Timothy Sullivan Authors Article, "Regulatory Issues in Financial Institution Executive Compensation"

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In the last few years, bank regulators have been taking steps to be more actively involved in compensation matters. Historically, the regulators could always intervene for safety and soundness reasons if they thought that the compensation was excessive. In October of 2008, the U.S. Treasury issued compensation rules for those companies that had received or would receive TARP funds. In February of 2009, the stimulus bill was signed into law creating several new compensation rules applicable to TARP recipients. These rules were finalized in June of 2009.

In October of 2009, the Fed issued for comment proposed guidelines on sound incentive compensation arrangements. These were only for bank holding companies and Fed member banks-coverage for some but not all banking organizations.

In January of 2010, the FDIC sought comment on ways its risk based assessment program could be changed to account for the risks posed by employee compensation programs (the “FDIC Proposal”).

In June of 2010, the regulatory agencies issued the Regulatory Guidance on Sound Incentive Compensation Policies which became effective on June 25, 2010 (the “Guidance”). This covered all banking organizations and superseded the Fed’s October 2009 proposal.

While all this was happening, the regulators were issuing written agreements and C&Ds in record numbers. Historically, these agreements included provisions that required a bank to get approval for the hiring and compensation arrangements for any new senior level employee or an employee being promoted to a senior level position. Regulatory orders are now being issued that, among other things, require banks to develop a written, comprehensive director and executive compensation policy.

The Dodd-Franks Wall Street Reform Act became effective on July 21, 2010. It requires all financial institutions with assets in excess of $1 billion to report the structure of all of their incentive compensation arrangements to the regulators. The regulators are directed to prohibit any incentive based payment arrangement that could encourage inappropriate risk taking by providing excessive compensation or that could lead to material financial loss. This applies to officers, directors and shareholders. The rules must be issued by April 21, 2011.

Attorneys

Timothy M. Sullivan

This article will review the Guidance, discuss the TARP compensation rules and the Dodd-Franks provision mentioned above, review briefly the FDIC Proposal, the provisions on compensation that are appearing in regulatory enforcement actions and other compensation provisions of the Dodd-Franks legislation that impact public companies.