FDIC

Federal Deposit Insurance Corporation
550 17th Street NW, Washington, D.C. 20429-9990

Financial Institution Letter
FIL-1-2010
January 14, 2010

EMPLOYEE COMPENSATION

Advance Notice of Proposed Rulemaking

Summary: On January 12, 2010, the FDIC issued the attached advance notice of proposed rulemaking (ANPR) seeking comment on ways that the FDIC's risk-based deposit insurance assessment system (risk-based assessment system) could be changed to account for the risks posed by certain employee compensation programs. The FDIC does not seek to limit the amount of employee compensation, but rather is concerned with adjusting risk-based deposit insurance assessment rates (risk-based assessment rates) to adequately compensate the Deposit Insurance Fund (DIF) for the risks inherent in the design of certain compensation programs. By doing this, the FDIC seeks to provide incentives for institutions to adopt compensation programs that better align employees' interests with the long-term interests of the firm and its stakeholders, including the FDIC. Any change to the risk-based assessment system would be intended to improve the way risk is differentiated among institutions rather than generate revenue for the DIF. Comments are due 30 days following publication of the ANPR in the *Federal Register*.

Distribution:
All FDIC-Insured Institutions

Suggested Routing:
Chief Executive Officer
President
Chief Financial Officer

Related Topics:
FDIC Regulations Governing the Assessment Process, 12 CFR Part 327

Attachment:
Advance Notice of Proposed Rulemaking

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Note:
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Highlights:

- The FDIC seeks to develop criteria that are straightforward. The criteria should allow the FDIC to determine whether an institution has adopted a compensation system that either meets a defined standard or does not. The FDIC could then use whether an institution's system meets that standard when setting assessment rates.

- The FDIC does not seek to impose a ceiling on the level of compensation that institutions may pay their employees. Rather, the criteria should focus on whether an employee compensation system is likely to be successful in aligning employee performance with the long-term interests of the firm and its stakeholders, including the FDIC.

- Any compensation-based adjustment should complement supervisory initiatives to ensure that institutions have compensation policies that do not encourage excessive risk-taking and that are consistent with the safety and soundness of the organization.

EMPLOYEE COMPENSATION
Advance Notice of Proposed Rulemaking

On January 12, 2010, the FDIC Board of Directors (Board) issued an advance notice of proposed rulemaking seeking comment on ways that the FDIC's risk-based deposit insurance assessment system (risk-based assessment system) could be changed to account for the risks posed by certain employee compensation programs. The FDIC is exploring whether and, if so, how to incorporate employee compensation criteria into the risk-based assessment system. The FDIC does not seek to limit the amount of employee compensation, but rather is concerned with adjusting risk-based deposit insurance assessment rates (risk-based assessment rates) to adequately compensate the Deposit Insurance Fund (DIF) for the risks inherent in the design of certain compensation programs. By doing this, the FDIC seeks to provide incentives for institutions to adopt compensation programs that better align employees' interests with the long-term interests of the firm and its stakeholders, including the FDIC.

The FDIC seeks to develop criteria that are straightforward and that would allow the FDIC to determine whether an institution has adopted a compensation system that either meets a defined standard or does not. The FDIC does not seek to impose a ceiling on the level of compensation that institutions may pay their employees. Rather, the criteria should focus on whether an employee compensation system is likely to be successful in aligning employee performance with the long-term interests of the firm and its stakeholders, including the FDIC. Any adjustment to the risk-based assessment system should complement supervisory initiatives to ensure that institutions have compensation policies that do not encourage excessive risk-taking and that are consistent with the safety and soundness of the organization.

Potential Features.

Compensation programs that meet the FDIC's goals may include the following features:

1. A significant portion of compensation for employees whose business activities can present greater risk to the institution and who also receive a portion of their compensation according to formulas based on meeting performance goals should be comprised of restricted, non-discounted company stock. Restricted, non-discounted company stock would be stock that becomes available to the employee at intervals over a period of years. Additionally, the stock would initially be awarded at the closing price in effect on the day of the award. Such employees would include the institution's senior management, among others.

2. Significant awards of company stock should only become vested over a multi-year period and should be subject to a look-back mechanism (e.g., clawback) designed to account for the outcome of risks assumed in earlier periods.

3. The compensation program should be administered by a committee of the Board composed of independent directors with input from independent compensation professionals.

Under the approach contemplated above, the FDIC could conclude that firms that are able to attest that their compensation programs include the identified features present a decreased risk to the DIF and, therefore, would face a lower risk-based assessment rate than those firms that could not make such attestation. Alternatively, the FDIC could conclude that firms that cannot attest that their compensation programs include these features present an increased risk to the DIF and, therefore, would face a higher risk-based assessment rate than those firms that do make such attestation.

Comments Requested.

The FDIC requests comment on all aspects of the proposal to incorporate employee compensation criteria into the FDIC's risk-based assessment system, including comments on the FDIC's stated goals and the features of compensation programs that meet such goals. In particular, the FDIC invites comment on the following:

1. Should an adjustment be made to the risk-based assessment rate an institution would otherwise be charged if the institution could/could not attest (subject to verification) that it had a compensation system that included the following elements?

    a. A significant portion of compensation for employees whose business activities can present significant risk to the institution and who also receive a portion of their compensation according to formulas based on meeting performance goals would be comprised of restricted, non-discounted company stock. The employees affected would include the institution's senior management, among others. Restricted, non-discounted company stock would be stock that becomes available to the employee at intervals over a period of years. Additionally, the stock would initially be awarded at the closing price in effect on the day of the award.
    b. Significant awards of company stock would only become vested over a multi-year period and would be subject to a look-back mechanism (e.g., clawback) designed to account for the outcome of risks assumed in earlier periods.
    c. The compensation program would be administered by a committee of the board composed of independent directors with input from independent compensation professionals.

2. Should the FDIC's risk-based assessment system reward firms whose compensation programs present lower risk or penalize institutions with programs that present higher risks?

3. How should the FDIC measure and assess whether an institution's board of directors is effectively overseeing the design and implementation of the institution's compensation program?

4. As an alternative to the FDIC's contemplated approach (see q. 1), should the FDIC consider the use of quantifiable measures of compensation—such as ratios of compensation to some specified variable—that relate to the institution's health or performance? If so, what measure(s) and what variables would be appropriate?

5. Should the effort to price the risk posed to the DIF by certain compensation plans be directed only toward larger institutions; institutions that engage only in certain types of activities, such as trading; or should it include all insured depository institutions?

6. How large (that is, how many basis points) would an adjustment to the initial risk-based assessment rate of an institution need to be in order for the FDIC to have an effective influence on compensation practices?

7. Should the criteria used to adjust the FDIC's risk-based assessment rates apply only to the compensation systems of insured depository institutions? Under what circumstances should the criteria also consider the compensation programs of holding companies and affiliates?

8. How should the FDIC's risk-based assessment system be adjusted when an employee is paid by both the insured depository institution and its related holding company or affiliate?

9. Which employees should be subject to the compensation criteria that would be used to adjust the FDIC's risk-based assessment rates? For example, should the compensation criteria be applicable only to executives and those employees who are in a position to place the institution at significant risk? If the criteria should only be applied to certain employees, how would one identify these employees?

10. How should compensation be defined?

11. What mix of current compensation and deferred compensation would best align the interests of employees with the long-term risk of the firm?

12. Employee compensation programs commonly provide for bonus compensation. Should an adjustment be made to risk-based assessment rates if certain bonus compensation practices are followed, such as: awarding guaranteed bonuses; granting bonuses that are greatly disproportionate to regular salary; or paying bonuses all-at-once, which does not allow for deferral or any later modification?

13. For the purpose of aligning an employee's interests with those of the institution, what would be a reasonable period for deferral of the payment of variable or bonus compensation? Is the appropriate deferral period a function of the amount of the award or

of the employee's position within the institution (that is, large bonus awards or awards for more senior employees would be subject to greater deferral)?

14. What would be a reasonable vesting period for deferred compensation?

15. Are there other types of executive compensation arrangements that would have a greater potential to align the incentives of employees with those of the firm's other stakeholders, including the FDIC?

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