TO: Board of Directors

FROM: Doreen R. Eberley, Director
Division of Risk Management Supervision

DATE: April 29, 2024

SUBJECT: Notice of Proposed Rulemaking on Incentive-based Compensation Arrangements

I. RECOMMENDATION

Staff recommends that the FDIC Board of Directors ("Board") approve the attached Notice of Proposed Rulemaking ("NPR," "proposed rule," or "the proposal") *entitled* **"Incentive-based Compensation Arrangements."**

II. SUMMARY

The NPR would implement section 956 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (section 956),[1] which requires the appropriate Federal regulators—the FDIC, the Board of Governors of the Federal Reserve System (FRB), the Office of the Comptroller of the Currency (OCC), the National Credit Union Administration (NCUA), the Federal Housing Finance Agency (FHFA), and the U.S. Securities and Exchange Commission (SEC)—to jointly prescribe regulations or guidelines with respect to incentive-based compensation practices at certain financial institutions that have $1 billion or more in assets. The NPR is being proposed by the FDIC, the OCC, the NCUA, and the FHFA (referred to as the "Agencies" for purposes of this NPR). The FRB has not acted to join this proposal. The SEC has included a rulemaking to implement section 956 on its Fall 2023 rulemaking agenda.[2] All six regulators will continue to coordinate to reach consensus on implementing section 956. If approved by the Board, and subject to adoption and approval by the other Agencies, along with the FRB and SEC, the NPR would be published jointly in the *Federal Register* with a 60 day comment period.

In this proposal, the Agencies are re-proposing the regulatory text previously proposed by the Agencies, the FRB, and the SEC, in June 2016, along with proposing certain alternatives and questions, for public comment. The proposed rule includes prohibitions intended to make incentive-based compensation arrangements more sensitive to risk, such as a prohibition on incentive-based compensation arrangements that do not include risk adjustment of awards, deferral of payments, and forfeiture and clawback provisions. The prohibitions also emphasize

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[1] Public Law 111–203, 124 Stat. 1376 (2010), codified at 12 U.S.C. 5641.

[2] *See* Agency Rule List – Fall 2023, Securities Exchange Commission, *available at* https://www.reginfo.gov/public/do/eAgendaMain?operation=OPERATION_GET_AGENCY_RULE_LIST&currentPub=true&agencyCode&showStage=active&agencyCd=3235.

Concur:

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Harrel M. Pettway
General Counsel

the important role of sound governance and risk management control mechanisms. These prohibitions would help safeguard covered institutions from types and features of incentive-based compensation arrangements that encourage inappropriate risks. The recordkeeping and disclosure requirements in the proposed regulatory text would assist the appropriate Federal regulator in monitoring and identifying areas of potential concern at covered institutions.

III. BACKGROUND

A. Statutory Mandate

Section 956 requires the appropriate Federal regulators to jointly prescribe regulations or guidelines with respect to incentive-based compensation practices at certain financial institutions that have $1 billion or more in assets (referred to as "covered financial institutions").[3] Specifically, section 956 requires that the FDIC, OCC, FRB, SEC, NCUA, and FHFA prohibit any types of incentive-based compensation[4] arrangements, or any feature of any such arrangements, that these regulators determine encourage inappropriate risks by a covered financial institution: (1) by providing an executive officer, employee, director, or principal shareholder of the covered financial institution with excessive compensation, fees, or benefits; or (2) that could lead to material financial loss to the covered financial institution.[5]

Under section 956, a covered financial institution also must disclose to its appropriate Federal regulator the structure of its incentive-based compensation arrangements sufficient to determine whether the structure provides excessive compensation, fees, or benefits or could lead to material financial loss to the institution.[6] Section 956 does not require a covered financial institution to report the actual compensation of particular individuals.

Section 956 also requires that any compensation standards adopted under the section be comparable to the safety and soundness standards applicable to insured depository institutions under section 39 of the FDIA[7] and that the appropriate Federal regulators take the compensation

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[3] Section 956 defines "covered financial institution" to include any of the following types of institutions that have $1 billion or more in assets: (A) a depository institution or depository institution holding company, as such terms are defined in section 3 of the Federal Deposit Insurance Act ("FDIA") (12 U.S.C. 1813); (B) a broker-dealer registered under section 15 of the Securities Exchange Act of 1934 (15 U.S.C. 78o); (C) a credit union, as described in section 19(b)(1)(A)(iv) of the Federal Reserve Act[3]; (D) an investment adviser, as such term is defined in section 202(a)(11) of the Investment Advisers Act of 1940 (15 U.S.C. 80b–2(a)(11)); (E) the Federal National Mortgage Association (Fannie Mae); (F) the Federal Home Loan Mortgage Corporation (Freddie Mac); and (G) any other financial institution that the appropriate Federal regulators, jointly, by rule, determine should be treated as a covered financial institution for these purposes. 12 U.S.C. 5641(e)(2).

[4] Section 956(b) uses the term "incentive-based payment arrangement." In section 956, it appears that Congress used the terms "incentive-based payment arrangement" and "incentive-based compensation arrangement" interchangeably. The Agencies have chosen to use the term "incentive-based compensation arrangement" throughout the proposed rule for the sake of clarity and consistency.

[5] *See* 12 U.S.C. 5641(b).

[6] *See* 12 U.S.C. 5641(a)(1).

[7] 12 U.S.C. 1831p–1. The OCC, FRB, and FDIC (collectively, the "Federal Banking Agencies") each have adopted guidelines implementing the compensation-related and other safety and soundness standards in section 39 of the FDIA. *See* Interagency Guidelines Establishing Standards for Safety and Soundness (the "Federal Banking Agency

standards described in section 39 of the FDIA into consideration in establishing compensation standards under section 956.[8]

B. Previous Issuances

1. <u>2011 Proposed Rule</u>[9]

On April 14, 2011, the FDIC, FRB, OCC, NCUA, SEC, and NCUA published a notice of proposed rulemaking ("2011 Proposed Rule") to implement section 956. The 2011 Proposed Rule would have provided seven factors for determining whether compensation paid is unreasonable or disproportionate to the services performed by a covered person. The 2011 Proposed Rule also would have required incentive-based compensation arrangements at covered financial institutions to meet three key principles-based requirements—that incentive-based compensation arrangements appropriately balance risk and financial rewards, be compatible with effective risk management and controls, and be supported by strong corporate governance.

Moreover, the 2011 Proposed Rule included two additional requirements for "larger covered financial institutions."[10] The first would have required these larger financial institutions to defer 50 percent of the incentive-based compensation for executive officers for a period of at least three years. The second would have required the board of directors (or a committee thereof) to identify and approve the incentive-based compensation for those covered persons who individually have the ability to expose the institution to possible losses that are substantial in relation to the institution's size, capital, or overall risk tolerance, such as traders with large position limits and other individuals who have the authority to place at risk a substantial part of the capital of the covered financial institution.

The FDIC, FRB, OCC, NCUA, SEC, and NCUA received more than 10,000 comments on the 2011 Proposed Rule.

Safety and Soundness Guidelines"), 12 CFR part 30, Appendix A (OCC); 12 CFR part 208, Appendix D–1 (FRB); 12 CFR part 364, Appendix A (FDIC).

[8] 12 U.S.C. 5641(c). Section 39 provides that compensation is excessive when the amounts are unreasonable or disproportionate to the services actually performed by the individual taking into consideration: (A) the combined value of all cash and noncash benefits provided to the individual; (B) the compensation history of the individual and other individuals with comparable expertise at the institution; (C) the financial condition of the institution; (D) comparable compensation practices at comparable institutions, based upon such factors as asset size, geographic location, and the complexity of the loan portfolio or other assets; (E) for postemployment benefits, the projected total cost and benefit to the institution; (F) any connection between the individual and any fraudulent act or omission, breach of trust or fiduciary duty, or insider abuse with regard to the institution; and (G) other factors that the agency determines to be relevant. 12 U.S.C. 1831p–1(c).

[9] 76 FR 21170 (April 14, 2011).

[10] In the 2011 Proposed Rule, the term "larger covered financial institution" for the Federal Banking Agencies and the SEC meant those covered financial institutions with total consolidated assets of $50 billion or more. For the NCUA, all credit unions with total consolidated assets of $10 billion or more would have been larger covered financial institutions. For FHFA, Fannie Mae, Freddie Mac, and all Federal Home Loan Banks with total consolidated assets of $1 billion or more would have been larger covered financial institutions.

2. 2016 Proposed Rule[11]

On June 10, 2016, the FDIC, FRB, OCC, NCUA, SEC, and FHFA published a second notice of proposed rulemaking to implement section 956 ("2016 Proposed Rule").

In this NPR, the Agencies are re-proposing the same regulatory text from the 2016 Proposed Rule. Key provisions are discussed in further detail below.

The FDIC, FRB, OCC, NCUA, SEC, and NCUA have reviewed and continue to consider the comments on the 2016 Proposed Rule.

C. Relevant Supervisory Experience and Developments

Section 956 was enacted by Congress to address certain types of incentive-based compensation arrangements that can lead to significant risks for financial institutions.[12] More recent supervisory experience continues to demonstrate the potential negative impact of misaligned incentive-based compensation arrangements on financial institutions.

For example, in September 2016, flawed incentive-based compensation practices led to the sales practices misconduct at Wells Fargo that resulted in harm to customers and fines, penalties and enormous reputational damage to the financial institution.[13] Wells Fargo's

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[11] 81 FR 37673 (June 10, 2016).

[12] In considering earlier legislation that formed the basis for section 956, the majority members of the Committee on Financial Services of the House of Representatives found that "a broad consensus has developed that executive and financial institution compensation structures relate directly to both the safety and soundness of individual financial institutions and the health of the broader financial system." *See* H.R. Rep. 111-236, Corporate and Financial Institution Compensation Fairness Act of 2009, at 6 (2009). *See also* Compensation Structure and Systemic Risk: Hearing Before the H. Comm. on Financial Services, 111th Cong. (2009).

[13] On September 8, 2016, the OCC assessed Wells Fargo a $35 million civil money penalty and issued a cease and desist order. *See* OCC, New Release 2016-106, *OCC Assesses Penalty Against Wells Fargo, Orders Restitution for Unsafe or Unsound Sales Practices*, (Sept. 8, 2016), *available at* https://www.occ.gov/news-issuances/news-releases/2016/nr-occ-2016-106.html (citing Wells Fargo Bank, N.A., Consent Order for a Civil Money Penalty, AA-EC-2016-67 (OCC, Sept. 6, 2016); Wells Fargo Bank, N.A., Consent Order, AA-EC-2016-66 (OCC, Sept. 6, 2016)). Further, on September 8, 2016, the Consumer Financial Protection Bureau (CFPB) issued a consent order to Wells Fargo that required the bank to (1) pay full refunds to consumers, (2) ensure proper sales practices, and (3) pay a $100 million fine. *See* CFPB, *Consumer Financial Protection Bureau Fines Wells Fargo $100 Million for Widespread Illegal Practices of Secretly Opening Unauthorized Accounts*, (Sept. 8, 2016) *available at* https://www.consumerfinance.gov/about-us/newsroom/consumer-financial-protection-bureau-fines-wells-fargo-100-million-widespread-illegal-practice-secretly-opening-unauthorized-accounts/ (citing Wells Fargo Bank, N.A., Consent Order, 2016-CFPB-0015 (Sept. 8, 2016)). On January 23, 2020, the OCC issued a notice of charges against five former senior Wells Fargo bank executives and announced settlements with the bank's former Chief Executive Officer and other members of the bank's operating committee. On March 15, 2023, the OCC announced that it had settled with eight former Wells Fargo senior bank executives to date, including the bank's former general counsel and former head of its Community Bank. *See* OCC, News Release 2020-6, *OCC Issues Notice of Charges Against Five Former Senior Wells Fargo Bank Executives, Announces Settlement with Others* (Jan. 23, 2020), *available at* https://www.occ.gov/news-issuances/news-releases/2020/nr-occ-2020-6.html.

compensation structure provided branch employees financial incentives to meet sales volume goals, without sufficient controls and oversight.

The bank failures in Spring 2023 also highlighted the importance of a financial institution's risk management practices and governance arrangements, including the incentives provided by senior management compensation schemes. Reports concerning the 2023 failures of Silicon Valley Bank, Signature Bank of New York, and First Republic Bank identified common weaknesses. These included excessive focus on growth and short-term profitability, and a lack of risk metrics in the banks' compensation policies and practices that may have encouraged excessive risk taking.[14] A report on the failure of Silicon Valley Bank noted that compensation packages of senior management through 2022 were tied to short-term earnings and equity returns and did not include risk metrics, and as such, the report concluded that managers had a financial incentive to focus on short-term profit over sound risk management.[15]

Since issuing the 2016 Proposed Rule, the Agencies have continued to address incentive-based compensation practices at supervised financial institutions as part of their ongoing supervision or other statutory responsibilities.[16] However, despite regulatory developments and supervisory efforts in this area since 2016, the Agencies continue to believe that a consistent set of enforceable standards, as proposed in this rulemaking, can play an important role in helping ensure that incentive compensation practices at covered financial institutions do not threaten their safety and soundness, are not excessive, and do not lead to material financial loss.

IV. PROPOSED RULE

A. Overview

In this proposal, the Agencies are re-proposing the regulatory text of the 2016 Proposed Rule, along with proposing certain alternatives and questions, for public comment. The Agencies believe that the prohibitions described in the 2016 Proposed Rule and under this proposal are consistent with section 956's mandate and would help safeguard covered financial institutions from the types and features of incentive-based compensation arrangements that encourage inappropriate risks.

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[14] *Id. See also Review of the Federal Reserve's Supervision and Regulation of Silicon Valley Bank*, Michael Barr, Board Vice Chairman for Supervision (Apr. 28, 2023), *available at* https://www.federalreserve.gov/publications/review-of-the-federal-reserves-supervision-and-regulation-of-silicon-valley-bank.htm; Office of Inspector General for the Board of Governors of the Federal Reserve System, "Material Loss Review of Silicon Valley Bank," 2023-SR-B-013 (Sept. 25, 2023), *available at* https://oig.federalreserve.gov/reports/board-material-loss-review-silicon-valley-bank-sep2023.pdf; Government Accountability Office, Report to the Committee on Financial Services, House of Representatives: Preliminary Review of Agency Actions Related to March 2023 Bank Failures (April 28, 2023), *available at* https://www.gao.gov/assets/gao-23-106736.pdf.

[15] *See* the Bank for International Settlements (BIS) Basel Committee on Banking Supervision, *Report on the 2023 banking turmoil* (Oct. 2023), at 7-8.

[16] In addition to section 39 of the FDIA, the FBA's supervisory work is informed by the Guidance on Sound Incentive Compensation Policies. 75 FR 36395 (June 25, 2010).

In consideration of the passage of time since the 2016 Proposed Rule was issued, additional supervisory experience, changes in industry practice, and other developments, [17] the Agencies are seeking additional feedback from commenters on the re-proposed regulatory text as well as on potential alternatives discussed in the preamble. The Agencies also note that the NPR includes regulatory text provisions from the 2016 Proposed Rule that address covered institutions on a consolidated basis.[18] The Agencies recognize that this may implicate FRB-supervised entities – namely depository institution holding companies – and SEC-regulated entities, and the Agencies will continue to coordinate with the FRB and the SEC on these and other issues, consistent with the requirements of section 956.[19]

Comments received on this proposal, as well as those submitted on the 2016 Proposed Rule, will further inform efforts to implement section 956's mandate.

B. Key requirements

1. Scope and Applicability to Covered Institutions

The proposed rule would define "covered institution" to include the covered financial institutions defined in section 956: depository institutions, depository institution holding companies, credit unions, Fannie Mae, and Freddie Mac.[20] In addition, the Agencies propose to jointly, by rule, designate Federal Home Loan Banks as covered institutions.

The proposed rule would distinguish covered institutions by asset size, applying less prescriptive incentive-based compensation program requirements to the smallest covered financial institutions within the statutory scope, and progressively more rigorous requirements to the larger covered institutions. The proposed rule identifies three categories of covered institutions based on average total consolidated assets:

- Level 1 (greater than or equal to $250 billion);

[17] Since the publication of the 2016 Proposed Rule, the SEC adopted a final rule and amendments to implement clawback provisions required by section 954 of the Dodd-Frank Act. *Listing Standards for Recovery of Erroneously Awarded Compensation*, Release No. 33-11126 (Oct. 26, 2022), 87 FR 73076 (Nov. 28, 2022). Under the new Exchange Act Rule 10D-1 and related amendments, the national securities exchanges have adopted listing standards that require listed issuers to recover incentive-based compensation from an executive officer if it was received during the three years preceding the date a restatement is required. A listed issuer must recover the amount of incentive-based compensation received by an executive officer that exceeds the amount the executive officer would have received had the incentive-based compensation been determined based on the accounting restatement, except to the extent that such recovery is impracticable. Such recovery must be on a "no fault" basis. In addition, the standards require a listed issuer to file its compensation recovery policy as an exhibit in its Exchange Act annual report. *See* 17 CFR 240.10D-1(a), amendments to Items 402 and 601 of Regulation S-K, the addition of Item 22(b)(20) to Schedule 14A, and amendments to Form 40-F and Form 20-F (and for listed funds, Form N-CSR).

[18] For covered financial institutions that are subsidiaries of other covered financial institutions, the requirements that apply would generally be determined by reference to the average total consolidated assets of the top-tier parent covered financial institution.

[19] The statute provides that the "appropriate Federal regulators jointly shall prescribe regulations or guidelines." The Agencies, the FRB, and the SEC will take coordinated and joint action consistent with the requirements of section 956.

[20] *See supra* note 4.

- Level 2 (greater than or equal to $50 billion and less than $250 billion); and
- Level 3 (greater than or equal to $1 billion and less than $50 billion).[21]

Under the proposed rule, covered institutions that are subsidiaries of other covered institutions would be subject to the same requirements, and be defined to be the same level, as the parent covered institution, even if the subsidiary covered institution is smaller than the parent covered institution. This feature is referred to as "consolidation" and is designed to reinforce the ability of institutions to establish and maintain effective risk management and controls for the entire consolidated organization with respect to the organization's incentive-based compensation program.

Covered persons are defined under the proposed rule as any executive officer, employee, director or principal shareholder who receives incentive-based compensation at a covered institution.

2. <u>General Prohibitions</u>

All covered institutions would be subject to general prohibitions on incentive compensation arrangements that encourage inappropriate risk by providing excessive compensation or that could lead to material financial loss. With respect to excessive compensation, the proposed rule provides six factors for determining whether compensation paid would be unreasonable or disproportionate to the services performed by the covered person.[22]

For the material financial loss prohibition, the proposed rule would require incentive-based compensation arrangements at covered institutions to meet three key principles—that incentive-based compensation arrangements appropriately balance risk and financial rewards, be compatible with effective risk management and controls, and be supported by strong corporate governance. In addition, the proposed rule specifically provides that an incentive-based compensation arrangement would not be considered to appropriately balance risk and reward unless it included financial and non-financial measures of performance; was designed to allow non-financial measures of performance to override financial measures of performance, when appropriate; and was subject to adjustment to reflect actual losses, inappropriate risks taken,

[21] The proposed rule also contains a reservation of authority that would allow the appropriate Federal regulator to require a Level 3 covered institution to comply with some or all of the provisions applicable to Level 1 and Level 2 institutions if the appropriate Federal regulator determined that the Level 3 covered institution's complexity of operations or compensation practices were consistent with those of a Level 1 or Level 2 covered institution.

[22] Under the proposed rule, compensation would be considered excessive when amounts paid are unreasonable or disproportionate to the value of the services performed by a covered person, taking into consideration all relevant factors, including, but not limited to: (1) The combined value of all compensation, fees, or benefits provided to the covered person; (2) the compensation history of the covered person and other individuals with comparable expertise at the covered institution; (3) the financial condition of the covered institution; (4) compensation practices at comparable institutions, based upon such factors as asset size, geographic location, and the complexity of the covered institution's operations and assets; (5) for post-employment benefits, the projected total cost and benefit to the covered institution; and (6) any connection between the covered person and any fraudulent act or omission, breach of trust or fiduciary duty, or insider abuse with regard to the covered institution. As required by section 956, these factors are comparable to the excessive compensation factors in section 39 of the FDIA. *See* 12 U.S.C. 1831p–1. As with the 2016 Proposed Rule, this NPR does not include the seventh factor that appeared in the 2011 Proposed Rule, "Any other factors that the [Agency] determines to be relevant."

compliance deficiencies, or other measures or aspects of financial and non-financial performance.

The proposed rule also would require covered institutions to create and maintain for at least seven years records documenting the structure of their incentive-based compensation arrangements and demonstrating compliance with the rule, and that such records be disclosed to an institution's primary Federal regulator upon request.

3. Additional Prohibitions and Requirements Applicable to Larger Covered Institutions

Level 1 and Level 2 institutions would be subject to additional requirements described below, many of which would expressly apply to "senior executive officers" and "significant risk takers" who receive incentive-based compensation.

"Senior executive officers" would be defined as a covered person who holds the title or, without regard to title, salary, or compensation, performs the function of one or more of the following positions at a covered institution for any period of time in the relevant performance period: President, chief executive officer, executive chairman, chief operating officer, chief financial officer, chief investment officer, chief legal officer, chief lending officer, chief risk officer, chief compliance officer, chief audit executive, chief credit officer, chief accounting officer, or head of a major business line or control function.

"Significant risk-takers" would be defined under one of two tests: 1) as covered persons who are among the top 5 percent (for Level 1 covered institutions), or top 2 percent (for Level 2 covered institutions), of highest compensated covered persons (excluding senior executive officers) in the entire consolidated organization, including affiliated covered institutions (the relative compensation test) or, 2) as a covered person who has the authority to commit or expose 0.5 percent or more of the capital of the covered institution or an affiliate that is itself a covered institution (the "exposure test").

a. Deferral, Forfeiture and Downward Adjustment, and Clawback Requirements

For Level 1 and Level 2 covered institutions, the proposed rule would require that incentive-based compensation arrangements for certain covered persons be subject to deferral of payments. Deferral requirements would apply to significant risk-takers as well as senior executive officers, and would require 40, 50, or 60 percent deferral depending on the size of the covered institution and whether the covered person receiving the incentive-based compensation was a senior executive officer or a significant risk-taker. Deferral periods range from one to four years depending on the type of incentive-based compensation arrangement, the size of the covered institution, and whether the covered person is a senior executive officer or a significant risk-taker.

A Level 1 or Level 2 covered institution would be required to consider forfeiture or downward adjustment of incentive-based compensation if any of the following adverse outcomes occurred: poor financial performance due to deviation from risk guidelines; inappropriate risk taking; material risk management or control failures; statutory, regulatory or supervisory noncompliance that results in enforcement or legal action by agencies or financial restatement; other poor performance or misconduct.

A Level 1 or Level 2 covered institution would be required to include clawback provisions in the incentive-based compensation arrangements for senior executive officers and significant risk-takers that, at a minimum, allow the covered institution to recover incentive-based compensation for seven years following the date on which such compensation vests, if the covered institution determined that a current or former senior executive officer or significant risk-taker engaged in misconduct that resulted in significant financial or reputational harm to the covered institution, fraud, or intentional misrepresentation of information used to determine the senior executive officer or significant risk-taker's incentive-based compensation.[23]

b. Other Prohibitions

The proposed rule contains a number of additional prohibitions that would apply to Level 1 and Level 2 covered institutions, including the following:

- *Options.* If a senior executive officer or significant risk-taker at a Level 1 or Level 2 covered institution receives incentive-based compensation in form of options, the amount of such options used to meet the minimum required deferred compensation could not exceed 15 percent of the amount of total incentive-based compensation awarded for the performance period.

- *Hedging.* Level 1 and Level 2 covered institutions would be prohibited from purchasing hedging instruments for covered persons that offset any decrease in the value of incentive-based compensation arrangements.

- *Maximum incentive-based compensation opportunity (also referred to as leverage).* A Level 1 or Level 2 covered institution would be prohibited from awarding incentive-based compensation to a senior executive officer in excess of 125 percent of the target amount for that incentive-based compensation. For a significant risk-taker the limit would be 150 percent of the target amount for that incentive-based compensation.

- *Relative Performance measures.* A Level 1 or Level 2 covered institution would be prohibited from using performance measures based solely on industry peer performance comparisons.

- *Volume-driven pay.* A Level 1 or Level 2 covered institution would be prohibited from providing incentive-based compensation to a covered person based solely on transaction revenue or volume without regard to transaction quality or compliance with sound risk management.

c. Risk Management and Controls

[23] It should be noted that covered institutions with a class of securities listed on a national securities exchange or association are required to comply with the clawback requirements of Securities Exchange Act Rule 10D-1, which requirement will continue to apply following the adoption of any final rule to implement section 956.

The proposed rule would require all Level 1 and Level 2 covered institutions to have a risk management framework for their incentive-based compensation programs that is independent of any lines of business, includes an independent compliance program, and is commensurate with the size and complexity of the covered institution's operations.

d. Governance

The proposed rule would require each Level 1 or Level 2 covered institution to establish a compensation committee composed solely of directors who are not senior executive officers. The compensation committee would be required to obtain input from the covered institution's risk and audit committees, and risk management function, including an independent written assessment, on the effectiveness of risk measures and adjustments used to balance incentive-based compensation arrangements.

e. Policies and Procedures

The proposed rule would require all Level 1 and Level 2 covered institutions to have policies and procedures that, among other things, specify procedures for forfeiture and clawback; document final forfeiture, downward adjustment, and clawback decisions; and specify the substantive and procedural criteria for the acceleration of payments of deferred incentive-based compensation to a covered person.

C. Alternatives

Based on experiences in reviewing and supervising incentive-based compensation at some covered institutions, the Agencies are considering, and seeking public comments on all aspects of the proposed rule including the following specific alternative regulatory provisions:

- *Compliance date.* The Agencies are seeking feedback on reducing the timeline for complying with the rule from 540 days to 365 days after a final rule is published in the *Federal Register*.

- *Including Credit Union Service Organizations ("CUSOs") in the definition of "affiliate."* While CUSOs would not fall within the proposed rule's "affiliate" definition, the NCUA is considering whether CUSOs should be included under that definition.

- *Two-tiered Asset Thresholds.* The Agencies are considering whether it would be appropriate to establish a two-level structure rather than a three-level structure. Under such an approach, the general prohibitions and requirements would, similar to the NPR, apply to all covered institutions, and the proposed additional prohibitions and requirements could apply to covered institutions with average consolidated assets of more than $50 billion.

- *Significant risk-taker definition.*

- The Agencies are considering, as an alternative, whether to simplify the significant risk-taker definition by replacing the two tests (i.e., relative compensation test and exposure test), with requiring covered institutions to identify significant risk-takers and submit a notice of its identification methodology to its primary Federal regulator.

    - As an option under this alternative, the Agencies could require that covered institutions identify significant risk-takers but require that a covered institution's identification methodology, at a minimum, capture covered persons who receive annual base salary and incentive-based compensation that places the covered persons among the top 2 percent of all covered persons (excluding senior executive officers) of a Level 1 or Level 2 covered institution. The Agencies also are considering whether this option could contain two percentage thresholds for measuring whether an individual is a significant-risk taker depending on whether the covered institution is a Level 1 (top 5 percent) or a Level 2 (top 2 percent). Covered institutions would be allowed to exclude covered persons in particular roles or functions, and primary federal regulators would be permitted to scope persons in, under certain criteria.

- Another alternative that the Agencies are considering is whether to remove the separate exposure test for determining who would be a significant risk-taker, both under the 2024 Proposed Rule and under the proposed alternative that would permit covered institutions to identify significant risk-takers.

- *Setting performance measures and targets before performance period begins.* The Agencies are considering whether to require that performance measures and targets be established before the beginning of the performance period.

- *Options.* The Agencies are considering whether to modify the proposed limit on options from 15 percent to no more than 10 percent of the amount of total incentive-based compensation awarded to the senior executive officer or significant risk-taker for that performance period.

- *Forfeiture and downward adjustment.* The Agencies are considering, as an alternative, whether to limit the discretion of a Level 1 or Level 2 covered institution to seek to recover incentive-based compensation by requiring (rather than requiring *consideration of*) forfeiture and downward adjustment of incentive-based compensation for the adverse outcomes listed in the proposed rule. Covered institutions also would be required, through policies and procedures, to formalize the governance and review processes surrounding such decision-making, and to document the decisions made.

- *Clawback.* The Agencies are considering whether to require a Level 1 or Level 2 covered institution to claw back (rather than *consider* clawing back) any vested (i.e. paid) incentive-based compensation from a current or former senior executive officer or significant risk-taker under the same circumstances as identified in the proposed rule.

This alternative would provide an exception to recovery if the covered institution can document that clawback is impracticable or an equivalent amount of incentive-based compensation has been impacted through forfeiture or downward adjustment.

- *Hedging.* The Agencies are considering whether to include an additional prohibition to prohibit a Level 1 and Level 2 covered institution from designing incentive-based compensation arrangements that allow a covered person to purchase a hedging instrument or similar instrument to offset any decrease in the value of the covered person's incentive-based compensation. This would include requiring covered institutions to have contracts with employees that ban personal hedging.

- *Volume driven incentive-based compensation.* The Agencies are considering whether to expand the prohibition in the proposed rule to cover *all* incentive-based compensation based on transaction revenue or volume, rather than limiting the provision to incentive-based compensation based *solely* on transaction revenue or volume.

- *Risk Management and Controls Requirements for Level 1 and Level 2 Covered Institutions.* The Agencies are considering adding a requirement for Level 1 and Level 2 covered institutions to include, as part of its risk management framework, a consideration of a risk management and controls assessment from the independent risk and control functions in setting incentive-based compensation for senior executive officers and significant risk-takers.

V. CONCLUSION

For the reasons set forth above, staff recommends that the Board approve the attached proposed rule for publication in the Federal Register, subject to adoption and approval by the other Agencies, along with the FRB and SEC.[24] Therefore, staff also requests Board approval to make nonsubstantive changes to the proposed rule prior to its publication to accommodate the ongoing review and approval procedures of the other Agencies, where necessary to ensure the FDIC and the other Agencies can jointly publish this document in the *Federal Register*.

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[24] The FDIC will accept comments on this proposal and post them on "Public Comments to the FDIC" page until the proposed rule is published in the Federal Register. *See* https://www.fdic.gov/regulations/laws/publiccomments/.