consolidated assets of $50 billion or more. For the NCUA, all credit unions with total consolidated assets of $1 billion or more are larger covered financial institutions. For the FHFA, all Federal Home Loan Banks with total consolidated assets of $1 billion or more are larger covered financial institutions.

- In connection with these restrictions, the Proposed Rule would require covered financial institutions to maintain policies and procedures appropriate to their size, complexity, and use of incentive-based compensation to help ensure compliance with these requirements and prohibitions.
- The Proposed Rule also would require covered financial institutions to provide certain information to their appropriate Federal regulator(s) concerning their incentive-based compensation arrangements for covered persons.

The Proposed Rule would supplement existing rules and guidance adopted by the Agencies regarding compensation and incentive-based compensation.[3] These include the Banking Agency Guidance, the Standards for Safety and Soundness adopted by the Federal banking agencies,[4] the compensation-related disclosure requirements adopted by the SEC for public companies,[5] the rules and guidance adopted by the FHFA for regulatory oversight of the executive compensation practices of its regulated entities[6] and the compensation rules adopted by

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[3] See, e.g., Banking Agency Guidance, supra note 2.
[4] 60 FR 35678 (July 10, 1995), as amended at 61 FR 43950 (Aug. 27, 1996).
[5] See, e.g., Item 402(s) of Regulation S-K, 17 CFR 229.402(s), adopted in Securities Act Release No. 9080, 74 FR 68334 (Dec. 23, 2009).
[6] 12 CFR 1770.1 (b) (1) requires the FHFA Director to prohibit the excessive compensation of executive officers. Section 1770.4 provides specific details as to the categories of information that are required to be submitted to the

the NCUA for institutions under its supervision.[7] Each Agency may issue supplemental guidance specific to their regulated entities, including guidance as necessary to clarify the regulatory requirements proposed in this rulemaking. Covered financial institutions supervised by the Federal banking agencies should continue to consult the Banking Agency Guidance for additional information on how to balance risk and financial rewards.

The Agencies propose to make the provisions of the Proposed Rule effective six months after publication of the final rule in the Federal Register, with annual reports due within 90 days of the end of each covered financial institution's fiscal year. The Agencies request specific comment on whether these dates will provide sufficient time for covered financial institutions to comply with the rule and, if not, why. Commenters are also asked to address whether the Agencies should designate different compliance dates for different types of covered financial institutions, or consider designating different compliance dates for different parts of the Proposed Rule (e.g., disclosure, prohibition, and policies and procedures).

A detailed description of the Proposed Rule with a request for comments is set forth below. Although this is a joint-interagency rulemaking, each Agency will codify its version of the rule in its specified portion of the Code of Federal Regulations in order to accommodate differences between regulated entities as well as other applicable statutory and regulatory

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FHFA pertaining to the prohibition of excessive compensation (Sept. 12, 2001). FHFA's examination guidance (PG-06-002), "Examination for Compensation Practices," sets forth the disclosure requirements pertaining to the compensation and benefits programs of Fannie Mae and Freddie Mac (together the Enterprises) (Nov. 8, 2006). In carrying out its corporate governance requirements, the FHFA is guided by the provisions set forth in 12 CFR 1710.13. FHFA's Advisory Bulletin (2009-AB-02), "Principles for Executive Compensation at the Federal Home Loan Banks and the Office of Finance," provides guidance to the Home Loan Banks on reporting requirements (Nov. 27, 2009). FHFA's proposed rule on executive compensation, 74 FR 26989 (Jun. 5, 2009), includes incentive compensation in its prohibition on excessive compensation. For the FHFA, the regulated entities are, collectively: the Enterprises, the Federal Home Loan Banks, and the Office of Finance.

[7] See, e.g., 12 U.S.C. 1761a; 12 CFR 701.2 & 12 CFR 701 App. A, Art. VII. §8; 12 CFR 701.21(c)(8)(i); 12 CFR 701.23(g) (1); 12 CFR 701.33; 12 CFR 702.203 & 702.204; 12 CFR 703.17; 12 CFR §704.19 & 704.20; 12 CFR Part 708a; 12 CFR 712.8; 12 CFR 721.7; 12 CFR part 750; and NCUA Examiners Guide Ch. 7 at http://www.ncua.gov/GenInfo/GuidesManuals/examiners_guide/chapters/Chapter07.pdf;

requirements. Any significant differences between the Proposed Rules issued by individual agencies are noted below.[8]

III. SECTION-BY-SECTION DESCRIPTION OF THE PROPOSED RULE

§___.1 Authority. Section ___.1 provides that this rule is issued pursuant to section 956 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (P.L. No. 111-203).

§___.2 Scope and Purpose. Section ___.2 provides that this rule applies to a covered financial institution that has total consolidated assets of $1 billion or more that offers incentive-based compensation arrangements to covered persons. This section also notes that this rule would in no way limit the authority of any Agency under other provisions of applicable law and regulations.

§___.3 Definitions. Section ___.3 defines the various terms used in the Proposed Rule. If a term is defined in section 956 of the Dodd-Frank Act, the Proposed Rule generally incorporates that definition.[9]

Compensation. The Proposed Rule defines "compensation" to mean all direct and indirect payments, fees or benefits, both cash and non-cash, awarded to, granted to, or earned by or for the benefit of, any covered person in exchange for services rendered to the covered financial institution, including, but not limited to, payments or benefits pursuant to an employment contract, compensation or benefit agreement, fee arrangement, perquisite, stock option plan, postemployment benefit, or other compensatory arrangement. For credit unions, the definition of compensation specifically excludes reimbursement for reasonable and proper costs incurred by covered persons in carrying out official credit union business; provision of reasonable health, accident and related types of personal insurance protection; and

[8] Since the Agencies' proposed rules use consistent section numbering, relevant sections are cited, for example, as "section ___.1."

[9] These definitions are proposed for purposes of administering Section 956, and are not intended to affect the interpretation or construction of the same or similar terms for purposes of any other statute or regulation administered by the Agencies.

indemnification. This is consistent with NCUA's regulations at 12 CFR 701.33. The Agencies seek comment on this proposed definition.

Covered Financial Institution. As noted above, only "covered financial institutions" that have total consolidated assets of $1 billion or more would be subject to the Proposed Rule. Under the Proposed Rule, a "covered financial institution" would include:

- In the case of the OCC, a national bank, Federal branch and agency of a foreign bank, and their subsidiaries that are not functionally regulated within the meaning of section 5(c)(5) of the Bank Holding Company Act of 1956 (12 U.S.C. 1844(c)(5)), as amended.
- In the case of the Board, a state member bank; a bank holding company; a state-licensed uninsured branch or agency of a foreign bank; and the U.S. operations of a foreign bank with more than $1 billion of U.S. assets] that is treated as a bank holding company pursuant to section 8(a) of the International Banking Act of 1978 (12 U.S.C. 3106(a)). A covered financial institution includes the subsidiaries of the institution.
- In the case of the FDIC, a state nonmember bank and an insured U.S. branch of a foreign bank.
- In the case of the OTS, a savings association as defined in 12 U.S.C. 1813(b), an operating subsidiary of a federal savings association as defined in 12 CFR 559.2, and a savings and loan holding company as defined in 12 U.S.C. 1467a(a). The Board, OCC, and FDIC will assume supervisory and rulemaking responsibility for these entities on the transfer date provided in Title III of the Dodd-Frank Act. These agencies expect to adopt, or incorporate, as appropriate, any final rule adopted by OTS as part of this rulemaking for relevant covered financial institutions that come under their respective supervisory authority after the transfer date.

- In the case of the NCUA, a credit union, as described in section 19(b)(1)(A)(iv) of the Federal Reserve Act, meaning an insured credit union as defined under 12 U.S.C. 1752(7) or credit union eligible to make application to become an insured credit union under 12 U.S.C. 1781. Instead of the term "covered financial institution", the NCUA uses the term "credit union" throughout its proposed rule.
- In the case of the SEC, a broker-dealer registered under section 15 of the Securities Exchange Act of 1934, 15 U.S.C. 78o; and an investment adviser, as such term is defined in section 202(a)(11) of the Investment Advisers Act of 1940, 15 U.S.C. 80b-2(a)(11).[10]
- In the case of the FHFA, the Fannie Mae, Freddie Mac, the Federal Home Loan Banks, and the Office of Finance as such term is defined in the Housing and Economic Recovery Act of 2008 (HERA), Public Law No.110-289,122 Stat 2654, Section 1002.

As indicated in the above listing, the Agencies propose to expand the definition of a covered financial institution beyond those specifically identified in section 956, as authorized by section 956(e)(2)(G) of the Dodd-Frank Act. Consistent with the principle of national treatment and equality of competitive opportunity, the Agencies propose to include as covered financial institutions the uninsured branches and agencies of a foreign bank, as well as the other U.S. operations of foreign banking organizations that are treated as bank holding companies pursuant to section 8(a) of the International Banking Act of 1978. These offices and operations currently are subject to the Banking Agency Guidance, and are subject to section 8 of the FDIA, which prohibits institutions from engaging in unsafe or unsound practices to the same extent as insured

[10] By its terms, the definition of "covered financial institution" in section 956 includes any firm that meets the definition of "investment adviser" under the Investment Advisers Act of 1940 ("Investment Advisers Act"), regardless of whether the firm is registered as an investment adviser under that Act. Banks and bank holding companies are generally excluded from the definition of "investment adviser" under section 202(a)(11) of the Investment Advisers Act.

depository institutions and bank holding companies.[11]

The Agencies also propose including the Federal Home Loan Banks because they pose similar risks and should be subject to the same regulatory regime. FHFA also proposes to subject the Office of Finance to the Proposed Rule, using authority other than section 956.[12]

Commenters are specifically asked to address whether there are there other types of financial institutions, such as a credit union service organization ("CUSO"), that the Agencies should treat as a covered financial institution to better promote the purpose of section 956 and competitive equity. Currently, no CUSOs wholly owned by a federally insured credit union have total consolidated assets of $1 billion or more.

Covered Person. Only incentive-based compensation paid to "covered persons" would be subject to the requirements of this Proposed Rule. A "covered person" would be any executive officer, employee, director, or principal shareholder of a covered financial institution. No specific categories of employees are excluded from the scope of the Proposed Rule, although it is the underlying purpose of this rulemaking to address those incentive-based compensation arrangements for covered persons or groups of covered persons that encourage inappropriate risk because they provide excessive compensation or pose a risk of material financial loss to a covered financial institution. Accordingly, as will be discussed later in this Supplementary Information, certain prohibitions in the Proposed Rule apply only to a subset of covered persons. As a result, the proposal contains separate definitions of director, executive officer, and principal

[11] See 12 U.S.C. 1813(c)(3) and 1818(b)(4).

[12] The Office of Finance is an agent of the Federal Home Loan Banks in issuing the hundreds of billions of dollars' worth of Federal Home Loan Bank System obligations that are outstanding at any time. It is not a financial institution, but because of its critical role in the mortgage finance system, it is proposed to be made subject to the provisions of the Proposed Rule that apply to financial institutions with assets of over $50 billion. Because it is not a financial institution and hence not within the scope of section 956, FHFA bases its authority over the Office of Finance for this purpose not on section 956 but on the Federal Housing Enterprises Financial Safety and Soundness Act, which in section 1311(b)(2) (12 U.S.C. § 4511(b)(2)) grants FHFA general regulatory authority over the Office of Finance.

shareholder. For federal credit unions, only one director, if any, may be considered a covered person since, under the Federal Credit Union Act section 112 (12 U.S.C. 1761a) and NCUA's regulations at 12 CFR 701.33, only one director may be compensated as an officer of the board.

Director and Board of Directors. The Proposed Rule defines "director" of a covered financial institution as a member of the board of directors of the covered financial institution, or of a board or committee performing a similar function to a board of directors. For NCUA's proposed rule, the director is always a member of the credit union's board of directors, so the definition is omitted. The Proposed Rule also defines "board of directors" as the governing body of any covered financial institution performing functions similar to a board of directors. For a foreign banking organization, "board of directors" refers to the relevant oversight body for the firm's U.S. branch, agency or operations, consistent with the foreign banking organization's overall corporate and management structure. The Agencies seek comment on these proposed definitions.

Executive Officer. As discussed in more detail later in this Supplementary Information, the Proposed Rule would apply certain restrictions on the incentive-based compensation of "executive officers" of larger covered financial institutions.[13] The Proposed Rule defines "executive officer" of a covered financial institution as a person who holds the title or performs the function (regardless of title, salary or compensation) of one or more of the following positions: president, chief executive officer, executive chairman, chief operating officer, chief financial officer, chief investment officer, chief lending officer, chief legal officer, chief risk

[13] As discussed previously, the term "larger covered financial institution" for the Federal banking agencies and the SEC means those covered financial institutions with total consolidated assets of $50 billion or more. For the NCUA, all credit unions with total consolidated assets of $1 billion or more are larger covered financial institutions. For the FHFA, all Federal Home Loan Banks with total consolidated assets of $1 billion or more are larger covered financial institutions.

officer, or head of a major business line.[14]

The Agencies seek comment on whether the types of positions identified in this proposed definition are appropriate, whether additional positions should be included, or if certain positions should be removed.

Incentive-based Compensation. Consistent with section 956 of the Dodd-Frank Act, the Proposed Rule would apply only to incentive-based compensation arrangements. The Proposed Rule defines "incentive-based compensation" to mean any variable compensation that serves as an incentive for performance. The definition is broad and principles-based to address the objectives of section 956 in a manner that provides for flexibility as forms of compensation evolve. The form of payment, whether it is cash, an equity award, or other property, does not affect whether compensation meets the definition of "incentive-based compensation."

There are types of compensation that would not fall within the scope of this definition. Generally, compensation that is awarded solely for, and the payment of which is solely tied to, continued employment (e.g., salary) would not be considered incentive-based compensation. Similarly, a compensation arrangement that provides rewards solely for activities or behaviors that do not involve risk-taking (for example, payments solely for achieving or maintaining a professional certification or higher level of educational achievement) would not be considered incentive-based compensation under the proposal. In addition, the Agencies do not envision that this definition would include compensation arrangements that are determined based solely on the

[14] For the FHFA, the Safety and Soundness Act of 1992, as reflected in 12 CFR 1770.3(g)(1), defines the term Executive Officer to mean, for Fannie Mae and Freddie Mac, the Chairman of the Board of Directors, chief executive officer, chief financial officer, chief operating officer, president, vice chairman, any executive vice president, and any individual who performs functions similar to such positions whether or not the individual has an official title; and any senior vice resident or other individual with similar responsibilities, without regard to title: (A) who is in charge of a principal business unit, division or function, or (B) who reports directly to the chairman of the board of directors, vice chairman, president or chief operating officer. The proposed Rule adopts a modified version of this definition for Fannie Mae and Freddie Mac, and a definition for the Federal Home Loan Banks that the FHFA has determined is appropriate for them.

employee's level of fixed compensation and do not vary based on one or more performance metrics (e.g., employer contributions to a 401(k) retirement savings plan computed based on a fixed percentage of an employee's salary). The proposed definition also would not include dividends paid and appreciation realized on stock or other equity instruments that are owned outright by a covered person. However, stock or other equity instruments awarded to a covered employee under a contract, arrangement, plan or benefit would not be considered owned outright while subject to any vesting or deferral arrangement (irrespective of whether such deferral is mandatory).

The Agencies request comment generally on this proposed definition. Comment is also requested on the following questions:

- Are there any particular forms of compensation that should be specifically designated as incentive-based compensation?
- Are there any other forms of compensation that the Agencies should clarify are not incentive-based compensation?

Principal Shareholder. Under the Proposed Rule, a "principal shareholder" means an individual that directly or indirectly, or acting through or in concert with one or more persons, owns, controls, or has the power to vote 10 percent or more of any class of voting securities of a covered financial institution.[15] For purposes of the Proposed Rule, shares owned or controlled by a member of an individual's immediate family are considered to be held by the individual. The NCUA's proposed rule does not include this definition since credit unions are not-for-profit financial cooperatives with member owners. The Agencies request comment on this proposed definition.

[15] The 10 percent threshold used in the definition of "principal shareholder" is also used in a number of bank regulatory contexts. See, e.g., 12 CFR 215.2(m), 12 CFR 225.2(n)(2), 12 CFR 225.41(c)(2).

Total Consolidated Assets. As provided in section 956, the Proposed Rule would apply to all covered financial institutions that have total consolidated assets of $1 billion or more. Additional requirements would apply to certain larger covered financial institutions. The Agencies have specified how total consolidated assets should be calculated in their agency specific rule text.

- OCC: For national banks, asset size would be determined by calculating the mean of the total assets reported in the institution's four most recent Consolidated Reports of Condition and Income ("Call Report"). [OCC insert re branches, agencies]
- Board: For a state member bank, total consolidated assets as determined based on the average of the bank's four most recent Consolidated Reports of Condition and Income ("Call Report"); for a bank holding company, total consolidated assets as determined based on the average of the company's four most recent Consolidated Financial Statements for Bank Holding Companies ("FR-Y-9C"); for a state-licensed uninsured branch or agency of a foreign bank, total consolidated assets as determined based on the average of the branch or agency's four most recent Call Reports; and for the U.S. operations of a foreign bank, total consolidated U.S. assets as determined by the Board.
- FDIC: For state nonmember banks, asset size would be determined by calculating the average of the total assets reported in the institution's four most recent Call Reports. For insured U.S. branches of foreign banks, asset size will be determined by calculating the average of the total assets reported in the branch's four most recent Reports of Assets and Liabilities of U.S. Branches and Agencies of Foreign Banks.
- OTS: For covered financial institutions regulated by the OTS, asset size will be determined by calculating the mean of total assets reported in the institution's four most

recent Thrift Financial Reports.

- NCUA: For credit unions, asset size will be determined by calculating the mean of the total assets reported in the credit union's four most recent 5300 Call Reports.
- SEC: For brokers or dealers registered with the SEC, asset size would be determined by the total consolidated assets reported in the firm's most recent year-end audited Consolidated Statement of Financial Condition filed pursuant to Rule 17a-5 under the Securities Exchange Act of 1934. For investment advisers, asset size would be determined by the adviser's total assets shown on the balance sheet for the adviser's most recent fiscal year end. The proposed method of calculation for investment advisers is consistent with the SEC's recent proposal that each investment adviser filing Form ADV Part 1A indicate whether the adviser had $1 billion or more in "assets," defined as the total assets shown on the balance sheet for the adviser's most recent fiscal year end.[16] In connection with that proposal, the SEC requested comment on the reporting requirement and the proposed method that advisers must use to determine the amount of their assets.
- FHFA: For covered financial institutions regulated by the FHFA, consolidated asset size will be determined from total assets reported in the institution's most recent annual report of financial condition.

The Agencies believe that by generally establishing a rolling average for asset size (with the exception of the SEC and the FHFA), the frequency that an institution may fall in or out of covered financial institution status would be minimized. If a covered financial institution does not have the number of reports specified above, total assets from all outstanding reports should be averaged for purposes of determining asset size. If a covered financial institution has a mix of

[16] See Rules Implementing Amendments to the Investment Advisers Act of 1940, Investment Advisors Release No. 3110, nn. 194-196 and related text (Nov. 19, 2010) [75 FR 77052 (Dec. 10, 2010)].

two or more different types of reports covering the relevant period, those should be averaged for purposes of determining asset size (e.g., an institution with two Call Reports and two Thrift Financial Reports as its four most recent reports would have its total assets from all four reports averaged).

Should all of the Agencies use a uniform method to determine whether an institution has $1 billion or more in assets? If so, what would commenters suggest as such a uniform method? If different calculations are required for each type of institution, should any of the Agencies define total consolidated assets differently than the proposed calculations described above?

§___ .4 Required Reports. Section 956(a)(1) of the Dodd-Frank Act requires that a covered financial institution submit an annual report to its appropriate Federal regulator disclosing the structure of its incentive-based compensation arrangements that is sufficient to determine whether the incentive-based compensation structure provides covered employees with excessive compensation, fees, or benefits, or could lead to material financial loss to the covered financial institution. In order to fulfill this requirement, the Proposed Rule would establish the general rule that a covered financial institution must submit a report annually to its appropriate regulator or supervisor in a format specified by its appropriate Federal regulator that describes the structure of the covered financial institution's incentive-based compensation arrangements for covered persons. The report must contain:

(1) A clear narrative description of the components of the covered financial institution's incentive-based compensation arrangements applicable to covered persons and specifying the types of covered persons to which they apply;

(2) A succinct description of the covered financial institution's policies and procedures governing its incentive-based compensation arrangements;

(3) For larger covered financial institutions, a succinct description of any specific incentive compensation policies and procedures for the institution's executive officers, and other covered persons who the board or a committee thereof determines under § __.5(b)(3)(ii) of the Proposed Rule individually have the ability to expose the institution to possible losses that are substantial in relation to the institution's size, capital, or overall risk tolerance;

(4) Any material changes to the covered financial institution's incentive-based compensation arrangements and policies and procedures made since the covered financial institution's last report was submitted; and

(5) The specific reasons the covered financial institution believes the structure of its incentive-based compensation plan does not provide covered persons incentives to engage in behavior that is likely to cause the covered financial institution to suffer a material financial loss, and does not provide covered persons with excessive compensation.

In developing the proposed reporting provisions, the Agencies have taken into account that substantially all the covered financial institutions are already supervised and/or subject to examination by one or more of the Agencies. Accordingly, in the Proposed Rule, the Agencies have tailored the annual reporting requirement to the types of information that would most efficiently assist the relevant Agency in determining whether there are any areas of potential concern with respect to the structure of the covered financial institution's incentive-based compensation arrangements. Generally, each Agency has reporting, examination and enforcement authority for substantially all of the covered financial institutions under its respective jurisdiction that the Agency may use if the information provided under section 956 were to indicate that the structure of a covered financial institution's incentive-based compensation arrangements may provide excessive compensation or encourage inappropriate risk-taking.[17] In this way, the Proposed Rule seeks to achieve the objective of section 956 in a manner that limits unnecessary reporting burden on covered financial institutions and leverages the existing supervisory framework for institutions.

The Agencies note that they have intentionally chosen phrases like "clear narrative description" and "succinct description" to describe the disclosures being sought. The Agencies also note that the use of the word "specific" in the Proposed Rule is designed to elicit statements that are direct and meaningful explanations of why a covered financial institution believes its incentive-based compensation plan properly addresses the "excessive compensation" and "material financial loss" components of section 956. These provisions are designed to help ensure that covered financial institutions will provide the Agencies with a streamlined set of materials that will help the Agencies promptly and effectively identify and address any areas of concern, rather than with voluminous materials that may obfuscate the actual structure and likely effects of an institution's incentive-based compensation arrangements. Further, in light of the nature of the information that will be provided to the Agencies under section ___.4 of the Proposed Rule, and the purposes for which the Agencies are requiring the information, the Agencies generally will maintain the confidentiality of the information submitted to the Agencies, and the information will be nonpublic to the extent permitted by law.[18] The nature of the reported information likely will be sensitive for a variety of reasons, including competitive reasons.

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[17] NCUA would likely consult with the appropriate state regulator in cases involving a state-chartered credit union.
[18] The Freedom of Information Act ("FOIA") provides at least two pertinent exemptions under which the Agencies have authority to withhold certain information. FOIA Exemption 4 provides an exemption for "trade secrets and commercial or financial information obtained from a person and privileged or confidential." 5 U.S.C. 552(b)(4). FOIA Exemption 8 provides an exemption for matters that are "contained in or related to examination, operating, or condition reports prepared by, on behalf of, or for the use of an agency responsible for the regulation or supervision of financial institutions." 5 U.S.C. 552(b)(8).

The volume and detail of information provided annually by a covered financial institution should be commensurate with the size and complexity of the institution, as well as the scope and nature of its incentive-based compensation arrangements. As such, the Agencies expect that the volume and detail of information provided by a large, complex institution that uses incentive-based arrangements to a significant degree would be substantially greater than that submitted by a smaller institution that has only a few incentive-based compensation arrangements or arrangements that affect only a limited number of covered persons.

The Agencies request comment on all aspects of the reporting provisions in the Proposed Rule. Specifically, the Agencies request comment on the following:

- Does the Proposed Rule appropriately fulfill the requirement to obtain meaningful and useful descriptions of incentive-based compensation arrangements for supervisory and compliance purposes while imposing reasonable burden and minimizing the potential for voluminous boilerplate disclosure?
- Is the language in the Proposed Rule sufficiently clear in describing the kinds of information the Agencies intend to solicit from covered financial institutions.
- Are there simpler and less burdensome methods of reporting to the Agencies that would still be sufficiently robust to help the Agencies assess whether the institution's compensation arrangements appropriately balance risk and financial rewards? For example, would setting up an electronic means of filing the required disclosure lessen the burden on covered financial institutions, and are there specific factors the Agencies should consider in developing such a disclosure mechanism?

- Are there any additional types of information that the Agencies should solicit in order to more accurately assess whether incentive-based compensation arrangements are consistent with the objectives of section 956?
- Should the Agencies consider modifying the Proposed Rule to require covered financial institutions to update their incentive-based compensation disclosure -- between annual disclosure cycles -- if any material changes to their respective incentive-based compensation plans occur?

§ ___.5 Prohibitions. Section ___.5 of the Proposed Rule would implement section 956(b) of the Dodd-Frank Act by prohibiting a covered financial institution from having incentive-based compensation arrangements that may encourage inappropriate risks (i) by providing excessive compensation or (ii) that could lead to a material financial loss. Consistent with section 956(c), the Proposed Rule also would establish standards for determining whether an incentive-based compensation arrangement violates these prohibitions.

Excessive Compensation. The Proposed Rule would establish a general rule that a covered financial institution may not establish or maintain any incentive-based compensation arrangement, or any feature of any such arrangement, that encourages a covered person to expose the institution to inappropriate risks by providing that person with excessive compensation. As noted previously, section 956 requires the Agencies to ensure that any compensation standards established under section 956 are comparable to those established under section 39 of the FDIA. In light of this directive, the Proposed Rule includes standards for determining whether an incentive-based compensation arrangement provides excessive compensation that are comparable to, and based on, the standards established under section 39 of the FDIA. Specifically, under the Proposed Rule, compensation for a covered person would be considered excessive when amounts paid are unreasonable or disproportionate to, among other things, the amount, nature, quality, and scope of services performed by the covered person. In making such a determination, the Agencies will consider:

(1) The combined value of all cash and non-cash benefits provided to the covered person;

(2) The compensation history of the covered person and other individuals with comparable expertise at the covered financial institution;

(3) The financial condition of the covered financial institution;

(4) Comparable compensation practices at comparable institutions, based upon such factors as asset size, geographic location, and the complexity of the institution's operations and assets;

(5) For postemployment benefits, the projected total cost and benefit to the covered financial institution;

(6) Any connection between the individual and any fraudulent act or omission, breach of trust or fiduciary duty, or insider abuse with regard to the covered financial institution; and

(7) Any other factors the Agency determines to be relevant.

The Agencies request comment on these standards.

Inappropriate Risks that May Lead to a Material Financial Loss. Section 956(b)(2) of the Act requires the Agencies to adopt regulations or guidelines that prohibit a covered financial institution from establishing or maintaining any incentive-based compensation arrangement, or any feature of such an arrangement, that encourages a covered person to expose the institution to inappropriate risks that could lead to a material financial loss at the covered financial institution. Section 39 of the FDIA does not include standards for determining whether compensation arrangements may encourage inappropriate risks that could lead to a material financial loss. Accordingly the Agencies have considered the language and purpose of section 956, existing supervisory guidance that addresses incentive-based compensation arrangements that may encourage excessive risk-taking,[19] the Principles for Sound Compensation Practices and the related Implementation Standards adopted by the Financial Stability Board,[20] and other relevant material in considering how to implement this aspect of section 956.

As an initial matter, the Agencies note that section 956 is focused on incentive-based compensation arrangements that could lead to a material financial loss. Accordingly, this prohibition will apply only to those incentive-based compensation arrangements for individual covered persons, or groups of covered persons, whose activities may expose the covered financial institution to a material financial loss. Such covered persons include:

- Executive officers and other covered persons who are responsible for oversight of the covered financial institution's firm-wide activities or material business lines;
- Other individual covered persons, including non-executive employees, whose activities may expose the covered financial institution to a material financial loss (e.g., traders with large position limits relative to the covered financial institution's overall risk tolerance); and
- Groups of covered persons who are subject to the same or similar incentive-based compensation arrangements and who, in the aggregate, could expose the covered financial institution to a material financial loss, even if no individual covered person in the group could expose the covered financial institution to a material financial loss (e.g.,

[19] See e.g., Banking Agency Guidance.
[20] Financial Stability Board, FSF Principles for Sound Compensation Practices, Basel, Switzerland (April 2009); Financial Stability Board, FSB Principles for Sound Compensation Practices: Implementation Standards, Basel. Switzerland (September 2009).

loan officers who, as a group, originate loans that account for a material amount of the covered financial institution's credit risk).

To implement section 956(b)(2) of the Act, section ___.5(b)(1) of the Proposed Rule prohibits a covered financial institution from establishing or maintaining any types of incentive compensation arrangements, or any feature of any such arrangements, for these covered persons or groups of covered persons, that could lead to a material financial loss to the covered financial institution. Section ___.5 of the Proposed Rule provides that an incentive-based compensation arrangement established or maintained by a covered financial institution for one or more covered persons does not comply with section ___.5(b)(1) unless it:

- Balances risk and financial rewards, for example by using deferral of payments, risk adjustment of awards, longer performance periods, or reduced sensitivity to short-term performance;
- Is compatible with effective controls and risk management; and
- Is supported by strong corporate governance.

These three standards are consistent with the principles for sound compensation practices in the Banking Agency Guidance.

The following describes these proposed standards in greater detail. In order to help ensure that the incentive-based compensation arrangements of covered financial institutions are consistent with their standards, section ___.6 of the Proposed Rule would require that covered financial institutions establish and maintain policies and procedures related to these standards.

Balance of risk and financial rewards

Incentive-based compensation arrangements typically attempt to encourage actions that result in greater revenue or profit for the covered financial institution. However, short-run revenue or profit can often diverge sharply from actual long-run profit because risk outcomes may become clear only over time. Activities that carry higher risk typically yield higher short-term revenue, and a covered person who is given incentives to increase short-term revenue or profit, without regard to risk, will naturally be attracted to opportunities to expose the institution to more risk.[21]

Accordingly, to be consistent with section 956, incentive-based compensation arrangements at a covered financial institution should balance risk and financial rewards in a manner that does not provide covered persons with incentives to take inappropriate risks that could lead to material financial loss at the covered financial institution. The Agencies would deem an incentive-based compensation arrangement to be balanced when the amounts paid to a covered person appropriately take into account the risks, as well as the financial benefits, from the covered person's activities and the impact of those activities on the covered financial institution.

In assessing whether incentive-based compensation arrangements are balanced, the Agencies will consider the full range of risks associated with a covered person's activities, as well as the time horizon over which those risks may be realized. The activities of a covered person may create a wide range of risks for a covered financial institution, including credit, market, liquidity, operational, legal, compliance, and reputational risks. Some of these risks may be realized in the short term, while others may become apparent only over the long term.

The Proposed Rule identifies four methods that currently are often used to make compensation more sensitive to risk. These methods are:

Risk Adjustment of Awards: Under this method of making a covered person's incentive-based compensation appropriately risk-sensitive, the amount of the person's incentive-

[21] See Banking Agency Guidance at 36407.

based compensation award is adjusted based on measures that take into account the risk the covered person's activities pose to the covered financial institution. Such measures may be quantitative, or the size of a risk adjustment may be based on managerial judgment , subject to appropriate oversight.

Deferral of Payment: Under this method, the actual payout of an award to a covered person is delayed significantly beyond the end of the performance period, and the amounts paid are adjusted for actual losses or other aspects of performance that become clear only during the deferral period. Deferred payouts may be altered according to risk outcomes either formulaically or based on managerial judgment, though extensive use of judgment might make it more difficult to execute deferral arrangements in a sufficiently predictable fashion to influence the risk-taking behavior of a covered person. To be most effective in ensuring balance, the deferral period should be sufficiently long to allow for the realization of a substantial portion of the risks from the covered person’s activities, and the measures of loss should be clearly explained to covered persons and closely tied to their activities during the relevant performance period.

Longer Performance Periods: Under this method of making incentive-based compensation risk sensitive, the time period covered by the performance measures used in determining a covered person’s award is extended (for example, from one year to two years). Longer performance periods and deferral of payment are related in that both methods allow awards or payments to be made after some or all risk outcomes associated with a covered person’s activities are realized or better known.

Reduced Sensitivity to Short-Term Performance: A covered financial institution using this method reduces the rate at which awards increase as a covered person achieves higher levels of the relevant performance measure(s) used in the person’s incentive-based compensation arrangement. Rather than offsetting risk-taking incentives associated with the use of short-term performance measures, this method reduces the magnitude of such incentives.

The Agencies recognize that these methods for achieving balance are not exclusive, and additional methods or variations of these approaches may exist or be developed.[22] Methods and practices for making compensation sensitive to risk-taking are likely to evolve during the next few years. Moreover, each method has its own advantages and disadvantages that may differ depending upon the situation in which they are used. For example, where reliable risk measures exist, risk adjustment of awards may be more effective than deferral of payment in reducing incentives for inappropriate risk-taking. This is because risk adjustment potentially can take account of the full range and time horizon of risks, rather than just those risk outcomes that occur or become evident during the deferral period. On the other hand, deferral of payment may be more effective than risk adjustment in mitigating incentives to take hard-to-measure risks (such as the risks of new activities or products, or certain risks such as reputational or operational risk that may be difficult to measure with respect to particular activities), especially if such risks are likely to be realized during the deferral period. In some cases two or more methods may be needed in combination for an incentive-based compensation arrangement to be balanced. The greater the potential incentives that an arrangement creates for a covered person to increase the risks borne by the covered financial institution, the stronger the effect should be of the methods applied to achieve balance.[23]

Compatibility with Effective Controls and Risk Management

A covered financial institution's risk management processes and internal controls should reinforce and support the development and maintenance of balanced incentive-based

[22] See Banking Agency Guidance at 36407.
[23] See Banking Agency Guidance at 36409.

compensation arrangements.[24] In particular, under this proposed standard, the Agencies would expect a covered financial institution to have strong controls governing its processes for designing, implementing and monitoring incentive-based compensation arrangements, and for ensuring that risk-management personnel have an appropriate role in the institution's processes for designing incentive-based compensation arrangements, monitoring their use and assessing whether they achieve balance. Covered financial institutions should have appropriate controls to ensure that their processes for achieving balanced compensation arrangements are followed and to maintain the integrity of their risk management and other functions. Such controls are important because employees may seek to evade or weaken an institution's processes to achieve balanced incentive-based compensation arrangements in order to increase their own compensation. For example, in order to increase his or her own incentive compensation, an employee may seek to influence inappropriately the risk measures, information, or judgments used to balance the employee's compensation. These activities can have additional damaging effects on the institution's financial health if they result in the weakening of the information or processes that the institution uses for other risk management, internal control or financial purposes.[25]

Strong Corporate Governance

Strong and effective corporate governance is critical to the establishment and maintenance of sound compensation practices.[26] The board of directors of a covered financial institution should actively oversee incentive-based compensation arrangements and is ultimately responsible for ensuring that the covered financial institution's incentive compensation arrangements are appropriately balanced. Accordingly, the board of directors, or a committee

[24] See Banking Agency Guidance at 36410-11.
[25] See Banking Agency Guidance at 36411.
[26] See Banking Agency Guidance at 36412.

thereof, should actively oversee the development and operation of a covered financial institution's incentive-based compensation systems and related control processes. For example, the board of directors, or a committee thereof, should review and approve the overall goals and purposes of the covered financial institution's incentive-based compensation system and ensure its consistency with the institution's overall risk tolerance. In addition, the board, or committee thereof, should receive data and analysis to assess whether the overall design, as well as the performance, of the institution's incentive compensation arrangements are consistent with section 956.

The Agencies request comment on all aspects of section ___.5 of the Proposed Rule. The Agencies also request comment on whether there are additional factors that should be considered in evaluating whether compensation is excessive or could lead to a material financial loss, and whether the Proposed Rule should include additional details about each of these standards.

Larger Covered Financial Institutions

Deferral arrangements required for Executive Officers.

Paragraph (b)(3) of section ___.5 of the Proposed Rule would establish a deferral requirement for larger covered financial institutions (i.e., generally those with $50 billion or more in total consolidated assets). At these covered financial institutions, at least 50 percent of the incentive-based compensation of an "executive officer" (as previously defined), would have to be deferred over a period of at least three years. The Proposed Rule also requires that deferred amounts paid be adjusted for actual losses or other measures or aspects or performance that are realized or become better known during the deferral period.

The Agencies believe that incentive-based compensation arrangements for executive officers at larger covered financial institutions are likely to be better balanced if they involve the deferral of a substantial portion of the executives' incentive compensation over a multi-year period in a way that reduces the amount received in the event of poor performance. The decisions of executive officers have a significant impact on the entire organization and often involve substantial strategic or other risks that are difficult to measure and model -- particularly at larger covered financial institutions -- and therefore difficult to address adequately by ex ante risk adjustments.

Requiring deferral for executive officers is consistent with international standards[27] that establish the expectation that large interconnected firms require the deferral of a substantial portion of incentive-based compensation (identified as 40 to 60 percent of the incentive award, or more) for certain employees for a fixed period of time not less than three years and that incentives be correctly aligned with the nature of the business, its risks and the activities of the employee in question. Because the risks of strategic and other high-level decisions of executive officers may not be apparent or become better known for many years, the Proposed Rule would require that the deferral arrangement for executive officers at these larger covered financial

[27] See supra note 20.

institutions extend for at least three years. Larger covered financial institutions tend to have more diverse business operations, which can make it more difficult to immediately recognize and assess risks for the organization as a whole. Furthermore, in enacting the Dodd-Frank Act, Congress recognized that larger organizations may pose a greater risk to the financial system by requiring the creation of enhanced prudential standards for certain nonbank financial companies with total consolidated assets greater than $50 billion.

The Proposed Rule recognizes that requiring deferral for this discrete group of individuals at larger covered institutions, where ex ante risk adjustment measures are less likely to be effective in and of themselves, is likely to be a useful balancing tool that allows a period of time for risks not previously discerned or quantifiable to ultimately materialize, and concurrently provides for adjustment of unreleased (or "unvested") deferral payments on the basis of observed consequences and actual performance as opposed to only predicted results.

If a covered financial institution is required to use deferral, the Proposed Rule provides it with flexibility in administering its specific deferral program. A covered financial institution may decide to release (or allow vesting of) the full deferred amount in a lump-sum only at the conclusion of the deferral period; alternatively, the institution may release the deferred amounts (or allow vesting) in equal increments, pro rata, for each year of the deferral period. However, in no event may the release or vesting of amounts required to be deferred under § ___.5(b)(3) of the Proposed Rule be faster than a pro rata equal-annual-increments distribution. For instance, an institution required to apply a three-year deferral to a $150,000 deferral amount could release a maximum of $50,000 each year, or could withhold the entire sum for the entire period and distribute it as a lump-sum at the conclusion of the three-year period. The institution could also employ an alternate distribution that is less rapid than a pro-rata equal-annual-increments schedule, such as releasing no amount after the first year, and then releasing a maximum of $100,000 the second year, and then $50,000 for the third year.

Specific comment is solicited on all aspects of the scope, and specific requirements, of this required deferral. In particular, commenters are asked to address whether it is appropriate to mandate deferral for executive officers at larger covered financial institutions to promote the alignment of employees' incentives with the risk undertaken by such employees. For example, comment is solicited on whether deferral is generally an appropriate method for achieving balanced incentive compensation arrangements for each type of executive officer at these institutions, or whether there are alternative or more effective ways to achieve such balance. Commenters are also asked to address the possible impact that the required minimum deferral provisions for senior executives may have on larger covered financial institutions, and whether the proposed or different deferral requirements should apply to senior executives at institutions other than larger covered financial institutions. For example, would it be prudent to mandate deferred incentive-based compensation for certain types of covered financial institutions but not require such deferral for other institutions based on the business, risks inherent to that business, or other relevant factors? Are there additional considerations, such as tax or accounting considerations, that may affect the ability of larger covered institutions to comply with the proposed deferral requirement or that the Agencies should consider in designing this provision in the rule? Comment is also sought on whether the mandatory deferral provisions of the rule should apply to a differently defined group of individuals at larger covered financial institutions, such as the institution's top 25 earners of incentive-based compensation? Commenters also are asked to address whether the three-year and 50 percent of incentive-based compensation minimums are appropriate? Should the minimum required deferral period be extended to, for example, five years?

Special Review and Approval Requirement for Other Designated Individuals

Other individuals at a larger covered financial institution, beyond the institution's executive officers, may have the ability to expose the institution to possible losses that are substantial in relation to the institution's size, capital, or overall risk tolerance. In order to help ensure that the incentive compensation arrangements for these individuals are appropriately balanced, and do not encourage the individual to expose the institution to risks that could pose a risk of material financial loss to the covered financial institution, the Proposed Rule would require that, at a larger covered financial institution, the board of directors, or a committee thereof, identify those covered persons (other than executive officers) that individually have the ability to expose the institution to possible losses that are substantial in relation to the institution's size, capital, or overall risk tolerance. The proposal notes that these covered persons may include, for example, traders with large position limits relative to the institution's overall risk tolerance and other individuals that have the authority to place at risk a substantial part of the capital of the covered financial institution. In addition, the Proposed Rule would require that the board of directors, or a committee thereof, of the institution approve the incentive-based compensation arrangement for such individuals, and maintain documentation of such approval.

Under the proposal, the board (or committee) of a larger covered financial institution may not approve the incentive-based compensation arrangement for an individual identified by the board (or committee) unless the board (or committee) determines that the arrangement, including the method of paying compensation under the arrangement, effectively balances the financial rewards to the employee and the range and time horizon of risks associated with the employee's activities. The proposal recognizes that the methods used to balance the rewards and risks of the individual's activities may include deferral of payments, risk adjustment of awards, reduced sensitivity to short-term performance, or extended performance periods, or other appropriate methods. However, the board (or committee) must determine that the method(s) used effectively balance the financial rewards to the employee and the range and time horizons of the risks associated with the employee's activities. In performing its duties in this regard, the board, or committee thereof, must evaluate the overall effectiveness of the balancing methods used in the identified covered person's incentive compensation arrangements in reducing incentives for inappropriate risk taking by the identified covered person, as well as the ability of the methods used to make payments sensitive to the full range of risks presented by that employee's activities, including those risks that may be difficult to predict, measure, or model.

The Agencies request comment on these proposed additional identification, review and approval requirements for larger covered financial institutions with respect to individuals that have the ability to expose the institution to possible losses that are substantial in relation to the institution's size, capital, or overall risk tolerance. Is the proposed special treatment of these covered persons necessary or appropriate, or is their incentive compensation adequately addressed by the prohibitions applicable to all other covered persons (other than executive officers at larger covered financial institutions) under the proposal? Is it sufficient that, as under the proposal, such covered persons are not subject to mandatory deferral but instead are separately identified by the institution's board and the board is required to approve the incentive-based compensation arrangement for the covered person after ensuring it is balanced and sensitive to risk? Should further guidance be provided as to the meaning of the phrase "substantial in relation to the institution's size, capital, or overall risk tolerance"?

§ ___.6 Policies and Procedures. As noted above, the Agencies believe that the incentive-based compensation practices of covered financial institutions should be supported by policies and procedures, appropriate to the size and complexity of the covered financial institution, to foster transparency of each covered financial institution's incentive-based compensation practices and to promote compliance and accountability regarding the practices that the Agencies propose to prohibit. Accordingly, the Proposed Rule would require covered financial institutions to have policies and procedures governing the award of incentive-based compensation as a way to help ensure the full implementation of the prohibitions in the Proposed Rule.

The Agencies believe that the policies and procedures developed by each covered financial institution in this area should be appropriately tailored to balance risk and reward for an institution of its size, complexity, and business activity, as well as the scope and nature of the covered financial institution's incentive-based compensation arrangements. Therefore, the policies and procedures of smaller covered financial institutions with less complex incentive-based compensation programs would be expected to be less extensive than those of larger covered financial institutions with relatively complex programs and business activities. The Agencies note, however, that no categories of covered financial institutions using incentive-based compensation would be systematically or completely exempt from developing, maintaining, and documenting their incentive-based compensation policies and procedures.

As noted above, the prohibition on incentive-based compensation arrangements that could lead to a material financial loss is likely to affect only those arrangements for covered persons that, either individually or as a group, may expose the institution to a material financial loss. Accordingly, the policies and procedures of an institution related to this prohibition should be focused on these employees. Depending on the facts and circumstances of the individual covered financial institution, certain jobs and classes of jobs may not have the ability to expose the organization to a material financial loss and, as a result, incentive-based compensation arrangements for these employees within these job classes may be outside the scope of these restrictions. Examples of jobs and classes of jobs that may be unlikely to expose the institution to material risk include tellers, bookkeepers, couriers, or data processing personnel.

Paragraph (b)(1) of section ___.6 of the Proposed Rule would require that the policies and procedures, at a minimum, be designed to address the prohibitions against incentive-based compensation arrangements that encourage inappropriate risks by providing covered persons with excessive compensation or that could lead to material financial loss to the covered financial institutions.[28] Requiring such policies and procedures of covered financial institutions that award incentive-based compensation would promote compliance with the prohibitions in practice.

In order to help ensure that the risks inherent in a covered person's actions are appropriately captured, the Agencies believe that risk-management, risk oversight, and internal control personnel should be involved in all phases of the process for designing incentive-based compensation arrangements. Risk-management and risk-oversight personnel also should have responsibility for ongoing assessment of incentive-based compensation policies to help to ensure that the covered financial institution's processes remain up-to-date and effective relative to its incentive compensation practices. The ongoing involvement of such personnel in the evaluation of incentive-based compensation arrangements also helps to ensure that risks are properly

[28] In the case of the U.S. operations of foreign banking organizations ("FBOs"), the organization's policies, including management, review, and approval requirements for its U.S. operations, should be coordinated with the FBO's group-wide policies developed in accordance with the rules of the FBO's home country supervisor. The policies of the FBO's U.S. operations should also be consistent with the FBO's overall corporate and management structure, as well as its framework for risk-management and internal controls. In addition, the policies for the U.S. operations of FBOs should be consistent with the Proposed Rule.

understood and evaluated as such risks change over time in light of a continuously changing business environment. Accordingly, paragraph (b)(2) of section ___.6 of the Proposed Rule would make such a requirement part of the covered financial institution's policies and procedures governing incentive-based compensation.

Paragraph (b)(3) of section ___.6 would require that a covered financial institution's policies and procedures provide for the monitoring by a group or person independent of the covered person, where practicable in light of the institution's size and complexity, of incentive-based compensation awards and payments, risks taken, and actual risk outcomes to determine whether incentive-based compensation payments are reduced to reflect adverse risk outcomes or high levels of risk taken. To be considered independent under the Proposed Rule, the group or person at the covered financial institution monitoring or assessing incentive-based compensation awards must have a separate reporting line to senior management from the covered person who is creating the risks so as to help ensure that the analysis of risk is unbiased. Given the dynamic nature of risk management, the Proposed Rule also provides for incentive-based compensation awards to be monitored in light of risks taken and outcomes to determine whether incentive-based payments should be modified. The Agencies contemplate that the procedures relating to the adjustment of deferred amounts would be used by covered financial institutions required to defer a portion of their incentive-based compensation under section ___.6 of this Rule to augment their compliance with the deferral obligation.

Paragraph (b)(4) of section ___.6 would require a covered financial institution to develop and maintain policies and procedures designed to ensure that the covered financial institution's board of directors, or a committee thereof, receive data and analysis from management and other sources sufficient to allow it to assess whether the overall design and performance of the firm's incentive-based compensation arrangements are consistent with section 956 of the Act. As with other provisions of the Proposed Rule, the scope and nature of the data and analysis should be appropriate to the size and complexity of the covered financial institution and its use of incentive-based compensation. The Agencies expect that the board, or its committee, would take into consideration the firm's overall risk management policies and procedures and the requirements of section 956(b) of the Act when assessing compliance with the Act.

Paragraph (b)(5) of section ___.6 of the Proposed Rule would specify that the policies and procedures of a covered financial institution must provide that the institution maintains sufficient documentation of the institution's processes for establishing, implementing, modifying, and monitoring incentive-based compensation arrangements sufficient to allow the institution's appropriate Federal regulator to determine the covered financial institution's compliance with section 956 of the Act and the Proposed Rule. Given that the determinations to be made regarding incentive-based compensation are fact-specific, the Agencies believe that effective documentation of the covered financial institution's policies, procedures and actions related to incentive-based compensation is essential both to help promote the risk-based discipline that section 956 of the Act seeks to foster with respect to covered financial institutions, and to facilitate meaningful oversight and examination. In this context, the Agencies would expect the documentation maintained by a covered financial institution under the Proposed Rule to include, but not be limited to, the following:

(1) A copy of the covered financial institution's incentive-based compensation arrangement(s) or plan(s);

(2) The names and titles of individuals covered by such arrangement(s) or plan(s);

(3) A record of the incentive-based compensation awards made under the arrangement(s) or plan(s); and

(4) Records reflecting the persons or units involved in the approval and ongoing monitoring of the arrangement(s) or plan(s).

Paragraph (b)(6) of section ___.6 of the Proposed Rule would provide that, where a covered financial institution uses deferral in connection with an incentive-based compensation arrangement, the institution's policies and procedures provide for deferral of any such payments in amounts and for a period of time appropriate to the duties and responsibilities of the covered financial institution's covered persons, the risks associated with those duties and responsibilities, and the size and complexity of the covered financial institution.[29] Further, proposed paragraph (b)(6) would require that any such deferred amounts paid be adjusted for actual losses or other measures or aspects of performance that are realized or become better known only during the deferral period. The Agencies believe that risk-management personnel at the covered financial institution would play a substantial role in identifying and evaluating risks that become better known with the passage of time. The Agencies contemplate that the procedures relating to the adjustment of deferred amounts would be used by covered financial institutions required to defer a portion of their incentive-based compensation under section ___.5 of the Proposed Rule to augment their compliance with the deferral obligation.

Given the importance of incentive-based compensation arrangements to a covered financial institution's safety and soundness, paragraph (b)(7) of section ___.6 would require the policies and procedures to subject any incentive-based compensation arrangement or component

[29] The Proposed Rule would require deferral for at least three years of at least 50 percent of the incentive-based compensation for executive officers of larger covered financial institutions (generally those with $50 billion or more in total consolidated assets). Most covered financial institutions with total consolidated assets under $50 billion would be required to adopt procedures applicable to deferred compensation only when the firm elects to use deferral in its incentive-based compensation program.

thereof to a corporate governance framework that provides for ongoing oversight by the board of directors or a committee of the board of directors. As discussed above, covered financial institutions should have strong and effective corporate governance to help ensure sound compensation practices, including active and effective oversight by the board of directors. The Agencies believe that the board of directors or a committee thereof is ultimately responsible for a covered institution's incentive-based compensation arrangements, which should appropriately balance risk and rewards. Therefore, the board or its committee should engage in regular oversight of the covered financial institution's incentive-based compensation arrangements.

The Agencies are aware that covered persons at certain covered financial institutions who have been awarded equity as part of a deferred incentive-based compensation arrangement may wish to use personal hedging strategies as a way to lock in value for equity compensation that is vested over time. The Agencies are concerned that undertaking such hedging strategies during deferral periods could diminish the alignment between risk and financial rewards that may be achieved through these types of deferral arrangements. The Agencies have not included policies and procedures regarding such personal hedging strategies in the Proposed Rule, but the Agencies are concerned that, to the extent personal hedging strategies may be widespread, such practices would serve to diminish the effectiveness of a covered financial institution's policies and procedures. Thus, the Agencies are considering whether a covered financial institution's policies and procedures should be required to specifically include limits on personal hedging strategies. To assist in the evaluation of such a provision, in addition to requesting comment on all aspects of section ___.6 of the Proposed Rule, the Agencies are requesting commenters to describe the extent to which covered financial institutions prohibit such practices among their employees today. Would prohibiting the use of financial derivatives, insurance contracts or other similar mechanisms to hedge against the market risk of equity-based incentive-based compensation be an effective means to help to ensure that incentive-based compensation arrangements remain aligned with the risk assumed by covered persons? Are there any other factors the Agencies should take into account when considering if, or how to, address personal hedging activity by covered persons?

§ ___.7 Evasion. Section ___.7(a) of the Proposed Rule would prohibit a covered financial institution from evading the restrictions of the rule by doing any act or thing indirectly, or through or by any other person, that would be unlawful for the covered institution to do directly under the Proposed Rule. This anti-evasion provision is designed to prevent covered financial institutions from, for example, making substantial numbers of its covered employees independent contractors for the purpose of evading this subpart. The Agencies do not intend, however, to disrupt bona fide independent contractor relationships of covered financial institutions. Comments are invited on whether greater specificity is required in identifying possible evasion tactics, and on all aspects of section ___.7.

IV. REQUEST FOR COMMENTS

The Agencies encourage comment on any aspect of this proposal and especially on those issues specifically noted in this preamble.

Solicitation of Comments on Use of Plain Language

Section 722 of the Gramm-Leach-Bliley Act, Pub. L. 106-102, sec. 722, 113 Stat. 1338, 1471 (Nov. 12, 1999), requires the Federal banking agencies to use plain language in all proposed and final rules published after January 1, 2000. The Federal banking agencies invite your comments on how to make this proposal easier to understand. For example:

- Have we organized the material to suit your needs? If not, how could this material be better organized?

• Are the requirements in the proposed regulation clearly stated? If not, how could the regulation be more clearly stated?

• Does the proposed regulation contain language or jargon that is not clear? If so, which language requires clarification?

• Would a different format (grouping and order of sections, use of headings, paragraphing) make the regulation easier to understand? If so, what changes to the format would make the regulation easier to understand?

• What else could we do to make the regulation easier to understand?

NCUA Agency Regulatory Goal

NCUA's goal is to promulgate clear and understandable regulations that impose minimal regulatory burden. We request your comments on whether the proposed rule is understandable and minimally intrusive if implemented as proposed.

[SEC insert]

V. REGULATORY ANALYSIS:

A. Regulatory Flexibility Act

OCC: Pursuant to § 605(b) of the Regulatory Flexibility Act, 5 U.S.C. 605(b) (RFA), the regulatory flexibility analysis otherwise required under § 603 of the RFA is not required if the agency certifies that the Proposed Rule will not, if promulgated, have a significant economic impact on a substantial number of small entities (defined for purposes of the RFA to include banks and Federal branches and agencies with assets less than or equal to $175 million) and publishes its certification and a short, explanatory statement in the Federal Register along with its Proposed Rule.

Consistent with section 956(f) of the Dodd-Frank Act, the OCC's Proposed Rule only would apply to national banks and Federal branches and agencies that have total consolidated assets of $1 billion or more. The Proposed Rule would not apply to any small national banks and Federal branches and agencies, as defined by the RFA. Therefore, the OCC certifies that the Proposed Rule would not, if promulgated, have a significant economic impact on a substantial number of small entities.

Board: The Board has considered the potential impact of the Proposed Rule on small banking organizations in accordance with the Regulatory Flexibility Act (5 U.S.C. § 603(b)). As discussed in the "Supplementary Information" above, section 956 of the Dodd-Frank Act (codified at 12 U.S.C. 5641) requires that the Agencies prohibit incentive-based payment arrangements, or any feature of any such arrangement, at a covered financial institution that the Agencies determine encourage inappropriate risks by a financial institution by providing excessive compensation or that could lead to a material financial loss. In addition, under the Act a covered financial institution also must disclose to its appropriate Federal regulator the structure of its incentive-based compensation arrangements. The Board and the other Agencies have issued the Proposed Rule in response to these requirements of the Dodd-Frank Act.

The Proposed Rule would apply to "covered financial institutions" as defined in section 956 of the Dodd-Frank Act. Covered financial institutions as so defined include specifically listed types of institutions, as well as other institutions added by the Agencies acting jointly by rule. In every case, however, covered financial institutions must have at least $1 billion in total consolidated assets pursuant to section 956(f). Thus the Proposed Rule is not expected to apply to any small banking organizations (defined as banking organizations with $175 million or less in total assets). See 13 CFR 121.201.

The Proposed Rule would implement section 956(a) of the Dodd-Frank act by requiring a covered financial institution to submit a report annually to its appropriate regulator or supervisor in a format specified by its appropriate Federal regulator that describes the structure of the covered financial institution's incentive-based compensation arrangements for covered persons. The volume and detail of information provided annually by a covered financial institution should be commensurate with the size and complexity of the institution, as well as the scope and nature of its incentive-based compensation arrangements. As such, the Board expects that the volume and detail of information provided by a large, complex institution that uses incentive-based arrangements to a significant degree would be substantially greater than that submitted by a smaller institution that has only a few incentive-based compensation arrangements or arrangements that affect only a limited number of covered persons.

The Proposed Rule would implement section 956(b) of the Dodd-Frank Act by prohibiting a covered financial institution from having incentive-based compensation arrangements that may encourage inappropriate risks (i) by providing excessive compensation or (ii) that could lead to a material financial loss. The Proposed Rule would establish standards for determining whether an incentive-based compensation arrangement violates these prohibitions. These standards would include deferral and other requirements for certain covered persons at covered financial institutions with total consolidated assets of more than $50 billion. Consistent with section 956(c), the standards adopted under section 956 are comparable to the compensation-related safety and soundness standards applicable to insured depository institutions under section 39 of the FDIA. The Proposed Rule also would supplement existing guidance adopted by the Board and the other Federal banking agencies regarding incentive-based compensation (i.e., the Banking Agency Guidance, as defined in the "Supplementary Information" above).

The Proposed Rule would require covered financial institutions to have policies and procedures governing the award of incentive-based compensation as a way to help ensure the full implementation of the prohibitions in the Proposed Rule. The Board believes that the policies and procedures developed by each covered financial institution in this area should be appropriately tailored to balance risk and reward for an institution of its size, complexity, and business activity, as well as the scope and nature of the covered financial institution's incentive-based compensation arrangements. Therefore, the policies and procedures of smaller covered financial institutions with less complex incentive-based compensation programs would be expected to be less extensive than those of larger covered financial institutions with relatively complex programs and business activities.

As noted above, because the Proposed Rule applies to institutions that have more than $1 billion in total consolidated assets, if adopted in final form it is not expected to apply to any small banking organizations for purposes of the Regulatory Flexibility Act. In light of the foregoing, the Board does not believe that the Proposed Rule, if adopted in final form, would have a significant economic impact on a substantial number of small entities supervised by the Board. The Board specifically seeks comment on whether the Proposed Rule would impose undue burdens on, or have unintended consequences for, small organizations and whether there are ways such potential burdens or consequences could be addressed in a manner consistent with section 956 of the Dodd-Frank Act.

FDIC: In accordance with the Regulatory Flexibility Act, 5 U.S.C. 601-612 (RFA), an agency must publish an initial regulatory flexibility analysis with its Proposed Rule, unless the agency certifies that the rule will not have a significant economic impact on a substantial number of small entities. For purposes of the RFA, small entities are defined to include banks with less than $175 million in assets.

Consistent with section 956 of the Dodd-Frank Act, the FDIC's Proposed Rule would only apply to a State nonmember bank and an insured U.S. branch of a foreign bank that has total consolidated assets of $1 billion or more and offers incentive compensation. The Proposed Rule would not apply to any small banks as defined by the RFA. Thus, the FDIC certifies that the Proposed Rule, if promulgated, would not have a significant economic impact on a substantial number of small entities.

OTS: Pursuant to § 605(b) of the Regulatory Flexibility Act, 5 U.S.C. 605(b) (RFA), the regulatory flexibility analysis otherwise required under § 604 of the RFA is not required if the agency certifies that the rule will not have a significant economic impact on a substantial number of small entities and publishes its certification and a short, explanatory statement in the Federal Register along with its rule. OTS certifies that the Proposed Rule would not have a significant impact on a substantial number of small entities. The Small Business Administration has defined "small entities" for banking purposes as a bank or savings association with $175 million or less in assets. 13 CFR 121.201. Since the Proposed Rule only applies to entities with $1 billion or more of assets, it will not apply to any small entities.

FHFA: Pursuant to section 605(b) of the Regulatory Flexibility Act, 5 U.S.C. 601 et seq., FHFA hereby certifies that the Proposed Rule will not have a significant economic impact on a substantial number of small entities.

NCUA: In accordance with the Regulatory Flexibility Act, 5 U.S.C. 601-612 (RFA), NCUA must publish an initial regulatory flexibility analysis with its Proposed Rule, unless the agency certifies that the rule will not have a significant economic impact on a substantial number of small entities, meaning those credit unions under $10 million in assets. NCUA Interpretive Ruling and Policy Statement 03-2, 68 FR 31949 (May 29, 2003). The Dodd-Frank Act section 956 and the NCUA's proposed rule only apply to credit unions of $1 billion in assets or more. Accordingly, NCUA certifies that the Proposed Rule would not have a significant economic impact on a substantial number of small entities and, therefore, a regulatory flexibility analysis is not required.

SEC: Pursuant to section 605(b) of the Regulatory Flexibility Act,[30] an agency must publish an initial regulatory flexibility analysis with its Proposed Rule, unless the agency certifies that the rule will not have a significant economic impact on a substantial number of small entities. The SEC hereby certifies that the Proposed Rule would not have a significant economic impact on a substantial number of small entities.

B. Paperwork Reduction Act

Request for Comment on Proposed Information Collection

In accordance with section 3512 of the Paperwork Reduction Act of 1995, 44 U.S.C. 3501-3521 ("PRA"), the agencies may not conduct or sponsor, and the respondent is not required to respond to, an information collection unless it displays a currently valid Office of Management and Budget ("OMB") control number. The information collection requirements contained in this joint notice of Proposed Rulemaking have been submitted by the OCC, FDIC, OTS, NCUA, and SEC to OMB for review and approval under section 3506 of the PRA and §1320.11 of OMB's implementing regulations (5 CFR 1320). For the FHFA, the Proposed Rule does not contain any information collected from Fannie Mae and Freddie Mac and the Federal Home Loan Banks, including the Office of Finance that requires the approval of OMB

[30] See 5 U.S.C. 601-612

under the PRA (44 USC 3501 et seq.). The Board reviewed the Proposed Rule under the authority delegated to the Board by the OMB. The Proposed Rule contains requirements subject to the PRA. The reporting requirements are found in sections ___.4, and the recordkeeping requirements are found in sections ___.5(b)(3)(ii)(B), ___.6(a), and ___.6(b)(5).

Comments are invited on:

(a) Whether the collection of information is necessary for the proper performance of the Agencies' functions, including whether the information has practical utility;

(b) The accuracy of the estimates of the burden of the information collection, including the validity of the methodology and assumptions used;

(c) Ways to enhance the quality, utility, and clarity of the information to be collected;

(d) Ways to minimize the burden of the information collection on respondents, including through the use of automated collection techniques or other forms of information technology; and

(e) Estimates of capital or start up costs and costs of operation, maintenance, and purchase of services to provide information.

All comments will become a matter of public record. Comments should be addressed to:

OCC: You should direct all written comments to: Communications Division, Office of the Comptroller of the Currency, Public Information Room, Mailstop 2-3, Attention: 1557-AD39, 250 E Street, SW., Washington, DC 20219. In addition, comments may be sent by fax to (202) 874-5274, or by electronic mail to regs.comments@occ.treas.gov. You may personally inspect and photocopy comments at the OCC, 250 E Street, SW., Washington, DC 20219. For security reasons, the OCC requires that visitors make an appointment to inspect comments. You may do so by calling (202) 874-4700. Upon arrival, visitors will be required to present valid government-issued photo identification and submit to security screening in order to inspect and photocopy comments.

Board: You may submit comments, identified by Docket No. R-XXX, by any of the following methods:

• Agency Web Site: http://www.federalreserve.gov. Follow the instructions for submitting comments on the http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm.

• Federal eRulemaking Portal: http://www.regulations.gov. Follow the instructions for submitting comments.

• E-mail: regs.comments@federalreserve.gov. Include docket number in the subject line of the message.

• FAX: 202-452-3819 or 202-452-3102.

• Mail: Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW, Washington, DC 20551.

All public comments are available from the Board's Web site at http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm as submitted, unless modified for technical reasons. Accordingly, your comments will not be edited to remove any identifying or contact information. Public comments may also be viewed electronically or in paper in Room MP-500 of the Board's Martin Building (20th and C Streets, NW.) between 9:00 a.m. and 5:00 p.m. on weekdays.

FDIC: You may submit written comments, identified by the RIN, by any of the following methods:

• Agency Web Site: http://www.fdic.gov/regulations/laws/federal/propose.html. Follow the instructions for submitting comments on the FDIC Web site.

• Federal eRulemaking Portal: http://www.regulations.gov. Follow the instructions for submitting comments.

• E-mail: Comments@FDIC.gov. Include RIN 3064 – AD56 on the subject line of the message.

• Mail: Robert E. Feldman, Executive Secretary, Attention: Comments, FDIC, 550 17th Street, NW., Washington, DC 20429.

• Hand Delivery/Courier: Guard station at the rear of the 550 17th Street Building (located on F Street) on business days between 7:00 a.m. and 5:00 p.m.

Public Inspection: All comments received will be posted generally without change to http://www.fdic.gov/regulations/laws/federal/propose/html including any personal information provided. Comments may be inspected at the FDIC Public Information Center, Room E-1002, 3501 Fairfax Drive, Arlington, VA 22226, between 9:00 a.m. and 5:00 p.m. on business days.

OTS: Information Collection Comments, Chief Counsel's Office, Office of Thrift Supervision, 1700 G Street, NW., Washington, DC 20552; send a facsimile transmission to (202) 906-6518; or send an e-mail to infocollection.comments@ots.treas.gov. OTS will post comments and the related index on the OTS Internet site at http://www.ots.treas.gov. In addition, interested persons may inspect the comments at the Public Reading Room, 1700 G Street, NW., by appointment. To make an appointment, call (202) 906-5922, send an e-mail to public.info@ots.treas.gov, or send a facsimile transmission to (202) 906-7755.

NCUA: You may submit comments by any of the following methods (Please send comments by one method only):

• Federal eRulemaking Portal: http://www.regulations.gov. Follow the instructions for submitting comments.

• NCUA Web Site:

http://www.ncua.gov/RegulationsOpinionsLaws/proposedregs/proposedregs.html. Follow the instructions for submitting comments.

• E-mail**:** Address to regcomments@ncua.gov. Include "[Your name] Comments on Notice of Proposed Rulemaking Incentive-Based Compensation Arrangements" in the e-mail subject line.

• Fax: (703) 518-6319. Use the subject line described above for e-mail.

• Mail**:** Address to David Chow, Deputy Chief Information Officer, National Credit Union Administration, 1775 Duke Street, Alexandria, VA 22314-3428.

• Hand Delivery/Courier: Same as mail address.

Additionally, you should send a copy of your comments to the OMB Desk Officer for the Federal banking agencies and NCUA, by mail to U.S. Office of Management and Budget, 725 17th Street, NW., 10235, Washington, DC 20503, or by fax to (202) 395-6974. The Paperwork Reduction Act requires OMB to make a decision concerning the collection of information contained in the proposed regulation between 30 and 60 days after publication of this document in the Federal Register. Therefore, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication. This does not affect the deadline for the public to comment to the NCUA on the proposed regulation.

SEC: You may submit comments by the following method:

Comments should be directed to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Room 10102, New Executive Office Building, Washington, DC 20503, and also should send a copy of their comments to Elizabeth M. Murphy, Secretary, Securities and Exchange

Commission, 100 F Street, NE, Washington, DC 20549-1090, and refer to File No. ____. Requests for materials submitted to OMB by the Commission with regard to this collection of information should be in writing, refer to File No. ____, and be submitted to the Securities and Exchange Commission, Office of Filings and Information Services, 100 F Street, NE, Washington, DC 20549-0213. OMB is required to make a decision concerning the collection of information between 30 and 60 days after publication of this release in the Federal Register. A comment to OMB is best assured of having full effect if OMB receives it within 30 days after publication of this release.

FHFA: The proposed regulation does not contain any information collection requirement that requires the approval of OMB under the Paperwork Reduction Act.

Proposed Information Collection

Title of Information Collection: Reporting and Recordkeeping Requirements Associated with Incentive-Based Compensation Arrangements.

Frequency of Response: Annual.

Affected Public:

OCC: National banks with $1 billion or more in total assets.

Board: State member banks, bank holding companies, state-licensed branches and agencies, and the U.S. operations of foreign banking organizations with $1 billion or more in U.S. assets.

FDIC: State nonmember banks or an insured U.S. branch of a foreign bank that has total consolidated assets of $1 billion or more.

OTS: Savings associations with $1 billion or more in total assets.

<u>NCUA</u>: Credit unions with $1 billion or more in assets, and their executive officers, directors, and employees.

<u>SEC: [forthcoming]</u>

<u>Abstract</u>:

Section 956 of the Dodd-Frank Act requires that the agencies prohibit incentive-based payment arrangements at a covered financial institution that encourage inappropriate risks by a financial institution by providing excessive compensation or that could lead to a material financial loss. Under the Dodd-Frank Act, a covered financial institution also must disclose to its appropriate Federal regulator the structure of its incentive-based compensation arrangements sufficient to determine whether the structure provides “excessive compensation, fees, or benefits” or “could lead to material financial loss” to the institution. The Dodd-Frank Act does not require a covered financial institution to disclose compensation of individuals as part of this requirement.

Section ___.4a would require covered financial institutions that have total consolidated assets of $1 billion or more to submit a report annually to the Agency that describes the structure of the covered financial institution’s incentive-based compensation arrangements for covered persons and that is sufficient to allow an assessment of whether the structure or features of those arrangements provide or are likely to provide covered persons with excessive compensation, fees, or benefits to covered persons or could lead to material financial loss to the institution. Section ___.4b would require the following minimum standards:

(1) A clear narrative description of the components of the covered financial institution's incentive-based compensation arrangements applicable to covered persons;

(2) A succinct description of the covered financial institution's policies and procedures governing its incentive-based compensation arrangements;

(3) If the covered financial institution has consolidated assets of $50 billion or more, an additional succinct description of incentive-based compensation policies and procedures specific to the covered financial institution's:

(i) Executive officers; and

(ii) Other covered persons who the board of directors, or a committee thereof, of the institution has identified and determined under § ___.5(b)(3)(ii) of this part individually have the ability to expose the institution to possible losses that are substantial in relation to the institution's size, capital, or overall risk tolerance;

(4) Any material changes to the covered financial institution's incentive-based compensation arrangements and policies and procedures made since the covered financial institution's last report submitted under paragraph (a)(1) of this section; and

(5) The specific reasons why the covered financial institution believes the structure of its incentive-based compensation plan: (i) does not provide covered persons incentives to engage in behavior that is likely to cause the covered financial institution to suffer a material financial loss; and (ii) does not provide covered persons with excessive compensation.

Section ___.5(b)(3)(ii)(B) would require the board of directors of covered financial institutions that have total consolidated assets of $50 billion or more to approve and document the identification of those covered persons that individually have the ability to expose the institution to possible losses that are substantial in relation to the institution's size, capital, or overall risk tolerance.

Section ___.6(b)(5) would ensure that documentation of the institution's processes for establishing, implementing, modifying, and monitoring incentive-based compensation arrangements is maintained that is sufficient to enable the Agency to determine the institution's compliance with 12 U.S.C. § 5641.

Estimated Burden:

FDIC

Number of Respondents: 301 (12 institutions with total consolidated assets of $50 billion or more and 289 institutions with total consolidated assets between $1 billion and $50 billion; 4,466 institutions with total consolidated assets below $1 billion are exempt).

Burden per Respondent for Initial Set up: 180 hours for institutions with $50 billion or more in total assets (80 hours for reporting requirements and 100 hours for recordkeeping requirements) and 70 hours for institutions between $1 billion and $50 billion in total assets (30 hours for reporting requirements and 40 hours for recordkeeping requirements).

Burden per Respondent for Ongoing Compliance: 70 hours for institutions with $50 billion or more in total assets (40 hours for reporting requirements and 30 hours for recordkeeping requirements) and 25 hours for institutions between $1 billion and $50 billion in total assets (15 hours for reporting requirements and 10 hours for recordkeeping requirements).

Total FDIC Annual Burden: 30,455 hours (22,390 hours for initial set-up and 8,065 hours for ongoing compliance).

OCC [Forthcoming]

Board [Forthcoming]

OTS [Forthcoming]

NCUA There are 167 credit unions (80 federal credit unions and 87 federally insured state-chartered credit unions) with assets of $1 billion or more.

C. OTS Executive Order 12866 Determination

[Revised analysis to be provided by OTS.]

D. OCC Unfunded Mandates Reform Act of 1995 Determination

Section 202 of the Unfunded Mandates Reform Act of 1995 (2 U.S.C. 1532), requires the OCC to prepare a budgetary impact statement before promulgating a rule that includes a Federal mandate that may result in the expenditure by State, local, and tribal governments, in the aggregate, or by the private sector, of $100 million or more in any one year (adjusted annually for inflation). The OCC has determined that this Proposed Rule will not result in expenditures by State, local, and tribal governments, or the private sector, of $100 million or more in any one year. Accordingly, the OCC has not prepared a budgetary impact statement.

E. OTS Unfunded Mandates Reform Act of 1995 Determination

Section 202 of the Unfunded Mandates Reform Act of 1995, Public Law 104–4 (Unfunded Mandates Act) requires that an agency prepare a budgetary impact statement before promulgating a rule that includes a Federal mandate that may result in expenditure by State, local, and tribal governments, in the aggregate, or by the private sector, of $100 million or more (adjusted annually for inflation) in any one year. (The inflation adjusted threshold for 2010 is $141 million or more.) If a budgetary impact statement is required, section 205 of the Unfunded Mandates Act also requires an agency to identify and consider a reasonable number of regulatory alternatives before promulgating a rule.

OTS has determined that this rule will not result in expenditures by State, local, and tribal governments, or the private sector, in excess of the threshold. Accordingly, OTS has not prepared a budgetary impact statement or addressed the regulatory alternatives considered.

F. NCUA Executive Order 13132 Determination

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their actions on state and local interests. In adherence to fundamental federalism principles, the NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5) voluntarily complies with the Executive Order. The Proposed Rule applies to credit unions with $1 billion in assets and over and would not have substantial direct effects on the states, on the connection between the national government and the states, or on the distribution of power and responsibilities among the various levels of government. The NCUA has determined that the Proposed Rule does not constitute a policy that has federalism implications for purposes of the Executive Order.

G. NCUA and FDIC: The Treasury and General Government Appropriations Act, 1999-Assessment of Federal Regulations and Policies on Families

The NCUA and FDIC have determined that this Proposed Rule would not affect family well-being within the meaning of section 654 of the Treasury and General Government Appropriations Act, 1999, Pub. L. 105-277, 112 Stat. 2681 (1998).

LIST OF SUBJECTS

12 CFR Part 372

Banks, Banking, Compensation, Foreign Banking

[Insert other Agency-specific subjects]

List of Subjects

12 CFR Part 372

Banks, Banking, Compensation, Foreign Banking

Federal Deposit Insurance Corporation

12 CFR Chapter III

Authority and Issuance

For the reasons set forth in the preamble, the Federal Deposit Insurance Corporation proposes to amend chapter III of title 12 of the Code of Federal Regulations to add a new part 372 as follows:

PART 372 – INCENTIVE-BASED COMPENSATION ARRANGEMENTS

Incentive-Based Compensation Arrangements

Sec.

Authority: 12 U.S.C. 1819 Tenth, 12 U.S.C. 5641.

§372.1 Authority.

This part is issued pursuant to section 956 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 5641).

§372.2 Scope and purpose.

This part applies to a covered financial institution that has total consolidated assets of $1 billion or more and offers incentive-based compensation arrangements to covered persons. Nothing in this part in any way limits the authority of the Corporation under other provisions of applicable law and regulations.

§372.3 Definitions.

For purposes of this part, the following definitions apply unless otherwise specified:

(a) Board of directors means the governing body of any covered financial institution performing functions similar to a board of directors. For an insured U.S. branch of a foreign bank, "board of directors" means the senior management of its parent bank.

(b) Compensation means all direct and indirect payments, fees or benefits, both cash and non-cash, awarded to, granted to, or earned by or for the benefit of, any covered person in exchange for services rendered to the covered financial institution, including, but not limited to, payments or benefits pursuant to an employment contract, compensation or benefit agreement, fee arrangement, perquisite, stock option plan, postemployment benefit, or other compensatory arrangement.

(c) Covered financial institution means a state nonmember bank and an insured U.S. branch of a foreign bank that has total consolidated assets of $1 billion or more.

(d) Covered person means any executive officer, employee, director, or principal shareholder of a covered financial institution.

(e) Director of a covered financial institution means a member of the board of directors of the covered financial institution, or of a board or committee performing a similar function to a board of directors.

(f) Executive officer of a covered financial institution means a person who holds the title or, without regard to title, salary, or compensation, performs the function of one or more of the following positions: president, chief executive officer, executive chairman, chief operating officer, chief financial officer, chief investment officer, chief legal officer, chief lending officer, chief risk officer, or head of a major business line.

(g) Incentive-based compensation means any variable compensation that serves as an incentive for performance.

(h) Principal shareholder means an individual who directly or indirectly, or acting through or in concert with one or more persons, owns, controls, or has the power to vote 10 percent or more of any class of voting securities of a covered financial institution.

(i) Total consolidated assets means:

(1) For a state nonmember bank, the average of the total assets reported in the institution's four most recent Consolidated Reports of Condition and Income; and

(2) For an insured U.S. branch of a foreign bank, the average of the total assets reported in the branch's four most recent Reports of Assets and Liabilities of U.S. Branches and Agencies of Foreign Banks.

§372.4 Required reports to regulators.

(a) In general. A covered financial institution must submit a report annually to, and in the format directed by, the Corporation, that describes the structure of the covered financial institution's incentive-based compensation arrangements for covered persons and that is sufficient to allow an assessment of whether the compensation structure or features of those arrangements provide or are likely to provide covered persons with excessive compensation, fees, or benefits to covered persons or could lead to material financial loss to the covered financial institution.

(b) Individual compensation. A covered financial institution is not required to report the actual compensation of particular covered persons as part of the report required by paragraph (a) of this section.

(c) Minimum standards. The information submitted by the covered financial institution pursuant to paragraph (a) of this section must include the following:

(1) A clear narrative description of the components of the covered financial institution's incentive-based compensation arrangements applicable to covered persons and specifying the types of covered persons to which they apply;

(2) A succinct description of the covered financial institution's policies and procedures governing its incentive-based compensation arrangements for covered persons;

(3) If the covered financial institution has total consolidated assets of $50 billion or more, an additional succinct description of incentive-based compensation policies and procedures specific to the covered financial institution's:

(i) Executive officers; and

(ii) Other covered persons who the board of directors, or a committee thereof, of the institution has identified and determined under §372.5(b)(3)(ii) of this part individually have the ability to expose the institution to possible losses that are substantial in relation to the institution's size, capital, or overall risk tolerance;

(4) Any material changes to the covered financial institution's incentive-based compensation arrangements and policies and procedures made since the covered financial institution's last report submitted under paragraph (a) of this section; and

(5) The specific reasons why the covered financial institution believes the structure of its incentive-based compensation plan does not encourage inappropriate risks by the covered financial institution by providing covered persons with:

(i) Excessive compensation; or

(ii) Incentive-based compensation that could lead to a material financial loss to the covered financial institution.

§372.5 Prohibitions.

(a) Excessive compensation prohibition. (1) In general. A covered financial institution must not establish or maintain any types of incentive-based compensation arrangements, or any feature of any such arrangements, that encourage inappropriate risks by the covered financial institution by providing a covered person with excessive compensation.

(2) Standards. An incentive-based compensation arrangement provides excessive compensation when amounts paid are unreasonable or disproportionate to the services performed by a covered person, taking into consideration:

(i) The combined value of all cash and non-cash benefits provided to the covered person;

(ii) The compensation history of the covered person and other individuals with comparable expertise at the covered financial institution;

(iii) The financial condition of the covered financial institution;

(iv) Comparable compensation practices at comparable institutions, based upon such factors as asset size, geographic location, and the complexity of the institution's operations and assets;

(v) For postemployment benefits, the projected total cost and benefit to the covered financial institution;

(vi) Any connection between the individual and any fraudulent act or omission, breach of trust or fiduciary duty, or insider abuse with regard to the covered financial institution; and

(vii) Any other factors the Corporation determines to be relevant.

(b) Material financial loss prohibition.

(1) Generally. A covered financial institution must not establish or maintain any types of incentive-based compensation arrangements, or any feature of any such arrangements, that encourage inappropriate risks by the covered financial institution, by providing incentive-based compensation to covered persons, either individually or as part of a group of persons who are subject to the same or similar incentive-based compensation arrangements, that could lead to material financial loss to the covered financial institution.

(2) Requirements for all covered financial institutions. An incentive-based compensation arrangement established or maintained by a covered financial institution for one or more covered persons does not comply with paragraph (b)(1) of this section unless it:

(i) Balances risk and financial rewards, for example, by using deferral of payments, risk adjustment of awards, reduced sensitivity to short-term performance, or extended performance periods;

(ii) Is compatible with effective controls and risk management; and

(iii) Is supported by strong corporate governance, including active and effective oversight by the covered financial institution's board of directors or a committee thereof.

(3) Specific requirements for institutions with $50 billion or more in total consolidated assets.

(i) Deferral required for executive officers. As part of appropriately balancing risk and financial rewards pursuant to paragraph (b)(2)(i) of this section, any incentive-based compensation arrangement for any executive officer established or maintained by a covered financial institution that has total consolidated assets of $50 billion or more must provide for:

(A) At least 50 percent of the annual incentive-based compensation of the executive officer to be deferred over a period of no less than three years, with the release of deferred amounts to occur no faster than on a pro rata basis; and

(B) The adjustment of the amount required to be deferred under paragraph (b)(3)(i)(A) of this section to reflect actual losses or other measures or aspects of performance that are realized or become better known during the deferral period.

(ii) Additional requirement for employees presenting particular loss exposure. As part of appropriately balancing risk and financial rewards pursuant to paragraph (b)(2)(i) of this section, if a covered financial institution has total consolidated assets of $50 billion or more—

(A) The board of directors, or a committee thereof, of the covered financial institution shall identify those covered persons (other than executive officers) who individually have the ability to expose the institution to possible losses that are substantial in relation to the institution's size, capital, or overall risk tolerance These covered persons may include, for example, traders with large position limits relative to the institution's overall risk tolerance and other individuals who have the authority to place at risk a substantial part of the capital of the covered financial institution;

(B) The incentive-based compensation arrangement for any covered person identified pursuant to paragraph (b)(3)(ii)(A) of this section must be approved by the board of directors, or a committee thereof, of the institution and such approval must be documented;

(C) The board of directors, or committee thereof, may not approve the incentive-based compensation arrangement for any covered person identified pursuant to paragraph (b)(3)(ii)(A) of this section unless the board or committee determines that the arrangement, including the method of paying compensation under the arrangement, effectively balances the financial rewards to the employee and the range and time horizon of risks associated with the employee's activities, employing appropriate methods for ensuring risk sensitivity such as deferral of payments, risk adjustment of awards, reduced sensitivity to short-term performance, or extended performance periods; and

(D) In fulfilling its duties under paragraph (b)(3)(ii)(C) of this section, the board of directors or committee thereof must evaluate the overall effectiveness of the balancing methods used in the identified covered person's incentive compensation arrangements in reducing incentives for inappropriate risk taking by the identified covered person considering the methods' suitability to ensure payments balance the full range of risks presented by that covered person's activities, and the methods' ability to make payments sensitive to all the risks arising from the employee's activities, including those that may be difficult to predict, measure or model.

§372.6 Policies and procedures.

(a) In general. Any incentive-based compensation arrangement, or any feature of any such arrangement, is prohibited under section 372.5 of this part, unless adopted pursuant to policies and procedures developed and maintained by each covered financial institution and approved by its board of directors, or a committee thereof, reasonably designed to ensure and monitor compliance with the requirements set forth in 12 U.S.C. 5641 and this part and commensurate with the size and complexity of the organization, as well as the scope and nature of its use of incentive-based compensation.

(b) Standards. The policies and procedures must, at a minimum:

(1) Be consistent with the reporting requirements in section 372.4 of this part and prohibitions in section 372.5 of this part;

(2) Ensure that risk-management, risk-oversight, and internal control personnel have an appropriate role in the institution's processes for designing incentive-based compensation arrangements and for assessing their effectiveness in restraining inappropriate risk-taking;

(3) Provide for the monitoring by a group or person independent of the covered person, where practicable in light of the institution's size and complexity, of incentive-based compensation awards and payments, risks taken, and actual risk outcomes to determine whether incentive compensation payments for covered persons, or groups of covered persons, are reduced to reflect adverse risk outcomes or high levels of risk taken;

(4) Provide for the covered financial institution's board of directors, or committee thereof, to receive data and analysis from management and other sources sufficient to allow the board, or committee thereof, to assess whether the overall design and performance of the institution's incentive-based compensation arrangements are consistent with 12 U.S.C. 5641;

(5) Ensure that documentation of the institution's processes for establishing, implementing, modifying, and monitoring incentive-based compensation arrangements is maintained that is sufficient to enable the Corporation to determine the institution's compliance with 12 U.S.C. 5641 and this part;

(6) Consistent with section 372.5(b)(3) of this part, where deferral is used in connection with an incentive-based compensation arrangement, provide for deferral of incentive-based compensation awards in amounts and for periods of time appropriate to the duties and responsibilities of the covered financial institution's covered persons, the risks associated with those duties and responsibilities, and the size and complexity of the covered financial institution and provide that the deferral amounts paid are adjusted to reflect actual losses or other measures or aspects of performance that are realized or become better known during the deferral period; and

(7) Subject any incentive-based compensation arrangement to a corporate governance framework that provides for ongoing oversight by the board of directors or a committee thereof, including the approval by the board of directors or a committee thereof of incentive-based compensation to executive officers.

§372.7 Evasion.

A covered financial institution is prohibited, for the purpose of evading the restrictions of this part, from doing indirectly or through or by any other person, any act or thing that it would be unlawful for such covered financial institution to do directly under this part.