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Proposed Banking Legislation May Gain Greater Urgency with Collapse of First Republic Bank

First Republic Bank's recent collapse may increase the likelihood of Congress moving forward on legislation that would impose special clawback and tax rules on banking executives compensation.

Two bills have been introduced in the Senate responding to the collapse of Silicon Valley Bank and Signature Bank. The key elements of these bills are described below.

- **Deliver Executive Profits on Seized Institutions to Taxpayers Act**. Sponsored by Senators Richard Blumenthal (D. Conn) and Krysten Sinema (I. AZ), would impose a 90% income tax rate on bonus payments and a 100% tax on gains from stock sales; when such payments and gains were received by a bank's executive officer after March 1, 2023, and within the 60-day period prior to the date on which the FDIC was appointed the bank's conservator or receiver. The special income tax rate would apply when an executive officer's adjusted gross income (excluding such bonuses and capital gains) was more than $250,000.
- **Failed Bank Executives Clawback Act ("Clawback Act")**. Sponsored by a bipartisan group of Senators[1], would require the FDIC to recoup up to 100% of a bank executive's compensation (and gains from buying or selling company stock) received during the 5-year period preceding the bank's failure as is "necessary to prevent unjust enrichment and assure that the [executive] bears losses consistent with the [executive's] responsibility." The bill provides no criteria under which the FDIC would determine the amount of an executive's compensation that would be subject to clawback.

Meridian comments. The genesis of these bills is the demise of Silicon Valley Bank, coupled with the unfortunate timing of stock sales and ordinary course annual bonus payments to employees shortly before the bank's failure. So far, the federal government has not alleged any misconduct regarding the payment of these bonuses or stock sales[2]. The proposed bills would impose substantial penalties on bank executives for, in essence, managerial mistakes.

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[1] The Failed Bank Executives Clawback Act *was introduced by Senator Elizabeth Warren (D. Mass), Senator Josh Hawley (R. Mo), Senator Cortez Masto (D. Nev.) and Senator Mike Braun (R. Ind).*

[2] The FDIC analysis of the collapse of Signature Bank noted that "the root cause of [Signature Bank's] failure was poor management. [Signature Bank's] board of directors and management pursued rapid, unrestrained growth without developing and maintaining adequate risk management practices and controls appropriate for the size, complexity and risk profile of the institution. [Signature Bank's] management did not prioritize good corporate governance practices, did not always heed FDIC examiner concerns, and was not always responsive or timely in addressing FDIC supervisory recommendations (SRs). [Signature Bank] funded its rapid growth through an overreliance on uninsured deposits without implementing fundamental liquidity risk management practices and controls.

While some recoupment of compensation may be appropriate for significant failures of risk management, the bills, if enacted, may result in unintended consequences. The level of recoupment and, in the case of the Clawback Act, the timeframe for recoupment are highly punitive, which could serve as a disincentive for top banking talent to accept or continue to serve in executive positions. This, in turn, could cause banks to include a risk premium in executive pay levels to continue to be able to attract and retain executive officers.

We will be closely monitoring the status of these bills and will provide periodic updates if these bills should start to move through the legislative process.

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