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INCENTIVE-BASED COMPENSATION: THE JOINT AGENCIES' PROPOSED REGULATIONS

Federal agencies have issued proposed rules requiring financial institutions to report incentive-based compensation arrangements to the agencies and prohibiting arrangements that would encourage inappropriate risks. Awards would have to be risk-adjusted and actual payouts deferred or adjusted depending on results during the payout period. The institution's policies and procedures would have to be redesigned to ensure full compliance with the proposed rules.

By Kenneth Muller and Seth Chertok *

Section 956 of the Dodd-Frank Act requires certain federal agencies to prescribe joint regulations or guidelines with respect to incentive-based compensation practices at financial institutions. Underlying the Dodd-Frank Act is a belief that flawed incentive compensation practices in the financial industry were one of many factors contributing to the financial crisis that began in 2007. Among the agencies ("Agencies") to which Section 956 relates are the 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"); the Securities and Exchange Commission ("SEC"); and Federal Housing Finance Agency ("FHFA").

Specifically, Section 956(a)(1) of the Dodd-Frank Act requires that such regulations or guidelines must require covered financial institutions to disclose to the appropriate federal regulator the structures of all incentive-based compensation arrangements offered by

such institutions sufficient to determine whether the compensation structure: (A) provides an executive officer, employee, director, or principal shareholder of the institution with excess compensation, fees, or benefits; or (B) could lead to material financial loss to the institution. Under Section 956(b), such regulations or guidelines shall prohibit any such incentive-based payment arrangement. The Dodd-Frank Act does not require a covered financial institution to report the actual compensation of particular individuals as part of this requirement. It also does not require a covered financial institution that does not have an incentive-based payment arrangement to make such disclosures.

Sections 956(e)(2) and (f) of the Dodd-Frank Act define "covered financial institutions" 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 defined in Section 3 of the Federal Deposit Insurance Act ("FDIA"); (B) a broker-dealer registered under Section 15 of the Securities Exchange Act of 1934; (C) a credit union, as

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