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Proposed Legislation Expands the FDIC's Executive Compensation Clawback Authority

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In what is likely the first of many legislative proposals in response to the recent failures of Silicon Valley Bank and Signature Bank, U.S. Senator Elizabeth Warren this week introduced a bill that would greatly expand the scope and impact of the Federal Deposit Insurance Corporation's (FDIC) authority to clawback executive compensation.

The proposed bill, titled the Failed Bank Executives Clawback Act of 2023, consists of three parts. First, the bill would amend the Federal Deposit Insurance (FDI) Act to impose liability on those bank executives responsible for the condition of a failed depository institution. Specifically, it would *require* the FDIC to claw back all or part of the compensation received by an institution-affiliated party during the preceding five years as necessary to prevent unjust enrichment and assure the individual bears losses consist with their responsibility. "Institution-affiliated party" under the FDI Act is broadly defined to include any director, officer, employee or controlling shareholder. It can also include, under certain conditions, an independent contractor, such as an attorney or CPA. As it relates to this new provision, the bill would also create an extremely broad definition of compensation that would include most forms of bank executive compensation, such as salary, bonuses, incentive and equity-based compensation, and gains from the buying or selling of securities.

The second part of the bill would expand the scope of the existing FDIC clawback authority created under the Dodd-Frank Act. Currently, the FDIC has the discretionary authority to claw back the compensation from current or former senior executives and directors "substantially responsible" for the failed condition of a financial company (certain large and complex financial organizations). This existing clawback authority allows the FDIC to look back two years preceding its appointment as receiver, but it only applies to resolutions undertaken pursuant to its Orderly Liquidation Authority (OLA). The proposed bill would expand this authority to all FDIC receiverships, not just those under the OLA.

The final portion of the bill would not amend the FDI Act, but, instead, clarifies that the creditor and shareholders of a holding company must bear the losses of any insured depository institution resolved by the FDIC.

Should Senator Warren's bill come to fruition, it would mark a vast expansion of the FDIC's clawback authority, including the lookback period (from two to five years), those subject to the clawback provisions (expanded to employees, controlling shareholders, and, in some cases, independent contractors), and the extended reach to all FDIC receiverships, not just resolutions under the OLA.

While on the topic of compensation clawbacks, it's also a worth noting two other related initiatives. The first being Section 956 of the Dodd-Frank Act, one of the last provisions of Dodd-Frank that has yet to be fully addressed. This section requires the federal financial regulators to promulgate rules restricting incentive compensation arrangements, primarily those encouraging excessive risk taking, and would apply to banks, bank holding companies, registered broker dealers, and investment advisors, among others. Joint rules were proposed by regulators in 2011 and 2016, but were never finalized. Included in the proposed regulations was a requirement that financial institutions include clawback provisions in any incentive-based compensation arrangements with certain executive officers. This would allow the institutions (as opposed to the FDIC) to recover incentive-based compensation in instances where the officer's misconduct caused harm to the institution. While these regulations never advanced, it's likely the events over the past three weeks will lead to fresh calls for their reconsideration.

Finally, in late 2022, the Securities and Exchange Commission (SEC) adopted rules to implement yet another section of the Dodd-Frank Act, this one directing national securities exchanges to establish listing standards that require listed "issuers" to adopt and comply with a compensation recovery policy, aka a clawback policy. The listing standards must require a listed issuer to develop and implement a clawback policy that provides for the recovery of any erroneously paid portion of incentive-based compensation from a current or former executive officer should the issuer be required to prepare an accounting restatement. These SEC rules generally apply to all listed companies, not just banks and bank holding companies.

Contact your Vorys lawyer if you have questions about the proposed legislation or any of the other executive compensation clawback initiatives.