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UA36I/29 Gary Ransdell - Federal Reserve Board - Final Guidance on Incentive Compensation

St. Louis Federal Reserve Board

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From: "Mary.H.Karr@stls.frb.org" <Mary.H.Karr@stls.frb.org>

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The text is selectively drawn from the original and summarized. Full text:
<http://www.federalreserve.gov/newsevents/press/bcreg/20100621a.htm>

The Federal Reserve, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, and the Federal Deposit Insurance Corporation issued final guidance today to ensure that incentive compensation arrangements at financial organizations take into account risk and are consistent with safe and sound practices. The Federal Reserve has completed a first round of in-depth analysis of incentive compensation practices at large, complex banking organizations as part of a horizontal review, a coordinated examination of practices across multiple firms. Last month, the Federal Reserve delivered assessments to the firms that included analysis of current compensation practices and areas requiring prompt attention. Firms are submitting plans to the Federal Reserve outlining steps and timelines for addressing outstanding issues to ensure that incentive compensation plans do not encourage excessive risk-taking.

"Many large banking organizations have already implemented some changes in their incentive compensation policies, but more work clearly needs to be done," Federal Reserve Governor Daniel K. Tarullo said. "The Federal Reserve expects firms to make material progress this year on the matters identified."

The banking agencies will be conducting additional horizontal reviews of incentive compensation practices at the large, complex banking organizations for employees in certain business lines, such as mortgage originators. The agencies will also be following up on specific areas that were found to be deficient at many firms, such as:

- Many firms need better ways to identify which employees, either individually or as a group, can expose banking organizations to material risk;
- While many firms are using or are considering various methods to make incentive compensation more risk sensitive, many are not fully capturing the risks involved and are not applying such methods to enough employees;
- Many firms are using deferral arrangements to adjust for risk, but they are not tailoring these deferral arrangements according to the type or duration of risk; and
- Many firms do not adequately evaluate whether established practices are successful in balancing risk.

The agencies are also working to incorporate oversight of incentive compensation arrangements into the regular examination process for smaller firms.

The guidance is designed to ensure that incentive compensation arrangements at banking organizations appropriately tie rewards to longer-term performance and do not undermine the safety and soundness of the firm or create undue risks to the financial system. Because improperly structured compensation arrangements for both executive and non-executive employees may pose safety and soundness risks, the guidance applies not only to top-level managers, but also to other employees who have the ability to

materially affect the risk profile of an organization, either individually or as part of a group.

Federal Reserve staff will prepare a report after the conclusion of 2010 on trends and developments in compensation practices at banking organizations.

The guidance will become effective when published in the Federal Register.

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