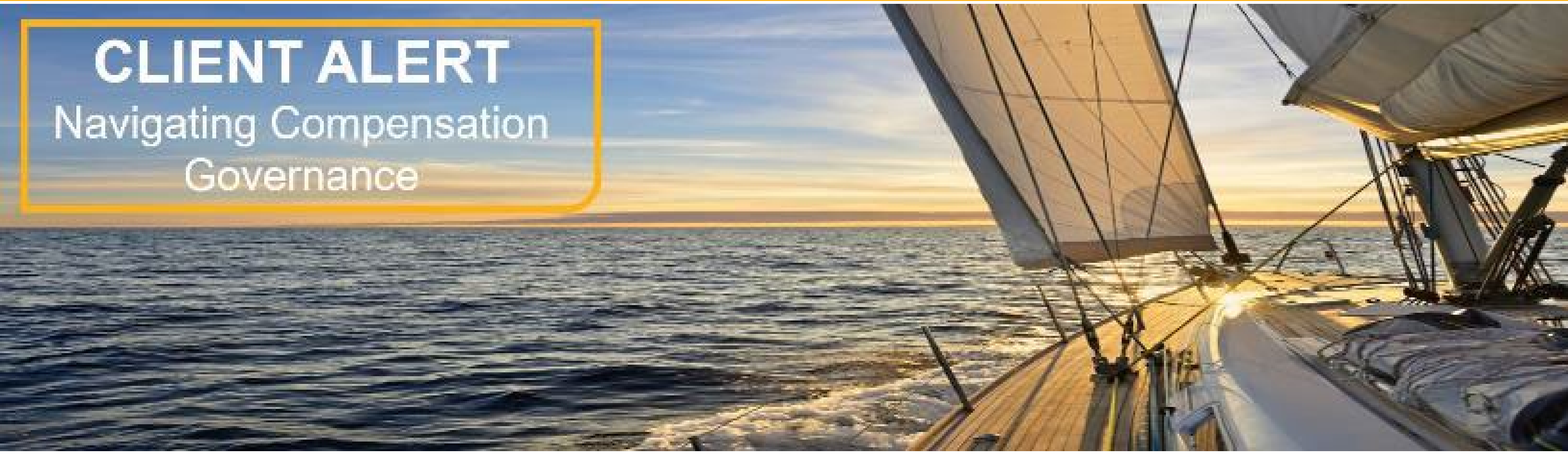
May 14, 2024 Volume 15, Issue 10

MERIDIAN COMPENSATION PARTNERS



Select Bank Regulators Re-Propose Rules on Incentive Compensation

Three of the six federal bank regulators have re-proposed rules on incentive compensation arrangements maintained by financial institutions.

Noticeably absent from this group of regulators is the Federal Reserve Board and Securities Exchange Commission.

Federal Reserve Chair Jerome Powell has questioned the appropriateness of the re-proposed rule noting the following in a recent congressional hearing:[1]

> ***"I would like to understand the problem we're solving, and then I would like to see a proposal that addresses that problem"***

Without the joint support of each of the six bank regulators, the re-proposal cannot proceed forward.

On May 6, the Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, and the Federal Housing Finance Agency jointly reproposed the 2016 proposed rule to implement Section 956 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The National Credit Union Administration is expected to act soon and join their counterparts.

This is the third attempt to revive these regulations. Bank regulators issued a jointly proposed rule in 2011, which was principles-based. In 2016, the same regulators issued new proposed rules that superseded the 2011 proposal and were significantly more prescriptive. For example, senior executive officers' incentive compensation (and "significant risk takers"') would be subject to potential deferral, forfeiture, downward adjustment and clawbacks under certain circumstances.

The re-proposed rule mirrors the 2016 proposal and requests public feedback on all aspects of the rule and specific alternatives.

For a summary of the 2016 proposed rule, please refer to Meridian's April 2016, Client Update.

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[1] Hearing: The Federal Reserve's Semi-Annual Monetary Policy Report | Financial Services Committee (house.gov), March 6, 2024.

Background

Section 956 of the Dodd-Frank Wall Street Reform and Consumer Protection Act requires bank regulators to jointly issue regulations or guidelines: (i) prohibiting incentive-based compensation arrangements that encourage inappropriate risks that provide excessive compensation or that could lead to a material financial loss, and (ii) requiring those financial institutions to disclose information concerning incentive-based compensation arrangements to the appropriate Federal regulator.

The bank regulators are under no deadline by which to issue a final rule and all six regulators must agree to the rules for them to take effect.

If all six regulators agree, a 60-day comment period will apply. Meanwhile, the applicable agencies are accepting comments. If a final rule is adopted by the bank regulators, under the current proposal covered financial institutions would become subject to the final rule 540 days after its publication in the federal register (though the release asks for feedback on whether the compliance period should be shortened to 365 days).

For Meridian's perspective on 2016's proposed rulemaking, please refer to our comment letter submitted to the six agencies in July 2016.

Request for Comment

The bank regulators are seeking comments on twenty-seven pages of questions set forth in the release of the re-proposed rule. These questions cover a broad range of topics including a number of specific alternatives to the proposed rule, many of which would add new prescriptive requirements to the regulations, such as:

- Moving from a three-tiered structure to two tiers (all banks with assets greater than $50 billion would be in the top tier);
- Requiring performance goals to be set before the beginning of the performance period;
- Reducing the limit on stock options at large banks from 15% to 10% of total incentives;
- Removing discretion from forfeiture and clawback provisions for large banks, making these mandatory;
- Requiring large banks to have contracts with employees that ban personal hedging of incentive compensation;
- Prohibiting large banks from having any incentive compensation based on revenue or volume without regard to transaction quality or compliance with sound risk management; and
- Requiring large banks to consider input from risk and control functions when setting incentive compensation for senior executives and significant risk takers.

Comments are due on or before 60 days after the date of publication in the Federal Register. In the meantime, each regulator is accepting comments.

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Meridian Comment

The lack of participation from the Federal Reserve throws the current round of rulemaking into uncharted and uncertain territory, particularly given the Chair's comments. It seems likely that political considerations in Washington may ultimately break the logjam. Regardless, we are now halfway through the second decade since the original Dodd-Frank legislation was passed, and nearly a full decade since the last round of proposed rulemaking. The long wait for clarity continues.

The ***Client Update*** is prepared by Meridian Compensation Partners' Financial Services Group led by Andrew McElheran, Daniel Rodda, Darren Moskovitz, and Laura Hay. Questions regarding this Client Update may be directed to each via our website.

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