

**DEPARTMENT OF THE TREASURY**

**Office of the Comptroller of the Currency**

12 CFR Part 42

[Docket ID OCC-2011-0001]

RIN 1557-AD39

**FEDERAL DEPOSIT INSURANCE CORPORATION**

12 CFR Part 372

RIN 3064-AD86

**FEDERAL HOUSING FINANCE AGENCY**

12 CFR Part 1232

RIN-2590-AA42

**NATIONAL CREDIT UNION ADMINISTRATION**

12 CFR Parts 741 and 751

RIN 3133-AE48

**Incentive-Based Compensation Arrangements**

**AGENCY:** Office of the Comptroller of the Currency, Treasury; Federal Deposit Insurance Corporation; Federal Housing Finance Agency; and National Credit Union Administration.

**ACTION:** Notice of proposed rulemaking and request for public comment.

**SUMMARY:** The Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, Federal Housing Finance Agency, and National Credit Union Administration seek comment on a proposed rule to implement section 956 of the Dodd-Frank Wall Street Reform and

Consumer Protection Act. The statute requires that the appropriate Federal regulators, jointly issue regulations or guidelines: (1) prohibiting incentive-based compensation arrangements at covered financial institutions that encourage inappropriate risks by providing excessive compensation or that could lead to material financial loss; and (2) requiring those covered financial institutions to disclose information concerning incentive-based compensation arrangements to the appropriate Federal regulator.

**DATES:** Comments are due on or before **[INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE *FEDERAL REGISTER*]**.

*OCC:* Commenters are encouraged to submit comments through the Federal eRulemaking Portal. Please use the title “Incentive-Based Compensation Arrangements” to facilitate the organization and distribution of the comments. You may submit comments by any of the following methods:

- *Federal eRulemaking Portal – Regulations.gov:* Go to <https://regulations.gov/>. Enter “Docket ID OCC-2011-0001” in the Search Box and click “Search.” Public comments can be submitted via the “Comment” box below the displayed document information or by clicking on the document title and then clicking the “Comment” box on the top-left side of the screen. For help with submitting effective comments, please click on “Commenter’s Checklist.” For assistance with the *Regulations.gov* site, please call 1-866-498-2945 (toll free) Monday-Friday, 8am-7pm ET, or e-mail [regulationshelpdesk@gsa.gov](mailto:regulationshelpdesk@gsa.gov).
- *Mail:* Chief Counsel’s Office, Attention: Comment Processing, Office of the Comptroller of the Currency, 400 7th Street, SW, Suite 3E-218, Washington, DC 20219.
- *Hand Delivery/Courier:* 400 7th Street, SW, Suite 3E-218, Washington, DC 20219.

*Instructions:* You must include “OCC” as the agency name and “Docket ID OCC-2011-0001” in your comment. In general, the OCC will enter all comments received into the docket and publish the comments on the Regulations.gov website without change, including any business or personal information provided such as name and address information, e-mail addresses, or phone numbers. Comments received, including attachments and other supporting materials, are part of the public record and subject to public disclosure. Do not include any information in your comment or supporting materials that you consider confidential or inappropriate for public disclosure.

You may review comments and other related materials that pertain to this action by the following methods:

- *Viewing Comments Electronically – Regulations.gov:*

Go to <https://regulations.gov/>. Enter “Docket ID OCC-2011-0001” in the Search Box and click “Search.” Click on the “Dockets” tab and then the document’s title. After clicking the document’s title, click the “Browse All Comments” tab. Comments can be viewed and filtered by clicking on the “Sort By” drop-down on the right side of the screen or the “Refine Comments Results” options on the left side of the screen. Supporting materials can be viewed by clicking on the “Browse Documents” tab. Click on the “Sort By” drop-down on the right side of the screen or the “Refine Results” options on the left side of the screen checking the “Supporting & Related Material” checkbox. For assistance with the Regulations.gov site, please call 1-866-498-2945 (toll free) Monday-Friday, 8am-7pm ET, or e-mail [regulationshelpdesk@gsa.gov](mailto:regulationshelpdesk@gsa.gov). The docket may be viewed after the close of the comment period in the same manner as during the comment period.

*FDIC:* You may submit comments, identified by RIN 3064–AD86, by any of the following methods:

- FDIC Website: <https://www.fdic.gov/regulations/laws/publiccomments/>. Follow instructions for submitting comments on the agency website.
- Email: [[IncentiveCompProposal2024@fdic.gov](mailto:IncentiveCompProposal2024@fdic.gov)]. Include RIN 3064– AD86 on the subject line of the message.
- Mail: James P. Sheesley, Assistant Executive Secretary, Attention: Comments RIN 3064– AD86, Federal Deposit Insurance Corporation, 550 17th Street NW, Washington, DC 20429.
- Hand Delivery to FDIC: Comments may be hand-delivered to the guard station at the rear of the 550 17th Street NW building (located on F Street NW) on business days between 7 a.m. and 5 p.m. Please include your name, affiliation, address, email address, and telephone number(s) in your comment. All statements received, including attachments and other supporting materials, are part of the public record and are subject to public disclosure.
- Public Inspection: Comments received, including any personal information provided, may be posted without change to <https://www.fdic.gov/regulations/laws/publiccomments/>. Commenters should submit only information that the commenter wishes to make available publicly. The FDIC may review, redact, or refrain from posting all or any portion of any comment that it may deem to be inappropriate for publication, such as irrelevant or obscene material. The FDIC may post only a single representative example of identical or substantially identical comments, and in such cases will generally identify the number of identical or substantially identical comments represented by the posted example. All comments that have been redacted, as well as those that have not been posted, that contain comments on the merits of this document will be retained in the public comment file and

will be considered as required under all applicable laws. All comments may be accessible under the Freedom of Information Act.

*NCUA*: You may submit comments, identified by RIN 3133-AE48, by any of the following methods (please send comments by one method only):

- *Federal eRulemaking Portal*: <https://www.regulations.gov>. The docket number for this proposed rule is 2024-0038. Follow the instructions for submitting comments. A plain language summary of the proposed rule is also available on the docket website.
- *Mail*: Address to Melane Conyers-Ausbrooks, Secretary of the Board, National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314-3428.
- *Hand Delivery/Courier*: Same as mailing address.

*Public Inspection*: You may view all public comments on the Federal eRulemaking Portal at <https://www.regulations.gov>, as submitted, except for those we cannot post for technical reasons. The NCUA will not edit or remove any identifying or contact information from the public comments submitted. If you are unable to access public comments on the internet, you may contact the NCUA for alternative access by calling (703) 518-6540 or emailing [OGCMail@ncua.gov](mailto:OGCMail@ncua.gov).

*FHFA*: You may submit your comments on the proposed rule, identified by regulatory information number (RIN) 2590-AA42, by any one of the following methods:

- *Agency Website*: [www.fhfa.gov/open-for-comment-or-input](http://www.fhfa.gov/open-for-comment-or-input).
- *Federal eRulemaking Portal*: <https://www.regulations.gov>. Follow the instructions for submitting comments. If you submit your comment to the Federal eRulemaking Portal, please also send it by email to FHFA at [RegComments@fhfa.gov](mailto:RegComments@fhfa.gov) to ensure timely

receipt by FHFA. Include the following information in the subject line of your submission: Comments/RIN 2590–AB30.

- *Hand Delivered/Courier:* The hand delivery address is: Clinton Jones, General Counsel, Attention: Comments/ RIN 2590–AB30, Federal Housing Finance Agency, 400 Seventh Street SW, Washington, DC 20219. Deliver the package at the Seventh Street SW entrance Guard Desk, First Floor, on business days between 9 a.m. and 5 p.m.
- *U.S. Mail, United Parcel Service, Federal Express, or Other Mail Service:* The mailing address for comments is: Clinton Jones, General Counsel, Attention: Comments/RIN 2590–AB30, Federal Housing Finance Agency, 400 Seventh Street SW, Washington, DC 20219. Please note that all mail sent to FHFA via U.S. Mail is routed through a national irradiation facility, a process that may delay delivery by approximately two weeks. For time sensitive correspondence, please plan accordingly.
- *Public Comments and Access:* Copies of all comments received by the deadline will be posted on the FHFA website at <http://www.fhfa.gov>, and will include any personal information you provide, such as your name, address, email address, and telephone number. In addition, copies of all comments received by the deadline will be available for examination by the public through the electronic rulemaking docket for this proposed rule, also located on the FHFA website.

**FOR FURTHER INFORMATION CONTACT:**

OCC: Alison MacDonald, Senior Counsel, (202) 649-7314, or Melissa Lisenbee, Counsel, (202) 649-7392, Chief Counsel’s Office; Tamara Culler, Director for Governance and Operational Risk Policy, Bank Supervision Policy, (202) 649-7866; or Heather Gilmore,

Lead Expert for Governance and Operational Risk, Supervision Risk and Analysis, (215) 494-7686, Office of the Comptroller of the Currency, 400 7th Street, SW, Washington, DC 20219. If you are deaf, hard of hearing, or have a speech disability, please dial 7–1–1 to access telecommunications relay services.

*FDIC*: Thomas Lyons, Associate Director, Risk Management Policy, (202) 898-6850, Nefretete Smith, Supervisory Counsel, Legal Division, (202) 898– 6851, [NefSmith@FDIC.gov](mailto:NefSmith@FDIC.gov), Catherine Topping, Counsel, Legal Division, (202) 898–3975, [CTopping@FDIC.gov](mailto:CTopping@FDIC.gov), Amy Ledig, Senior Attorney, Legal Division, (202) 898-7261, [ALedig@fdic.gov](mailto:ALedig@fdic.gov), Chantal Hernandez, Counsel, Legal Division, (202) 898-7388, [ChHernandez@FDIC.gov](mailto:ChHernandez@FDIC.gov).

*NCUA*: Office of Examination and Insurance: Summer Chapman, Policy Division Director, (703) 203-6262, [schapman@ncua.gov](mailto:schapman@ncua.gov), and John Berry, Policy Officer, (571) 451-7264, [jberry@ncua.gov](mailto:jberry@ncua.gov); Office of General Counsel: Senior Staff Attorneys, Ariel Pereira, (703) 548-2778, [apereira@ncua.gov](mailto:apereira@ncua.gov), and Gira Bose, (703) 518-6562, [gbose@ncua.gov](mailto:gbose@ncua.gov).

*FHFA*: Richard Oettinger, Policy Manager, Executive Compensation and Benefits, (202) 649-3797, [richard.oettinger@fhfa.gov](mailto:richard.oettinger@fhfa.gov); or Dinah Knight, Assistant General Counsel, Office of General Counsel, (202) 748-7801, [dinah.knight@fhfa.gov](mailto:dinah.knight@fhfa.gov), Federal Housing Finance Agency, 400 Seventh Street, SW, Washington, DC 20219. These are not toll-free numbers. For TTY/TRS users with hearing and speech disabilities, dial 711 and ask to be connected to any of the contact numbers above.

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## I. INTRODUCTION

Section 956 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act” or the “Act”)<sup>1</sup> requires “the appropriate Federal regulators,” defined as the Federal Deposit Insurance Corporation (“FDIC”), the Office of the Comptroller of the Currency (“OCC”), the Board of Governors of the Federal Reserve System (“Board”), the Federal Housing Finance Agency (“FHFA”), the National Credit Union Administration (“NCUA”), and the Securities and Exchange Commission (“SEC”),<sup>2</sup> to jointly prescribe regulations or guidelines with respect to incentive-based compensation practices at certain financial institutions (referred to as “covered financial institutions”).<sup>3</sup> Specifically, section 956 of the Dodd-Frank Act (“section 956”) requires that the appropriate Federal regulators prohibit any types of incentive-based compensation

<sup>1</sup> Public Law 111–203, 124 Stat. 1376 (2010), codified at 12 U.S.C. 5641.

<sup>2</sup> The Act also lists the Office of Thrift Supervision, which was abolished in 2011.

<sup>3</sup> 12 U.S.C. 5641(b).



arrangements,<sup>4</sup> or any feature of any such arrangements, that the appropriate Federal 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. Under the Act, 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. The Dodd-Frank Act does not require a covered financial institution to report the actual compensation of particular individuals.

The Act 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<sup>5</sup>; (D) an investment adviser, as such term is defined in

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<sup>4</sup> Section 956(b) uses the term “incentive-based payment arrangement.” 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 regulatory text and preamble for the sake of clarity, except when referencing or citing other sources.

<sup>5</sup> This definition encompasses “any insured credit union as defined in section 101 of the Federal Credit Union Act [12 U.S.C. 1752] or any credit union which is eligible to make application to become an insured credit union pursuant to section 201 of such Act [12 U.S.C.1781].” Under section 201 of the Federal Credit Union Act, state-chartered credit unions are eligible to apply for Federal insurance at any time. Accordingly, the requirements of section 956 apply to all credit unions, regardless of whether they are Federally insured. The NCUA’s supervisory authority in this area, however, is limited to Federally insured credit unions. Section 956(d) provides that the “provisions of this section and the regulations issued under this section shall be enforced under section 505 of the Gramm-Leach-Bliley Act [15 U.S.C. 6805] and, for purposes of such section, a violation of this section or such regulations shall be treated as a violation of subtitle A of title V of such Act.” Section 505 of the Gramm-Leach-Bliley Act grants the Federal Trade Commission enforcement authority “for any other financial institution or other person that is not subject to the jurisdiction” of another agency under the act. This same provision refers to the NCUA’s authority over “federally insured credit unions” only. Accordingly, compliance with section 956 and this proposed rule by state-chartered credit unions that are not Federally-insured is subject to enforcement by the Federal Trade Commission.

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.

The Act also requires that any compensation standards adopted under section 956 be comparable to the safety and soundness standards applicable to insured depository institutions (“IDIs”) under section 39 of the FDIA<sup>6</sup> and that the appropriate Federal regulators take the compensation standards described in section 39 of the FDIA into consideration in establishing compensation standards under section 956.<sup>7</sup>

On April 14, 2011, the FDIC, OCC, Board, FHFA, NCUA, and SEC published in the *Federal Register* a proposal to implement section 956 of the Dodd-Frank Act (the “2011 Proposed Rule”).<sup>8</sup>

On June 10, 2016, the FDIC, OCC, Board, FHFA, NCUA, and SEC published in the *Federal Register* a subsequent proposal to implement section 956 of the Dodd-Frank Act (the “2016 Proposed Rule”).<sup>9</sup>

Section 956 was enacted by Congress to address certain types of incentive-based compensation arrangements that could lead to significant risks for financial institutions. Recent events and supervisory experience with industry practices show that, absent specific prohibitions,

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<sup>6</sup> 12 U.S.C. 1831p–1. The OCC, Board, 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 Safety and Soundness Guidelines”), 12 CFR part 30, Appendix A (OCC); 12 CFR part 208, Appendix D–1 (Board); 12 CFR part 364, Appendix A (FDIC).

<sup>7</sup> 12 U.S.C. 5641(c).

<sup>8</sup> 76 FR 21170 (April 14, 2011).

<sup>9</sup> 81 FR 37673 (June 10, 2016).

some covered institutions offer incentive-based compensation arrangements that encourage inappropriate risks. In this notice of proposed rulemaking (the “proposal”, “proposed rule”, or the “2024 Proposed Rule”), the FDIC, OCC, FHFA, and NCUA (referred to collectively as “the Agencies” for purposes of this proposal) are re-proposing the regulatory text of the 2016 Proposed Rule.<sup>10</sup> The 2016 Proposed Rule’s approach would provide a consistent set of enforceable standards and help safeguard covered financial institutions from certain types and features of incentive-based compensation arrangements that encourage inappropriate risks.

The Agencies have reviewed and continue to consider the comments on the 2016 Proposed Rule.<sup>11</sup> In consideration of the passage of time since the 2016 Proposed Rule was issued, additional supervisory experience, changes in industry practice, and other developments, the Agencies are seeking additional feedback from commenters on the re-proposed regulatory text as well as on potential alternatives discussed in the preamble. Comments received on this proposal, as well as those submitted on the 2016 Proposed Rule, will further inform the Agencies’ efforts to implement section 956’s mandate.

The first part of this Supplementary Information section provides background information on the proposed rule, including a description of the Agencies’ supervisory experience and other developments since the issuance of the 2016 Proposed Rule. The second part contains a discussion of the 2024 Proposed Rule. The third part contains requests for comments, including descriptions

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<sup>10</sup> The Board has not acted to join this proposal. Rulemaking to implement section 956 is on the SEC’s rulemaking agenda. *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](https://www.reginfo.gov/public/do/eAgendaMain?operation=OPERATION_GET_AGENCY_RULE_LIST&currentPub=true&agencyCode&showStage=active&agencyCd=3235).

<sup>11</sup> Comments received on the 2016 Proposed Rule are available here: [https://www.federalreserve.gov/apps/foia/ViewComments.aspx?doc\\_id=R-1536&doc\\_ver=1](https://www.federalreserve.gov/apps/foia/ViewComments.aspx?doc_id=R-1536&doc_ver=1) (Board); <https://www.fdic.gov/resources/regulations/federal-register-publications/2016/2016-compensation-arrangements-3064-ad86.html> (FDIC); <https://www.fhfa.gov/SupervisionRegulation/Rules/Pages/Comment-List.aspx?RuleID=555> (FHFA); <https://www.regulations.gov/docket/NCUA-2016-0033/comments> (NCUA); <https://www.regulations.gov/document/OCC-2011-0001-2367> (OCC); <https://www.sec.gov/comments/s7-07-16/s70716.htm> (SEC).

of alternative regulatory provisions under consideration by the Agencies based on experiences in reviewing and supervising incentive-based compensation at some covered institutions. The final part contains the regulatory analysis sections.

For ease of reference, the proposed rules of the Agencies are referenced in this Supplementary Information section using a common designation of section \_\_\_\_\_.1 to section \_\_\_\_\_.14 (excluding the title and part designations for each agency). Each agency would codify its rule, if adopted, within its respective title and part of the Code of Federal Regulations.<sup>12</sup>

### **Overview of Previous Issuances**

#### *1. 2011 Proposed Rule*

In 2011, the FDIC, OCC, Board, FHFA, NCUA, and SEC issued a notice of proposed rulemaking to implement section 956 of the Dodd-Frank Act.<sup>13</sup>

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.”<sup>14</sup> 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.

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<sup>12</sup> Specifically, the Agencies propose to codify the rules as follows: 12 CFR part 42 (OCC); 12 CFR part 372 (FDIC); 12 CFR part 1232 (FHFA); and 12 CFR parts 741 and 751 (NCUA).

<sup>13</sup> 76 FR 21170 (April 14, 2011).

<sup>14</sup> The 2011 Proposed Rule provided that a “covered person” would be any executive officer, employee, director, or principal shareholder of a “covered institution.”

The 2011 Proposed Rule included two additional requirements for “larger covered financial institutions.”<sup>15</sup> 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, OCC, Board, FHFA, NCUA, and SEC received more than 10,000 comments on the 2011 Proposed Rule, including comments from private individuals, community groups, several Members of Congress, pension funds, labor federations, academic faculty, covered financial institutions, financial industry associations, and industry consultants.<sup>16</sup>

## 2. *2016 Proposed Rule*

In 2016, the FDIC, OCC, Board, FHFA, NCUA, and SEC issued a second proposed rule.

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<sup>15</sup> 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.

<sup>16</sup> Comments received on the 2011 Proposed Rule are available here: [https://www.federalreserve.gov/apps/foia/ViewComments.aspx?doc\\_id=R%2D1410&doc\\_ver=1](https://www.federalreserve.gov/apps/foia/ViewComments.aspx?doc_id=R%2D1410&doc_ver=1) (Board); <https://www.fdic.gov/regulations/laws/federal/2011/11comad56.html> (FDIC); <https://www.fhfa.gov/SupervisionRegulation/Rules/Pages/Comment-List.aspx?RuleID=187> (FHFA); <http://web.archive.org/web/20120916130332/http://www.ncua.gov/Legal/Pages/PRs20110217Comp.aspx> (NCUA); <https://www.regulations.gov/document?D=OCC-2011-0001-0001> (OCC); <https://www.sec.gov/comments/s7-12-11/s71211.shtml> (SEC). A summary of the comments received in connection with the 2011 Proposed Rule was included in the 2016 Proposed Rule.

With respect to the prohibition on excessive compensation, the 2016 Proposed Rule provided six factors<sup>17</sup> for determining whether compensation paid is unreasonable or disproportionate to the services performed by the “covered person.”<sup>18</sup> As required by section 956, these factors were comparable to the excessive compensation factors in section 39 of the FDIA.

The 2016 Proposed Rule would have prohibited incentive-based compensation arrangements at covered financial institutions that did not 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. The 2016 Proposed Rule specifically provided that an incentive-based compensation arrangement would not have been 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, compliance deficiencies, or other measures or aspects of financial and non-financial performance.

The 2016 Proposed Rule also would have required covered financial institutions to create and maintain for at least seven years records documenting the structure of their incentive-based

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<sup>17</sup> Under the 2016 Proposed Rule, compensation would have been considered excessive when amounts paid were 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. The 2016 Proposed Rule did not include the seventh factor that appeared in the 2011 Proposed Rule, “Any other factors that the [Agency] determines to be relevant.”

<sup>18</sup> The 2016 Proposed Rule defines “covered person” to mean “any executive officer, employee, director, or principal shareholder who receives incentive-based compensation at a covered institution.”

compensation arrangements and demonstrating compliance with the rule, and that such records be disclosed to an institution's primary Federal regulator upon request.

The 2016 Proposed Rule would have defined "covered institution" to include the covered financial institutions defined in section 956, as described above: depository institutions, depository institution holding companies, credit unions, Fannie Mae, and Freddie Mac. In addition, the proposal would have included Federal Home Loan Banks as covered institutions.

Moreover, the 2016 Proposed Rule distinguished covered financial 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 financial institutions. The 2016 Proposed Rule identified three categories of covered financial institutions based on average total consolidated assets:<sup>19</sup>

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

The 2016 Proposed Rule also contained a reservation of authority allowing 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.

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<sup>19</sup> For covered financial institutions that are subsidiaries of other covered financial institutions, levels would generally have been determined by reference to the average total consolidated assets of the top-tier parent covered financial institution.

Level 1 and Level 2 institutions would have been subject to the following additional requirements, many of which would expressly apply to certain covered persons, “senior executive officers” and “significant risk takers.”

Disclosure and Recordkeeping Requirements. All Level 1 and Level 2 covered institutions would have been required to create annually and maintain for at least seven years records that document: (1) the covered institution’s senior executive officers and significant risk-takers, listed by legal entity, job function, organizational hierarchy, and line of business; (2) the incentive-based compensation arrangements for senior executive officers and significant risk-takers, including information on the percentage of incentive-based compensation deferred and form of award; (3) any forfeiture and downward adjustment or clawback reviews and decisions for senior executive officers and significant risk-takers; and (4) any material changes to the covered institution’s incentive-based compensation arrangements and policies.

Deferral, Forfeiture and Downward Adjustment, and Clawback Requirements. For Level 1 and Level 2 covered institutions, the 2016 Proposed Rule would have required that incentive-based compensation arrangements for certain covered persons be subject to deferral of payments and risk of downward adjustment, forfeiture, and clawback. Deferral requirements would have applied to significant risk-takers as well as senior executive officers, and would have required 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 ranged 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 receiving the incentive-based compensation was a senior executive officer or a significant risk-taker.



A Level 1 or Level 2 covered institution would have been required to make subject to forfeiture all unvested deferred incentive-based compensation of any senior executive officer or significant risk-taker, including unvested deferred amounts awarded under long-term incentive plans. Similarly, a Level 1 or Level 2 covered institution also would have been required to make subject to downward adjustment all incentive-based compensation amounts not yet awarded to any senior executive officer or significant risk-taker for the current performance period, including amounts payable under long-term incentive plans. A Level 1 or Level 2 covered institution would have been required to consider forfeiture or downward adjustment of incentive-based compensation if any of the following adverse outcomes occurred:

- Poor financial performance attributable to a significant deviation from the covered institution's risk parameters set forth in the covered institution's policies and procedures;
- Inappropriate risk-taking, regardless of the impact on financial performance;
- Material risk management or control failures;
- Non-compliance with statutory, regulatory, or supervisory standards resulting in enforcement or legal action brought by a federal or state regulator or agency, or a requirement that the covered institution report a restatement of a financial statement to correct a material error; and
- Other aspects of conduct or poor performance as defined by the covered institution.

A Level 1 or Level 2 covered institution would have been 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 from a current or former senior executive officer or significant risk-taker for seven years following the date on which such compensation vests, if the covered institution determined

that the 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.

Additional Prohibitions. The 2016 Proposed Rule contained a number of additional prohibitions for Level 1 and Level 2 covered institutions, including:

- Hedging: The 2016 Proposed Rule would have prohibited a Level 1 or Level 2 covered institution from purchasing a hedging instrument on behalf of a covered person to hedge or offset any decrease in the value of the covered person's incentive-based compensation.
- Maximum incentive-based compensation opportunity (also referred to as leverage): The 2016 Proposed Rule would have prohibited a Level 1 or Level 2 covered institution 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 have been 150 percent of the target amount for that incentive-based compensation.
- Relative performance measures: The 2016 Proposed Rule would have prohibited a Level 1 or Level 2 covered institution from using performance measures that are based solely on industry peer performance comparisons.
- Volume-driven incentive-based compensation: The 2016 Proposed Rule would have prohibited a Level 1 or Level 2 covered institution 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.

Risk Management and Controls. The 2016 Proposed Rule would have required 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. In addition, the 2016 Proposed Rule would have required Level 1 and Level 2 covered institutions to:

- Provide individuals in control functions with appropriate authority to influence the risk-taking of the business areas they monitor, and ensure covered persons engaged in control functions are compensated in accordance with the achievement of performance objectives linked to their control functions and independently of the performance of the business areas they monitor; and
- Provide for independent monitoring of: (1) incentive-based compensation plans to identify whether the plans appropriately balance risk and reward; (2) events related to forfeiture and downward adjustment and decisions of forfeiture and downward adjustment reviews to determine consistency with the proposed rule; and (3) compliance of the incentive-based compensation program with the covered institution's policies and procedures.

Governance. The 2016 Proposed Rule would have required 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 have been 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. Additionally, management would have been required to submit to the compensation committee on an annual or more frequent basis a written

assessment of the effectiveness of the covered institution's incentive-based compensation program. The internal audit or risk management function of the covered institution also would have been required to submit an independent written assessment, developed independently of the covered institution's management, to the compensation committee on an annual or more frequent basis.

Policies and Procedures. The 2016 Proposed Rule would have required all Level 1 and Level 2 covered institutions to have policies and procedures that, among other requirements:

- Are consistent with the requirements and prohibitions of the proposed rule;
- Specify the procedures for forfeiture and clawback;
- Document final forfeiture, downward adjustment, and clawback decisions;
- Specify the substantive and procedural criteria for the acceleration of payments of deferred incentive-based compensation to a covered person;
- Describe the role of any employees, committees, or groups authorized to make incentive-based compensation decisions, including when discretion is authorized;
- Describe how discretion is exercised to achieve balance;
- Document processes for the establishment, implementation, modification, and monitoring of incentive-based compensation arrangements;
- Describe how incentive-based compensation arrangements will be monitored;
- Describe procedures for the independent compliance program; and
- Ensure appropriate roles for risk management, risk oversight, and other control functions.

The 2016 Proposed Rule also proposed a new defined term, "significant risk-taker," which included two tests for determining whether a covered person would be a significant risk-taker. The "relative compensation test" in paragraphs (1)(i) and (ii) of the proposed definition would have

required a covered institution to determine which covered persons are among the top 5 percent (for Level 1 covered institutions) or 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 second test was based on whether the covered person 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”). The significant risk-taker definition under either test would be applicable only to covered persons at a Level 1 or Level 2 covered institution who received annual base salary and incentive-based compensation for the last calendar year that ended at least 180 days before the beginning of the performance period of which at least one-third is incentive-based compensation (one-third threshold). In addition, the proposed rule’s definition of significant risk-taker would have allowed the FDIC, OCC, Board, FHFA, NCUA, and SEC the flexibility to designate additional covered persons as significant risk-takers if the covered person has the ability to expose the covered institution to risks that could lead to material financial loss in relation to the covered institution’s size, capital, or overall risk tolerance. Significant risk-takers at Level 1 and Level 2 institutions would have been subject to additional requirements, including mandatory deferral.

Under the 2016 Proposed Rule, covered institutions that are subsidiaries of other covered institutions would have been subject to the same requirements, and 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 of the 2016 Proposed Rule was referred to as “consolidation,” and it was 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.

The 2016 Proposed Rule specified that risk would need to be assessed at both the holding company level and at the level of individual covered institutions within the consolidated organization. However, the rules proposed in 2016 by the Board, OCC, and FDIC, would have permitted the covered institutions they supervised that are subsidiaries of another covered institution to meet the requirements of the proposed rule if the parent covered institution complied with the requirements in a way that caused the relevant portion of the incentive-based compensation program of the subsidiary covered institution to comply with the requirements.

#### *Overview of Public Comments on the 2016 Proposed Rule*

The FDIC, OCC, Board, FHFA, NCUA, and SEC received more than one hundred comments on the 2016 Proposed Rule from private individuals, state officials, Members of Congress, community groups, pension funds, labor federations, academic faculty, covered institutions, financial industry associations, industry consultants, and other interested parties. In addition, agency staff members held a number of meetings to obtain supplementary information.<sup>20</sup> The following paragraphs provide a brief overview of comments received on the 2016 Proposed Rule. However, the Agencies emphasize that they will consider all comments received on the 2016 Proposed Rule, including any comments not specifically described in this overview, and all comments received in connection with the 2024 Proposed Rule when determining how to implement section 956.

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<sup>20</sup> Comments received on the 2016 Proposed Rule are available here: [https://www.federalreserve.gov/apps/foia/ViewComments.aspx?doc\\_id=R-1536&doc\\_ver=1](https://www.federalreserve.gov/apps/foia/ViewComments.aspx?doc_id=R-1536&doc_ver=1) (Board); <https://www.fdic.gov/resources/regulations/federal-register-publications/2016/2016-compensation-arrangements-3064-ad86.html> (FDIC); <https://www.fhfa.gov/SupervisionRegulation/Rules/Pages/Comment-List.aspx?RuleID=555> (FHFA); <https://www.regulations.gov/document/NCUA-2016-0033-0001/comment> (NCUA); <https://www.regulations.gov/document/OCC-2011-0001-2367> (OCC); <https://www.sec.gov/comments/s7-07-16/s70716.htm> (SEC).

Many commenters recommended strengthening the 2016 Proposed Rule, stating that flawed incentive-based compensation practices were a major contributing factor to the 2008 financial crisis and continue to have negative implications for the financial services industry.

A significant number of commenters expressed concerns regarding the 2016 Proposed Rule overall or criticized specific aspects of it.

For example, the FDIC, OCC, Board, FHFA, NCUA, and SEC received many comments on the definitions included in the 2016 Proposed Rule, such as the definitions of “senior executive officer” and “significant risk-taker.” With regard to the definition of “senior executive officer,” some commenters recommended that the rule define senior executive officers on a consolidated basis (e.g., only those executives at the top-tier covered institution), using a definition similar to the “executive officer” definition under Section 16 of the Securities Exchange Act of 1934, or based on the Guidance on Sound Incentive Compensation Policies (“2010 Federal Banking Agency Guidance.”)<sup>21</sup> The FDIC, OCC, Board, FHFA, NCUA, and SEC received a range of comments on the definition of the term “significant risk-takers,” including, for example, recommendations that the rule identify significant risk-takers in a manner similar to how material risk-takers are identified under the 2010 Federal Banking Guidance, that the rule apply a dollar threshold rather than a percentage threshold for the relative compensation test, and that the rule eliminate the exposure test.

Several commenters stated that the definition of “incentive-based compensation” was overly broad and should exclude compensation that does not encourage inappropriate risk taking, such as employees’ ownership interests, qualified pensions and profit sharing plans, and equity with multi-year vesting that is not based on performance measures.

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<sup>21</sup> 75 FR 36395 (June 25, 2010).

The FDIC, OCC, Board, FHFA, NCUA, and SEC received a significant number of comments on the deferral provisions of the 2016 Proposed Rule. For example, some commenters argued that the deferral requirements were too complicated and recommended simplification, such as a requirement for deferral of a fixed percentage of all incentive-based compensation, both short-term and long-term, to be deferred for the same set period of time. Many commenters also stated that the deferral requirements would negatively affect institutions' ability to attract and retain talent, and that covered persons would seek employment at institutions where they would not be subject to deferral requirements. Some commenters suggested that covered institutions would be forced to offer higher base salaries in lieu of the incentive-based compensation subject to deferral.

Some commenters asserted that the deferral provisions in the 2016 Proposed Rule would mean that outcomes of inappropriate risk-taking may not be discovered until a majority of incentive-based compensation vests, and they urged that the rule establish stricter deferral requirements and longer deferral periods. For example, some commenters suggested deferral periods of up to seven years to either be consistent with the average length of a business cycle or to align with the U.K.'s deferral requirement for senior managers, recommended that a substantial portion of incentive-based compensation be held through retirement age, and suggested that the rule permit only "cliff" vesting.

The FDIC, OCC, Board, FHFA, NCUA, and SEC received a significant number of comments on the forfeiture and downward adjustment provisions for Level 1 and Level 2 covered institutions. For example, some commenters recommended that forfeiture be mandatory in certain circumstances, while others stated that the board of directors should retain discretion to consider relevant facts and circumstances in making a final determination. Other commenters suggested changes to the triggers and proposed decision-making factors for forfeiture and downward



adjustment, with some suggesting that the provisions were too prescriptive and others that they were not prescriptive enough.

The FDIC, OCC, Board, FHFA, NCUA, and SEC also received comments on the 2016 Proposed Rule's requirement that Level 1 and Level 2 covered institutions include clawback provisions in incentive-based compensation arrangements for senior executive officers and significant risk-takers. For example, some commenters recommended that covered institutions should be required, rather than have discretion, to exercise clawback remedies; suggested that institutions should be required to publicly disclose the identities of senior executive officers and significant risk-takers whose pay was clawed back and the amounts involved; or recommended expanding and/or clarifying the types of conduct that would trigger the imposition of the clawback.

The FDIC, OCC, Board, FHFA, NCUA, and SEC also received comments on the 2016 Proposed Rule's risk management and controls, governance and policies, and procedural requirements. For example, some commenters suggested that these provisions of the rule should be in the form of guidelines rather than requirements. Others suggested that the rule further clarify the independence requirements for members of the compensation committee, while others recommended that the compensation committee should not be required to obtain two separate, written assessments of the effectiveness of its incentive-based compensation program. Some commenters also questioned the application of these sections to subsidiaries, raising concerns about redundancy in the case of compliance programs and the need to manage risk on a consolidated basis. Some commenters asserted that the recordkeeping requirements that apply to all incentive-based compensation plans and awards (and not just those of senior executive officers and significant risk-takers) were overly burdensome, the proposal would increase burdens on boards of directors to oversee and approve the incentive-based compensation plans and awards for

all senior executive officers, and the tests for determining excessive compensation were unworkable because of, among other reasons, anticipated difficulty in obtaining the market data that would be required to perform the required analysis.

A number of commenters expressed concerns about the 2016 Proposed Rule's overall approach, with many recommending that the Board, OCC, FDIC, FHFA, SEC, and NCUA adopt the 2010 Federal Banking Agency Guidance or a similar, principles-based approach. Some commenters indicated that the more prescriptive approach in the 2016 Proposed Rule was impractical, would reduce flexibility, would create unintended consequences and complications, and would not adequately account for the risks posed by different individuals and types of institutions. For example, several commenters specifically opposed the use of prescriptive requirements or bright-line tests to identify significant risk-takers. Some of these commenters also opposed the use of prescriptive requirements to distinguish among covered financial institutions based on asset size, or opposed specific requirements related to deferral, forfeiture, downward adjustment, and clawback.

Other commenters offered a number of specific recommendations covering a broad range of issues, including tax and accounting implications; recordkeeping and disclosure requirements; specific definitions; proposed compliance periods and effective dates; and the additional prohibitions related to hedging, leverage, the use of relative performance measures, and volume-driven incentive-based compensation.

## Relevant Supervisory Experience and Developments

There is evidence that flawed incentive-based compensation practices in the financial industry may have contributed to the 2008 financial crisis (“the financial crisis”).<sup>22</sup> Some compensation arrangements rewarded employees—including non-executive personnel such as traders, underwriters, and loan officers—for increasing an institution’s revenue or short-term profit without sufficient recognition of the risks the employees’ activities posed to the institutions, their customers, and to the broader financial system.<sup>23</sup> 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.”<sup>24</sup> More recent supervisory experience continues to demonstrate the potential negative impact of misaligned incentive-based compensation arrangements on financial institutions.

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<sup>22</sup> *E.g.*, Financial Crisis Inquiry Commission, “Financial Crisis Inquiry Report” (Jan. 2011), at 209, 279, 291, 343, available at <https://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf>; Senior Supervisors Group, “Observations on Risk Management Practices during the Recent Market Turbulence” (March 6, 2008), available at [https://www.newyorkfed.org/medialibrary/media/newsevents/news/banking/2008/SSG\\_Risk\\_Mgt\\_doc\\_final.pdf](https://www.newyorkfed.org/medialibrary/media/newsevents/news/banking/2008/SSG_Risk_Mgt_doc_final.pdf). See also Institute of International Finance, Inc., *Compensation in Financial Services: Industry Progress and the Agenda for Change* (2009); Financial Stability Forum, *FSF Principles for Sound Compensation Practices (87 KB PDF)* (Basel, Switzerland: FSF, April 2009), available at [http://www.financialstabilityboard.org/publications/r\\_0904b.pdf](http://www.financialstabilityboard.org/publications/r_0904b.pdf); and Senior Supervisors Group, *Risk-management Lessons from the Global Banking Crisis of 2008* (Basel, Switzerland: SSG, Oct. 2009), available at <http://www.newyorkfed.org/newsevents/news/banking/2009/ma091021.html>. The Financial Stability Forum was renamed the Financial Stability Board (“FSB”) in April 2009.

<sup>23</sup> One example of the effect of flawed incentive-based compensation practices also is demonstrated by the arrangements implemented by Washington Mutual (“WaMu”). According to the Senate Permanent Subcommittee on Investigations Staff’s report on the failure of Washington Mutual “[l]oan officers and processors were paid primarily on volume, not primarily on the quality of their loans, and were paid more for issuing higher risk loans. Such arrangements “enriched WaMu in the short term but made defaults more likely down the road.” See Staff of S. Permanent Subcomm. on Investigations, *Wall Street and the Financial Crisis: Anatomy of a Financial Collapse* at 143 (Comm. Print 2011) (hereinafter Senate Subcommittee Report).

<sup>24</sup> 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).

For example, in September 2016, flawed incentive-based compensation practices contributed 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.<sup>25</sup> Wells Fargo's compensation structure provided branch employees financial incentives to meet sales volume goals, without sufficient controls and oversight.

The bank failures in March 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. 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. As such, the report concluded that managers had a financial incentive to focus on short-term profit over sound risk management.<sup>26</sup>

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<sup>25</sup> 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> (citing Carrie Tolstedt, et al., Notice of Charges for Orders of Prohibition and Orders to Cease and Desist and Notice of Assessments of a Civil Money Penalty, AA-EC-2019-82, AA-EC-2019-81, AA-EC-2019-70, AA-EC-2019-71, AA-EC-2019-72 (OCC, Jan. 23, 2020); John Stumpf, Consent Order, AA-EC-2019-83 (OCC Jan. 22, 2020); Hope Hardison, Consent Order, AA-EC-2019-69 (OCC, Jan. 21, 2020); and Michael Loughlin, Consent Order, AA-EC-2019-86 (OCC, Jan. 8, 2020)).

<sup>26</sup> See the Bank for International Settlements (BIS) Basel Committee on Banking Supervision, *Report on the 2023 banking turmoil* (Oct. 2023), at 7-8.

The Agencies continue to focus on this critical area and work with financial institutions to develop incentive-based compensation policies that tie pay to longer-term performance, as discussed below. 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. A consistent set of enforceable standards as proposed in this rulemaking would complement regulatory developments and supervisory efforts since 2016 and could play an important role in helping ensure that incentive-based compensation arrangements at covered financial institutions are not excessive and do not lead to material financial loss.

*Federal Banking Agencies*<sup>27</sup>

The Federal Banking Agencies have used sections 8 and 39 of the FDIA to supervise for, and address, unsafe and unsound compensation practices at their respective institutions.<sup>28</sup> Section 39 of the FDIA includes specific standards related to compensation and directs the Federal Banking Agencies to prescribe standards for all IDIs that would prohibit, as an unsafe and unsound practice, compensation that would be excessive or could lead to material financial loss to the institution.<sup>29</sup> The Federal Banking Agencies' work in this area is also informed by the 2010 Federal Banking Agency Guidance.<sup>30</sup> In the 2010 Federal Banking Agency Guidance, the Federal

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<sup>27</sup> The "Federal Banking Agencies" refer to the FDIC, OCC, and the Board.

<sup>28</sup> See 12 U.S.C. 1818 and 1831p-1.

<sup>29</sup> See 12 U.S.C. 1831p-1(c)(1). 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.

<sup>30</sup> 75 FR 36395 (June 25, 2010).

Banking Agencies identified practices that could constitute unsafe and unsound practices. The Federal Banking Agencies also identified risk management and controls practices, as well as other practices, that would assist banking organizations in operating in a safe and sound manner with respect to incentive-based compensation.<sup>31</sup> The 2010 Federal Banking Agency Guidance uses a principles-based approach designed to encourage incentive-based compensation arrangements that appropriately tie rewards to longer-term performance and do not undermine the safety and soundness of banking organizations or create undue risks to the financial system.<sup>32</sup>

In addition, to foster implementation of improved incentive-based compensation practices, the Board, in cooperation with the OCC and FDIC, initiated in late 2009 an ongoing multidisciplinary, horizontal review (“Horizontal Review”) of incentive-based compensation practices at 25 large, complex banking organizations.<sup>33</sup> The goals of the Horizontal Review were to help improve the Federal Banking Agencies’ understanding of the range and evolution of incentive-based compensation practices across institutions and categories of employees within institutions, and to provide guidance to each institution regarding ways to improve their incentive-based compensation practices. As part of the Horizontal Review, the Board conducted compensation reviews of line of business operations in the areas of trading, mortgage, credit card, sales compensation, and commercial lending as well as senior executive incentive-based compensation awards and payouts. In 2011, the Board made public its initial findings from the

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<sup>31</sup> 75 FR at 36398, n.4.

<sup>32</sup> To the extent that the proposed rule uses terms and concepts similar to the 2010 Federal Banking Agency Guidance, such as methods for appropriately balancing risk and reward, the FDIC and OCC intend for such terms to have meanings consistent with the 2010 Federal Banking Agency Guidance.

<sup>33</sup> The financial institutions in the Horizontal Review are Ally Financial Inc.; American Express Company; Bank of America Corporation; The Bank of New York Mellon Corporation; Capital One Financial Corporation; Citigroup Inc.; Discover Financial Services; The Goldman Sachs Group, Inc.; JPMorgan Chase & Co.; Morgan Stanley; Northern Trust Corporation; The PNC Financial Services Group, Inc.; State Street Corporation; SunTrust Banks, Inc.; U.S. Bancorp; and Wells Fargo & Company; and the U.S. operations of Barclays plc, BNP Paribas, Credit Suisse Group AG, Deutsche Bank AG, HSBC Holdings plc, Royal Bank of Canada, The Royal Bank of Scotland Group plc, Societe Generale, and UBS AG.

Horizontal Review, recognizing the steps the institutions had made towards improving their incentive-based compensation practices, but also noting that each institution needed to do more.<sup>34</sup>

#### FDIC supervisory activities

The FDIC reviews incentive-based compensation practices as part of its safety and soundness examinations of state nonmember banks and state savings associations, most of which are smaller community institutions that would not be covered by the proposed rule because they or their parent holding company have average total consolidated assets of less than \$1 billion. The FDIC's incentive-based compensation reviews are conducted in the context of supervising institutions' compliance with section 39 of the FDIA. As noted above, IDIs are subject to Section 39(c) of the FDIA that prohibits as an unsafe and unsound practice compensation arrangements that provide executive officers, employees, directors, and principal shareholders with excessive compensation, fees, or benefits and compensation arrangements that could lead to material financial loss to the institution. The implementing guidelines are found within the 12 CFR Part 364, Appendix A, Interagency Guidelines Establishing Standards for Safety and Soundness. Appendix A, Section II, requires financial institutions to maintain safeguards that prevent excessive compensation or compensation that could lead to material financial loss. Section III of the Appendix A addresses excessive compensation and prohibits compensation that constitutes an unsafe and unsound practice.

In addition, the FDIC issued for public comment a new Appendix C to its existing standards for safety and soundness in 12 CFR part 364, which proposes, among other things, certain corporate governance and risk management guidelines for FDIC-supervised institutions

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<sup>34</sup> Board, *Incentive Compensation Practices: A Report on the Horizontal Review of Practices at Large Banking Organizations* (October 2011) ("2011 FRB White Paper"), available at <http://www.federalreserve.gov/publications/other-reports/files/incentive-compensation-practices-report-201110.pdf>.

with total consolidated assets of \$10 billion or more that address risk management practices for incentive-based compensation programs.<sup>35</sup>

The FDIC employs an ongoing risk-based supervision approach focused on evaluating risk, identifying material and emerging concerns, and issuing Supervisory Recommendations (SR), including Matters Requiring Board Attention (MRBA),<sup>36</sup> instructing banks to take timely corrective action before deficiencies compromise their safety and soundness. The FDIC conducts targeted reviews and assessments of overall incentive-based compensation programs at FDIC-supervised institutions as part of normal supervisory activities, and has identified SRs and MRBAs related to incentive-based compensation practices, including governance, risk management, and controls for compensation. In considering supervisory ratings assigned under the Uniform Financial Institutions Rating System (UFIRS),<sup>37</sup> FDIC examiners assess the board of directors' and management's capability in, among other things, identifying, measuring, monitoring, and controlling the risks of an institution's activities; ensuring the financial institution's safe, sound and efficient operations are in compliance with applicable laws and regulations; and assessing the reasonableness of compensation policies and avoidance of self-dealing. Beginning in 2016 and concluding in 2017, the FDIC conducted a comprehensive horizontal review of sales practices at 17 FDIC-supervised institutions with total assets greater than \$10 billion. As backup supervisor for all IDIs, the FDIC also participated in similar reviews at institutions supervised by the OCC

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<sup>35</sup> See *Guidelines Establishing Standards for Corporate Governance and Risk Management for Covered Institutions with Total Consolidated Assets of \$10 Billion or More*, 88 FR 70391 (Oct. 11, 2023). Under the proposed Guidelines, the board of directors of covered institutions would be expected to establish a Compensation and Performance Management Program that ensures adherence to effective risk management and does not incentivize imprudent risk-taking or noncompliance with laws and regulations. In addition, a Compensation Committee of the board must comply with all applicable laws and regulations and, among other things, ensure adherence to the Compensation and Performance Management Program and review compensation packages for executives.

<sup>36</sup> See *Statement of FDIC Board of Directors on the Development and Communication of Supervisory Recommendations* (July 27, 2016), available at <https://www.fdic.gov/regulations/examinations/supervisory/guidance/recommendations.html>.

<sup>37</sup> FDIC, *Uniform Financial Institutions Rating System*, 62 FR 752.



and Board. These reviews were prompted, in part, by issues with incentive-based compensation tied to retail sales practices at Wells Fargo.

#### FDIC experience resolving failed institutions

Of the 543 bank failures resolved by the FDIC between 2007 and 2023, 69 involved banks with total assets of \$1 billion or more that would have been covered by the proposed rule.<sup>38</sup> Of the 69 institutions that failed with total assets of \$1 billion or more, 21 institutions or approximately 30 percent, were identified as having some level of issues or concerns related to compensation arrangements, many of which involved incentive-based compensation. Overall, most of the compensation issues related to either excessive compensation or tying financial incentives to volume-based metrics such as corporate performance or loan production without adequate consideration of related risks. Also, several cases involved poor governance practices, most commonly, dominant management influencing improper incentives.<sup>39</sup>

Reports concerning the 2023 bank failures of Silicon Valley Bank, Signature Bank of New York, and First Republic Bank in Spring 2023 identified common weaknesses. These weaknesses included an 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, such

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<sup>38</sup> Of note, there was one large state member bank that voluntarily self-liquidated in March 2023.

<sup>39</sup> The Inspector General of the appropriate Federal banking agency must conduct a Material Loss Review ("MLR") when losses to the Deposit Insurance Fund from failure of an IDI exceed certain thresholds. See FDIC MLRs, available at <https://www.fdicigo.gov/reports-publications/bank-failures>; Board MLRs available at <http://oig.federalreserve.gov/reports/audit-reports.htm>; and OCC MLRs, available at [https://www.treasury.gov/about/organizational-structure/ig/Pages/audit\\_reports\\_index.aspx](https://www.treasury.gov/about/organizational-structure/ig/Pages/audit_reports_index.aspx). See also Senate Subcommittee Report, *supra* note 23, at 3, 25, 49, 143-155. In 2011, the Federal Reserve's Office of Inspector General (OIG) reviewed 35 state member bank failures that occurred between 2009 and 2011 to identify common themes related to the cause of failure and the role of Federal Reserve supervision. The OIG's findings included incentive compensation programs that inappropriately encouraged risk taking. See Board of Governors of the Federal Reserve System, Office of Inspector General, *Summary Analysis of Failed Bank Reviews* (Washington: Board of Governors, September 2011), 1, [https://oig.federalreserve.gov/reports/Cross\\_Cutting\\_Final\\_Report\\_9-30-11.pdf](https://oig.federalreserve.gov/reports/Cross_Cutting_Final_Report_9-30-11.pdf).

as rapid deposit and loan growth, and funding concentrations.<sup>40</sup> Despite elevated risks, unaddressed audit and supervisory issues, and deteriorating financial conditions at both Silicon Valley Bank and Signature Bank, the executives continued to receive cash bonuses, in some cases right up until the bank’s failure.<sup>41</sup>

### OCC supervisory activities

In carrying out its mission, the OCC employs an ongoing risk-based supervision approach focused on evaluating risk, identifying material and emerging concerns, and requiring banks to take timely corrective action before deficiencies compromise their safety and soundness. The OCC reviews and assesses compensation practices at individual banks as part of its normal supervisory activities. For example, the OCC may identify matters requiring attention (“MRAs”) relating to compensation practices, including matters relating to governance and risk management and controls for compensation. As part of its rating system, the OCC assesses the capability of a bank’s board and management, in their respective roles, to identify, measure, monitor, and control the risks of their bank’s activities and to ensure the bank’s safe, sound, and efficient operation in compliance with applicable laws and regulations. This includes an assessment of the reasonableness of compensation policies.

Beginning in 2016, the OCC undertook a comprehensive review of sales practices at large and midsize banks, including incentive-based compensation related to sales at all employee levels,

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<sup>40</sup> See BIS, *Report on the 2023 Banking Turmoil*, *supra* note 27. 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-reserve-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>.

<sup>41</sup> *Review of the Federal Reserve’s Supervision and Regulation of Silicon Valley Bank*, *supra* note 41, at 74-75.

not just executives. This review included an examination of incentive-based compensation plan design and risk management at the banks. The boards and senior executives of many of the institutions examined increased their attention to sales practices, as well as to culture and conduct risk. Overall, the banks examined strengthened their policies, procedures, and controls over sales practices, as well as the design and execution of the sales and incentive programs. The OCC expects that each bank's governance program addressing sales practices be commensurate with the risk presented by the bank's sales culture, the composition of products and services, the nature and design of incentive compensation programs, the presence of sales goals or quotas, and any other relevant bank-specific considerations.

Reviews of incentive compensation are supported by OCC regulations including 12 CFR 30, Appendix A, Interagency Guidelines Establishing Standards for Safety and Soundness and 12 CFR 30, Appendix D, OCC Guidelines Establishing Heightened Standards for Certain Large Insured Banks, Insured Federal Savings Associations, and Insured Federal Branches<sup>42</sup> (the "OCC's Heightened Standards"). Appendix A prohibits compensation that is excessive or that could lead to material financial loss. Appendix D requires covered banks to establish and adhere to compensation programs that prohibit incentive-based payment arrangements that encourage inappropriate risks by providing excessive compensation or that could lead to material financial loss. OCC publications also address incentive-based compensation, including the Corporate and Risk Governance Booklet of the Comptroller's Handbook (published July 2016, rev. 2019). The Corporate and Risk Governance Booklet addresses board oversight and implementation of risk

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<sup>42</sup> The OCC's Heightened Standards applies to any insured national bank, insured Federal savings association, or insured Federal branch of a foreign bank: "(a) With average total consolidated assets, as calculated according to paragraph I.A. of these Guidelines, equal to or greater than \$50 billion; (b) With average total consolidated assets less than \$50 billion if that bank's parent company controls at least one covered bank; or (c) With average total consolidated assets less than \$50 billion, if the OCC determines such bank's operations are highly complex or otherwise present a heightened risk as to warrant the application of these Guidelines pursuant to paragraph I.C. of these Guidelines." 12 CFR Part 30, Appendix D, § I.E.

governance frameworks including culture, risk appetite, and the three lines of defense. The booklet specifically discusses performance and talent management and board oversight of compensation. The OCC also updated several booklets of the Comptroller's Handbook since 2016 to include discussion of banks' implementation, management, and oversight of consumer complaints, including complaints received by a bank's third parties.

### *FHFA*

FHFA has express statutory authorities and mandates related to compensation paid by its regulated entities, in addition to overall responsibility for safety and soundness oversight. By statute, FHFA must prohibit Fannie Mae and Freddie Mac (together, "the Enterprises") and the Federal Home Loan Banks from providing compensation to any of their executive officers that is not reasonable and comparable with compensation for employment in other similar businesses (including publicly held financial institutions or major financial services companies) involving similar duties and responsibilities.<sup>43</sup> FHFA has additional authority over its regulated entities during conservatorship, and, under this authority, has established compensation programs for the Enterprises' executives.<sup>44</sup>

Since 2014, FHFA has issued three final rules related to compensation pursuant to the Safety and Soundness Act.<sup>45</sup> The Executive Compensation Rule implements the statutory directive that FHFA prohibit its regulated entities from providing compensation to an executive

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<sup>43</sup> 12 U.S.C. 4518(a). This mandate extends to Common Securitizations Solutions, LLC, a joint venture of Fannie Mae and Freddie Mac, as an affiliate of the Enterprises and to the Office of Finance of the Federal Home Loan Bank System. *See* 12 U.S.C. 4502(20) and 12 U.S.C. 4511(b)(2).

<sup>44</sup> As conservator, FHFA succeeded to all rights, titles, and privileges of the Enterprises, and of any shareholder, officer or director of each company with respect to the company and its assets. The Enterprises have been under conservatorship since September 2008.

<sup>45</sup> *See* 12 CFR parts 1230, 1231, and 1239, each authorized by the Safety and Soundness Act, as amended by the Housing and Economic Recovery Act of 2008 (HERA). Congress enacted HERA in large part to strengthen supervisory oversight of FHFA's regulated entities, including oversight of compensation, in response to the financial crisis that began in 2007.

officer that is not reasonable and comparable, and sets forth requirements and processes for compensation provided to executive officers by the Enterprises, the Federal Home Loan Banks, and the Federal Home Loan Bank System's Office of Finance.<sup>46</sup> Under the rule, those entities may not enter into an incentive plan with an executive officer or pay any incentive compensation to an executive officer without providing advance notice to FHFA.<sup>47</sup> FHFA's Golden Parachute Payments Rule governs golden parachute payments in the case of a regulated entity's insolvency, conservatorship, or other troubled condition.<sup>48</sup> These two rules implement FHFA's specific authority over compensation at its regulated entities. The third rule, on Responsibilities of Boards of Directors, Corporate Practices, and Corporate Governance Matters, requires the risk management program at each FHFA-regulated entity to include, among other things, provisions integrating risk management with management's goals and the compensation structure. The proposed rule would enhance FHFA's focus on compensation below the executive level, including bringing additional attention to overall compensation structures, and disclosure of those structures.

### *NCUA*

The NCUA reviews compensation practices at federally insured credit unions to ensure compliance with applicable regulations and to assess whether the compensation presents a material safety and soundness risk to the credit union. The NCUA has regulations that address compensation matters and periodically reviews them for ways to enhance their effectiveness. For example, the NCUA has historically prohibited, by regulation, credit unions from compensating employees, directors, and their immediately family members directly for loans made by the credit

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<sup>46</sup> 12 CFR Part 1230; *see also* 12 U.S.C. 4518(a) and 12 U.S.C. 4511(b)(2).

<sup>47</sup> 12 CFR 1230.3(d).

<sup>48</sup> 12 CFR Part 1231; *see also* 12 U.S.C. 4518(e).

union.<sup>49</sup> The NCUA’s regulations prohibit credit union officials and senior management from receiving anything of value in connection with investment transactions.<sup>50</sup>

The NCUA’s regulations related to corporate credit unions require these institutions to disclose the compensation of their most highly compensated employees.<sup>51</sup> This transparency gives member-owners of corporate credit unions the opportunity to assess the reasonableness of executive compensation in relation to the financial performance of the corporate credit union.

#### *Other regulatory developments*

After publication of the Proposed Rule in 2016, the SEC adopted rules to implement the clawback provision contained in Section 954 of the Dodd-Frank Act, which added Section 10D to the Securities Exchange Act of 1934.<sup>52</sup> Specifically, Section 10D(a) of the Securities Exchange Act requires the SEC to adopt rules directing the national securities exchanges<sup>53</sup> and the national securities associations<sup>54</sup> to prohibit the listing of any security of an issuer that is not in compliance with the requirements of Section 10D(b), which requires the recovery of incentive-based compensation from an issuer’s current or former executive officers if the issuer prepares an accounting restatement due to its material noncompliance with any financial reporting requirement under the securities laws (the “954 clawback rules”).<sup>55</sup> In July 2015, the SEC proposed rules and

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<sup>49</sup> 12 CFR 701.21(c)(8)(i).

<sup>50</sup> 12 CFR 703.17.

<sup>51</sup> 12 CFR 704.19.

<sup>52</sup> 15 U.S.C. 78a *et seq.*

<sup>53</sup> A “national securities exchange” is an exchange registered as such under section 6 of the Exchange Act (15 U.S.C. 78f).

<sup>54</sup> A “national securities association” is an association of brokers and dealers registered as such under Section 15A of the Exchange Act (15 U.S.C. 78o-3). The Financial Industry Regulatory Authority (“FINRA”) is the only association registered with the SEC under section 15A(a) of the Exchange Act, but FINRA does not list securities.

<sup>55</sup> Section 10D(b) requires the SEC to adopt rules directing the exchanges to establish listing standards to require each issuer to develop and implement a policy providing: (1) for the disclosure of the issuer’s policy on incentive-based compensation that is based on financial information required to be reported under the securities laws; and (2) that, in the event that the issuer is required to prepare an accounting restatement due to the issuer’s material noncompliance with any financial reporting requirement under the securities laws, the issuer will recover from any of the issuer’s

rule amendments to implement the 954 clawback rules.<sup>56</sup> In October 2022, the SEC adopted final rules to implement the requirements of Exchange Act Section 10D<sup>57</sup> through new Exchange Act Rule 10D-1<sup>58</sup> and related amendments.<sup>59</sup> Under the rules and related amendments, the national securities exchanges have adopted listing standards that require listed issuers to recover incentive-based compensation from an executive officer<sup>60</sup> 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.<sup>61</sup>

Such recovery must be on a “no fault” basis, without regard to whether any misconduct occurred or an executive officer’s responsibility for the erroneous financial statements. In addition,

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current or former executive officers incentive-based compensation (including stock options awarded as compensation) during the three-year period preceding the date that the issuer is required to prepare the accounting restatement, based on the erroneous data, in excess of what would have been paid to the executive officer under the accounting restatement.

<sup>56</sup> *Listing Standards for Recovery of Erroneously Awarded Compensation*, Release No. 33-9861 (July 1, 2015), 80 FR 41144 (July 14, 2015).

<sup>57</sup> *Listing Standards for Recovery of Erroneously Awarded Compensation*, Release No. 33-11126 (Oct. 26, 2022), 87 FR 73076 (Nov. 28, 2022). The rules and amendments became effective January 27, 2023, and required the exchanges to file proposed listing standards no later than February 27, 2023, and required the listing standards to be effective no later than November 28, 2023.

<sup>58</sup> See 17 CFR 240.10D-1(a).

<sup>59</sup> These include amendments to Items 402 [17 CFR 229.402] and 601 [17 CFR 229.601] of Regulation S-K, the addition of Item 22(b)(20) to Schedule 14A [17 CFR 240.14a-101], and amendments to Form 40-F [17 CFR 249.240f] and Form 20-F [17 CFR 249.220f] (and for listed funds, Form N-CSR [17 CFR 249.331 and 17 CFR 274.128]).

<sup>60</sup> An executive officer is the company’s president; principal financial officer; principal accounting officer (or if there is no such accounting officer, the controller); any vice president of the company in charge of a principal business unit, division, or function (such as sales, administration or finance); any other officer who performs a policymaking function; or any other person who performs similar significant policymaking functions for the listed company.

<sup>61</sup> Recovery might be impracticable because (1) the direct expense paid to a third party to assist in enforcing the policy would exceed the amount to be recovered, (2) recovery would violate home country law, where that law was adopted prior to the November 28, 2022 due date set forth in Rule 10D(1)(a)(2) for effectiveness of the listing standards, based on an opinion of counsel acceptable to the national securities exchange, or (3) recovery would cause a broad-based qualified retirement plan to fail to meet the tax-qualification requirements of Section 401(a) of the Internal Revenue Code and regulations thereunder.

the standards require a listed issuer to file its compensation recovery policy as an exhibit in its Exchange Act annual report.

As discussed in the SEC’s 954 clawback rules adopting release, these rules and rule amendments, as well as the resulting listing standards, were designed to implement the proposition underlying Section 10D of the Dodd-Frank Act, which noted that “executive officers of exchange-listed companies should not be entitled to retain incentive-based compensation that was erroneously awarded on the basis of materially misreported financial information that requires an accounting restatement.”<sup>62</sup>

#### *International Developments*

The Agencies also have considered and reviewed international developments regarding compensation and governance since developing the 2016 Proposed Rule to understand the international context for the regulation of incentive-based compensation, especially as it applies to cross-border institutions the Agencies supervise. The Agencies continue to consider whether any of these developments should inform the Agencies’ determinations regarding the regulation of U.S. covered institutions. The Agencies welcome comment on whether and, if so, how, these developments should be considered relevant to the covered institutions subject to this rulemaking.

Following the 2008 financial crisis, in 2009, the Financial Stability Board (“FSB”) published the “Principles for Sound Compensation Practices: Implementation Standards” (“FSB Principles”).<sup>63</sup> The FSB’s Principles mainly concern the design of executive compensation, and in general the remuneration of all Material Risk Takers (“MRTs”) in banks, including CEOs.

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<sup>62</sup> See *supra* note 58 at 87 FR 73077.

<sup>63</sup> See *supra* note 23.



Furthermore, the FSB called for executive compensation to be tied more closely to the risks assumed in the core business of banking.<sup>64</sup>

For the past several years, the Agencies that belong to the FSB, have been actively engaged in the development of international compensation and governance principles, as well as conducting working groups that have produced a variety of publications aimed at further improving incentive-based compensation practices.<sup>65</sup>

### European Union

The European Union (EU) implemented the FSB Principles through the adoption of the Capital Requirements Directives (“CRD”), which require member states’ national regulators to establish and implement remuneration policies for institutions including banks.<sup>66</sup> The CRD was first issued in 2013 and became effective in January 2014. The European Banking Authority

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<sup>64</sup> See, e.g., Vittoria Cerasi et al., *How Post-Crisis regulation has affected bank CEO compensation*, 104 JOURNAL OF INTERNATIONAL MONEY & FINANCE at § 2 (2020).

<sup>65</sup> See, e.g., FSB, *Climate-Related Financial Risk Factors in Compensation Frameworks* (Apr. 20, 2023), available at <https://www.fsb.org/wp-content/uploads/P204023.pdf>; FSB, *Effective Implementation of FSB Principles for Sound Compensation Practices and Implementation Standards, 2021 Progress Report* (Nov. 4, 2021), available at <https://www.fsb.org/wp-content/uploads/P041121.pdf>; FSB, *FSB Workshop on Compensation Practices 2021: Summary of Discussion* (August 9, 2021), available at <https://www.fsb.org/wp-content/uploads/P090821.pdf>; FSB, *FSB Compensation Workshop 2019: Key Takeaways* (May 8, 2020), available at <https://www.fsb.org/wp-content/uploads/P080520.pdf>; FSB, *FSB Member Jurisdictions’ National Regulation and Supervisory Guidance on Compensation* (June 17, 2019), available at <https://www.fsb.org/wp-content/uploads/P170619-2.pdf>; FSB, *Implementing the FSB Principles for Sound Compensation Practices and Their Implementation Standards: Sixth Progress Report* (June 17, 2019), available at <https://www.fsb.org/wp-content/uploads/P170619-1.pdf>; FSB, *FSB Member Jurisdictions’ National Regulation and Supervisory Guidance on Compensation* (June 17, 2019), available at <https://www.fsb.org/wp-content/uploads/P170619-2.pdf>; FSB, *Implementing the FSB Principles for Sound Compensation Practices and Their Implementation Standards: Fifth Progress Report* (July 4, 2017), available at <https://www.fsb.org/wp-content/uploads/P040717-6.pdf>; FSB, *Implementing the FSB Principles for Sound Compensation Practices and their Implementation Standards: Fourth Progress Report* (Nov. 10, 2015), available at <https://www.fsb.org/wp-content/uploads/FSB-Fourth-progress-report-on-compensation-practices.pdf>; FSB, *Implementing the FSB Principles for Sound Compensation Practices and Their Implementation Standards: Third Progress Report* (Nov. 4, 2014), available at [https://www.fsb.org/wp-content/uploads/r\\_141104.pdf](https://www.fsb.org/wp-content/uploads/r_141104.pdf); FSB, *Implementing the FSB Principles for Sound Compensation Practices and Their Implementation Standards: Second Progress Report* (Aug. 26, 2013), available at [https://www.fsb.org/wp-content/uploads/r\\_130826.pdf](https://www.fsb.org/wp-content/uploads/r_130826.pdf); FSB, *Implementing the FSB Principles for Sound Compensation Practices and Their Implementation Standards: Progress Report* (June 13, 2012), available at [https://www.fsb.org/wp-content/uploads/r\\_120613.pdf](https://www.fsb.org/wp-content/uploads/r_120613.pdf).

<sup>66</sup> Directive 2013/36/EU (CRD), as amended by Directive 2019/878/EU (CRD V). The directive addresses institutions including credit institutions and investment firms, which includes banks.

(EBA) is responsible for promulgating prudential regulations via the Single Rulebook,<sup>67</sup> and has issued guidelines related to compensation. The Guidelines on Sound Remuneration Policies were first published by the EBA in 2015<sup>68</sup> and were most recently revised in 2021.<sup>69</sup> The requirements “aim to ensure that remuneration policies are consistent with and promote sound and effective risk management, do not provide incentives for excessive risk taking, and are aligned with the long-term interests of the institutions across the EU.”<sup>70</sup>

Under the Guidelines, compensation policies must be in place for identified staff at institutions subject to the CRD, including banks. Identified staff subject to the compensation policies include those whose “professional activities have a material impact on the institution’s individual or the group’s risk profile.”<sup>71</sup> Staff with a material impact on the institution’s risk profile include, at a minimum, all members of the management body and senior management; staff with managerial responsibility over control functions or material business units; and staff entitled to significant remuneration the prior year - at least € 500,000 and equal to or greater to the remuneration of certain management figures - and whose professional activity in a material business unit is of a kind that has a significant impact on its risk profile.<sup>72</sup> In keeping with the

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<sup>67</sup> The Single Rulebook is intended “[t]o contribute to the stability and effectiveness of the European financial system, the EBA develops harmonised rules for financial institutions, promotes convergence of supervisory practices, monitors, and advises on the impact of financial innovation and the transition to sustainable finance.” European Banking Agency, Single Rulebook, <https://www.eba.europa.eu/activities/single-rulebook>. The Single Rulebook aims to assist EU member countries in consistently implementing directives issued by the European Parliament and the Council of the EU.

<sup>68</sup> EBA, Guidelines on Sound Remuneration Policies under Articles 74(3) and 75(2) of Directive 2013/36 EU and Disclosures under Article 450 of Regulation (EU) No 575/2013 (December 21, 2015), <https://www.eba.europa.eu/sites/default/files/documents/10180/1314839/1b0f3f99-f913-461a-b3e9-fa0064b1946b/EBA-GL-2015-22%20Final%20report%20on%20Guidelines%20on%20Sound%20Remuneration%20Policies.pdf>.

<sup>69</sup> EBA, Guidelines on Sound Remuneration Policies Under Directive 2013/36/EU (July 2, 2021), [https://www.eba.europa.eu/sites/default/files/document\\_library/Publications/Guidelines/2021/1016720/Draft%20Final%20report%20on%20GL%20on%20remuneration%20policies%20under%20CRD.pdf](https://www.eba.europa.eu/sites/default/files/document_library/Publications/Guidelines/2021/1016720/Draft%20Final%20report%20on%20GL%20on%20remuneration%20policies%20under%20CRD.pdf) [hereinafter Guidelines].

<sup>70</sup> *Id.* at ¶ 3.

<sup>71</sup> *Id.* at ¶ 11.

<sup>72</sup> CRD Article 92(3).

principle of proportionality, the Guidelines set forth a bonus cap limiting the maximum ratio between the variable and fixed components of remuneration to 100 percent, or 200 percent with shareholder approval.<sup>73</sup> Policies must address clawback and other restrictions, including a minimum deferral period of four to five years for the management body of significant institutions.<sup>74</sup> There are also governance requirements including the establishment of a compensation committee, as well as transparency and reporting requirements.<sup>75</sup>

The EBA issued a 2021 update to the Guidelines. One notable change was that in light of retention bonuses and severance payments being used to circumvent compensation requirements, revisions were made to limit circumstances for and require more documentation of the circumstances surrounding such payments.<sup>76</sup> The revisions also clarified a number of other aspects, including that the Guidelines apply on a group, parent, and subsidiary level, even for subsidiaries that are not otherwise subject to the CRDs, unless they are already subject to other compensation regulatory requirements.<sup>77</sup>

### United Kingdom

The United Kingdom (UK) implemented its remuneration rules for the banking sector along with the EU member states through the adoption of the CRD, and its current framework and requirements remain relatively similar following the UK's separation from the EU.

The Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) Remuneration Code requires minimum deferral periods of four years for non-managerial “material risk takers,” five years for management of a significant firm, and seven years for higher paid

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<sup>73</sup> Guidelines ¶ 91.

<sup>74</sup> *Id.* at ¶ 260. Institutions should defer a minimum of 40 percent of remuneration for a category of identified staff or a single identified staff member, and a minimum of 60 percent of remuneration for cases involving particularly high amounts of variable remuneration. *Id.* at ¶ 262.

<sup>75</sup> *Id.* at ¶ 28 *et seq.*

<sup>76</sup> *Id.* at 5.

<sup>77</sup> *Id.* at ¶¶ 8-9.

material risk takers who perform senior management functions.<sup>78</sup> However, one significant change came in October 2023, when the PRA and the FCA amended the cap on bonuses for the banking sector. The regulators removed the provision limiting bonuses for certain staff to 100 percent of fixed compensation, or up to 200 percent with shareholder approval.<sup>79</sup> The regulators noted that bonus caps are not routinely imposed in non-EU international financial centers, and that the caps had been identified as impacting competitiveness of UK institutions, driving up fixed compensation, and limiting labor mobility. The change impacted banks, building societies, and designated investment firms, but not credit unions, insurers, and certain other investment firms.<sup>80</sup> The regulators also stressed that their other rules regarding, for example, mandatory deferrals, the composition of variable pay, and risk adjustment mechanisms, remain in place and aim to better align remuneration with prudent risk taking.<sup>81</sup>

## II. OVERVIEW OF THE 2024 PROPOSED RULE

The Agencies believe that the developments discussed above continue to demonstrate the need to prohibit types and features of incentive-based compensation arrangements that encourage inappropriate risks, as required by section 956. The Agencies are re-proposing the regulatory text of the 2016 Proposed Rule without change, along with proposing certain alternatives, for consideration by the public.

The Agencies, along with the Board and the SEC, jointly developed and issued the 2016 Proposed Rule. As stated above, the Board has not acted to join this proposal. Rulemaking to

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<sup>78</sup> See UK PRUDENTIAL REGULATION AUTHORITY, PRA RULEBOOK § 11.

<sup>79</sup> Prudential Regulation Authority & Financial Conduct Authority, *PS9/23 Remuneration: Ratio between fixed and variable components of total remuneration ('bonus cap')* (Oct. 24, 2023), <https://www.bankofengland.co.uk/prudential-regulation/publication/2023/october/remuneration-ratio-between-fixed-and-variable-components-of-total-remuneration>.

<sup>80</sup> *Id.*

<sup>81</sup> *Id.*

implement section 956 is on the SEC's rulemaking agenda. This proposal continues to include the provisions of the regulatory text from the 2016 Proposed Rule that address covered institutions on a consolidated basis. The Agencies recognize that this may implicate Board-supervised entities – namely depository institution holding companies – and SEC-regulated entities, and the Agencies will continue to coordinate with the Board and the SEC on these and other issues, consistent with the requirements of section 956.

As more fully described in the 2016 Proposed Rule,<sup>82</sup> incentive-based compensation arrangements that result in payments that are unreasonable or disproportionate to the value of services performed could encourage inappropriate risks by providing excessive compensation, fees, and benefits. Further, incentive-based compensation arrangements that do not appropriately balance risk and reward, that are not compatible with effective risk management and controls, or that are not supported by effective governance are types of incentive-based compensation arrangements that could encourage inappropriate risks that could lead to material financial loss to covered institutions. Because these types of incentive-based compensation arrangements encourage inappropriate risks, they would be prohibited under the proposed rule.

As more fully described in the 2016 Proposed Rule,<sup>83</sup> the proposed regulatory text 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 the important role of sound governance and risk management control mechanisms. The recordkeeping and disclosure requirements in the proposed regulatory text

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<sup>82</sup> See 81 FR 37670.

<sup>83</sup> See Section II of the 2016 Proposed Rule, 81 FR at 37682-37743, which contains a section-by section description of the proposed regulatory text.

would assist the appropriate Federal regulator in monitoring and identifying areas of potential concern at covered institutions.

The Agencies invite further comment on the proposed regulatory text. The Agencies acknowledge that, given the passage of time, commenters may have additional or different views about the proposed regulatory text. To provide greater opportunity for comment, including up-to-date input on current data and practices across the range of proposed covered institutions, the Agencies will consider comments received in response to the 2016 Proposed Rule as well as any comments received in response to this re-proposal when determining how to implement section 956. Comments are particularly helpful to the Agencies if accompanied by detailed analysis and supporting data regarding the issues addressed in those comments. Those who submitted comments in response to the 2016 Proposed Rule are welcome to submit new or updated comments in response to this re-proposal. To assist with reconciling comments from parties who submitted comments to the 2016 Proposed Rule and who again submit comments to this re-proposal that reflect changes to their previous viewpoints, the Agencies invite such commenters to clarify the relationship between their two comments. Specifically, the Agencies invite commenters to clarify whether their comments to the 2024 Proposed Rule in part or in whole supersede their previously submitted comments.

The Agencies are also inviting comment on alternatives to the proposed regulatory text, discussed below.

### **III. REQUESTS FOR COMMENT**

#### **A. Requests for Comment**

As described above, there have been various developments in incentive-based compensation, risk management, and governance practices at financial institutions since the

public submitted comments in response to the 2016 Proposed Rule. In light of these developments, the Agencies are inviting comment on all aspects of this proposal. Additionally, the Agencies have listed specific requests for comment below organized by section number. These include revised versions of questions posed in the 2016 Proposed Rule along with new questions.

Based on the comments received, and further consideration by the Agencies of the issues involved, a future action implementing section 956 may include changes raised in the requests for comment set forth below or the alternatives set forth in section III.B. As discussed previously, the agencies continue to consider comments submitted on the 2016 Proposed Rule.

### **Section 1 – Authority, Scope, and Initial Applicability**

*Question 1.1:* The Agencies invite comment on whether the proposed compliance date would be sufficient to allow covered institutions to implement any changes necessary for compliance with the proposed rule, particularly the development and implementation of policies and procedures. What specific changes would be required to bring existing policies and procedures into compliance with the rule? What constraints exist on the ability of covered institutions to meet the proposed deadline?

### **Section 2 – Definitions**

*Question 2.1:* The Agencies invite comment on whether other financial institutions should be included in the definition of “covered institution” and why.

*Question 2.2:* The Agencies invite comment on the proposed rule’s approach to consolidation. What are the advantages to or disadvantages of the approach? For example, the Agencies invite comment on whether the proposed rule’s approach would reinforce the ability of an institution to establish and maintain effective risk management and controls for the entire consolidated organization and enabling holding company structures to more effectively manage

human resources. Are there advantages or disadvantages to the approach of the proposed rule in helping to reduce the possibility of evasion of the more specific standards applicable to certain individuals at Level 1 or Level 2 covered institutions? The Agencies also invite comment on any challenges smaller subsidiaries of a larger covered institution may have by applying the more specific provisions of the proposed rule to these smaller institutions that would not otherwise apply to them but for being a subsidiary of a larger institution. Is there another approach that the proposed rule should take?

*Question 2.3:* The Agencies invite commenters to discuss whether the asset thresholds used in these definitions are appropriate for determining which requirements apply. Would other alternative methodologies be more appropriate and why?

*Question 2.4:* The Agencies invite comment on the methods for determining whether Federal branches and agencies are Level 1, Level 2, or Level 3 covered institutions. Should the same method be used for Federal branches and agencies? Why or why not?

*Question 2.5:* The Agencies invite comment on whether the definition of “principal shareholder” reflects a common understanding of who would be a principal shareholder of a covered institution.

*Question 2.6:* The Agencies invite comment on whether the types of positions identified in the proposed definition of senior executive officer are appropriate, whether additional positions should be included, whether any positions should be removed, and why. For example, should the Agencies include the chief technology officer (“CTO”), chief information security officer, or similar titles as positions explicitly listed in the definition of “senior executive officer”? Why or why not?



*Question 2.7:* The Agencies invite comment on whether the term “major business line” provides enough information to allow a covered institution to identify individuals who are heads of major business lines. Should the proposed rule refer instead to a “core business line,” as defined in FDIC and Board rules relating to resolution planning (12 CFR 381.2), to a “principal business unit, division or function,” as described in SEC definitions of the term “executive officer” (17 CFR 240.3b-7), or to business lines that contribute greater than a specified amount to the covered institution’s total annual revenues or profit? Why?

*Question 2.8:* For purposes of a designation under paragraph (2) of the definition of significant risk-taker, should the Agencies provide a specific standard for what would constitute “material financial loss” and/or “overall risk tolerance”? If so, how should these terms be defined and why? Should certain distributions be excluded from the calculation of a material financial loss, such as certain incentive-based compensation distributions, and if so, why?

*Question 2.9:* The Agencies specifically invite comment on the one-third threshold in the proposed rule. Is one-third of the total of annual base salary and incentive-based compensation an appropriate threshold level of incentive-based compensation that would be sufficient to influence risk-taking behavior? Is using compensation from the last calendar year that ended at least 180 days before the beginning of the performance period for calculating the one-third threshold appropriate?

*Question 2.10:* The Agencies specifically invite comment on the time frame needed to identify significant risk-takers under the relative compensation test. Is using compensation from the last calendar year that ended at least 180 days before the beginning of the performance period appropriate? The Agencies invite comment on whether there is another measure of total

compensation that would be possible to measure closer in time to the performance period for which a covered person would be identified as a significant risk-taker.

*Question 2.11:* How many covered persons would likely be identified as significant risk-takers under the proposed rule and the alternatives described above?

*Question 2.12:* To the extent covered institutions are already deferring incentive-based compensation, does the proposed definition of deferral reflect current practice? If not, in what way does it differ?

*Question 2.13:* Are there any financial instruments that are used for incentive-based compensation and have a value that is dependent on the performance of a covered institution's shares, but are not captured by the definition of "equity-like instrument"? If so, what are they, and should such instruments be added to the definition? Why or why not?

*Question 2.14:* The Agencies invite comment on the proposed definition of incentive-based compensation. Should the definition be modified to include additional or fewer forms of compensation, and in what way? Is the definition sufficiently broad to capture all forms of incentive-based compensation currently used by covered institutions? Why or why not? If not, what forms of incentive-based compensation should be included in the definition? What forms of incentive-based compensation should be excluded in the definition, and why?

*Question 2.15:* The Agencies do not expect that most pensions would meet the proposed rule's definition of "incentive-based compensation" because pensions generally are not conditioned on performance achievement. However, it may be possible to design a pension that would meet the proposed rule's definition of "incentive-based compensation." The Agencies invite comment on whether the proposed rule should contain express provisions addressing the

status of pensions in relation to the definition of “incentive-based compensation.” Why or why not?

*Question 2.16:* The Agencies invite comment on whether the proposed definition of “long-term incentive plan” is appropriate for purposes of the proposed rule. Are there incentive-based compensation arrangements commonly used by financial institutions that would not be included within the definition of “long-term incentive plan” under the proposed rule but that, given the scope and purposes of section 956, should be included in such definition? If so, what are the features of such incentive-based compensation arrangements, why should the definition include such arrangements, and how should the definition be modified to include such arrangements?

*Question 2.17:* Does the proposed rule’s definition of “performance period” meet the goal of providing covered institutions with flexibility in determining the length and start and end dates of performance periods? Why or why not? Should the rule establish a fixed length for a performance period, for example, one calendar year? Why or why not?

*Question 2.18:* Is the interplay of the award date, vesting date, performance period, and deferral period clear? If not, why not?

*Question 2.19:* Have the Agencies made clear the distinctions between the proposed definitions of clawback, forfeiture, and downward adjustment? Do these definitions align with current industry practice? If not, in what ways do they differ and what are the implications of such differences for both the operations of covered institutions and the effective supervision of compensation practices?

### **Section 3 – Applicability**

*Question 3.1:* The Agencies invite comment on whether a covered institution’s average total consolidated assets (a rolling average) is appropriate for determining a covered institution’s level when its total consolidated assets increase. Why or why not?

*Question 3.3:* The Agencies invite comment on whether four consecutive quarters is an appropriate period for determining a covered institution’s level when its total consolidated assets decrease. Why or why not?

*Question 3.4:* Should the transition period for an institution that changes levels or becomes a covered institution due to a merger or acquisition be different than an institution that changes levels or becomes a covered institution without a change in corporate structure? If so, why? If so, what transition period would be appropriate and why?

*Question 3.5:* The Agencies invite comment on whether covered institutions transitioning from Level 1 to Level 2 or Level 2 to Level 3 should be permitted to modify incentive-based compensation plans with performance periods that began prior to their transition in level in such a way that would cause the plans not to meet the requirements of the proposed rule that were applicable to the covered institution at the time when the performance periods for the plans commenced. Why or why not?

### **Section 4 – Requirements and Prohibitions Applicable to All Covered Institutions**

*Question 4.1:* The Agencies invite comment on the requirements for performance measures contained in section \_\_.4(d) of the proposed rule. Are these measures sufficiently tailored to allow for incentive-based compensation arrangements to appropriately balance risk and reward? If not, why?

*Question 4.2:* The Agencies invite comment on whether the terms “financial measures of performance” and “non-financial measures of performance” should be defined. If so, what should be included in the defined terms?

*Question 4.3:* Would preparation of annual records be appropriate or should another method be used? Would covered institutions find a more specific list of topics and quantitative information for the content of required records helpful? Should covered institutions be required to maintain an inventory of all such records and to maintain such records in a particular format? If so, why? How would such specific requirements increase or decrease burden? Should covered institutions only be required to create new records when incentive-based compensation arrangements or policies change? Should the records be updated more frequently, such as promptly upon a material change? What should be considered a “material change”?

*Question 4.4:* Is seven years a sufficient time to maintain the records required under section \_\_\_\_ .4(f) of the proposed rule? Why or why not?

### **Section 5 – Additional Disclosure and Recordkeeping Requirements for Level 1 and Level 2 Covered Institutions**

*Question 5.1:* Should the level of detail in records created and maintained by Level 1 and Level 2 covered institutions vary among institutions regulated by different Agencies? If so, how? Or would it be helpful to use a template with a standardized information list?

*Question 5.2:* In addition to the proposed records, what types of information should Level 1 and Level 2 covered institutions be required to create and maintain related to deferral and to forfeiture, downward adjustment, and clawback reviews?

### **Section 6 – Reservation of Authority for Level 3 Covered Institutions**

*Question 6.1:* The Agencies based the \$10 billion dollar floor of the reservation of authority on existing similar reservations of authority that have been drawn at that level.<sup>84</sup> Did the Agencies set the correct threshold or should the floor be set lower or higher than \$10 billion? If so, at what level and why?

*Question 6.2:* Are there certain provisions in section \_\_\_\_.5 and sections \_\_\_\_.7 through \_\_\_\_.11 of the proposed rule that would not be appropriate to apply to a covered institution with total consolidated assets of \$10 billion or more and less than \$50 billion regardless of its complexity of operations or compensation practices? If so, which provisions and why?

*Question 6.3:* The Agencies invite comment on the types of notice and response procedures the Agencies should use in determining that the reservation of authority should be used.

*Question 6.4:* What specific features of incentive-based compensation programs or arrangements at a Level 3 covered institution should the Agencies consider in determining whether the institution should comply with some or all of the more rigorous requirements within the rule and why? What process should be followed in removing such institution from the more rigorous requirements?

### **Section 7 – Deferral, Forfeiture and Downward Adjustment, and Clawback Requirements for Level 1 and Level 2 Covered Institutions**

*Question 7.1:* The Agencies invite comment on the proposed minimum required deferral periods and percentages. Should Level 1 and Level 2 covered institutions be subject to different deferral requirements, as in the proposed rule, or should they be treated more similarly for this purpose and why?

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<sup>84</sup> See, e.g., 12 CFR 3.12, 12 CFR 217.12, and 12 CFR 324.12 (community bank leverage ratio in the Federal banking regulators' domestic capital rule).

*Question 7.2:* Commenters are invited to address the possible impact that the required minimum deferral provisions for senior executive officers and significant risk-takers may have on covered institutions.

*Question 7.3:* What implications do the minimum deferral requirements under the proposed rule have on “level playing fields” between covered institutions and non-covered institutions?

*Question 7.4:* The Agencies invite comment on whether longer performance periods can provide risk balancing benefits similar to those provided by deferral. Are the shorter deferral periods for incentive-based compensation awarded under long-term incentive plans appropriate?

*Question 7.5:* Would the proposed distinction between the deferral requirements for qualifying incentive-based compensation and incentive-based compensation awarded under a long-term incentive plan pose practical difficulties for covered institutions or increase compliance burdens? Why or why not?

*Question 7.6:* Would the requirement in the proposed rule that amounts awarded under long-term incentive plans be deferred result in covered institutions offering fewer long-term incentive plans? If so, why and what other compensation plans will be used in place of long-term incentive plans and what negative or positive consequences might result?

*Question 7.7:* Are there additional considerations, such as tax or accounting considerations, that may affect the ability of Level 1 or Level 2 covered institutions to comply with the proposed deferral requirement or that the Agencies should consider in connection with this provision in the final rule? Should the determination of required deferral amounts under the proposed rule be adjusted for certain covered institutions and, if so, how? Could the tax liabilities immediately payable on deferred amounts be paid from the compensation that is not deferred?

*Question 7.8:* Agencies invite comment on whether the proposed deferral, forfeiture, downward adjustment, and clawback requirements in section \_\_.7 of the proposed rule are consistent with, more lenient, or more stringent than current practices at Level 1 and Level 2 covered institutions.

*Question 7.9:* The Agencies invite comment on the circumstances under which acceleration of payment should be permitted. Should accelerated vesting be allowed in cases where employees are terminated without cause or cases where there is a change in control and the covered institution ceases to exist and why? Are there other situations for which acceleration should be allowed? If so, how can such situations be limited to those of necessity?

*Question 7.10:* Should practices such as paying personnel in a manner as to enable the recipients to make tax payments on unrealized income as they became due, including tax liabilities payable on unrealized amounts of incentive-based compensation, be permissible under the proposed rule, including, for example, as a permissible acceleration of vesting under the proposed rule? Why or why not?

*Question 7.11:* In order to allow Level 1 and Level 2 covered institutions sufficient flexibility in designing their incentive-based compensation arrangements, the Agencies are not proposing a specific definition of “substantial” for the purposes of this section. Should the Agencies more precisely define the term “substantial” (for example, one-third or 40 percent) and if so, should the definition vary among covered institutions and why? Should the term “substantial” be interpreted differently for senior executive officers or significant risk-takers and why? Are there particular tax or accounting implications attached to use of particular forms of incentive-based compensation, such as those related to debt or equity?



*Question 7.12:* The Agencies invite commenters' views on whether the proposed rule should include a requirement that a certain portion of incentive-based compensation be structured with debt-like attributes. Do debt instruments (as opposed to equity-like instruments or deferred cash) meaningfully influence the behavior of senior executive officers and significant risk-takers? If so, how? How could the specific attributes of deferred cash be structured, if at all, to limit the amount of interest that can be paid? How should such an interest rate be determined, and how should such instruments be priced? Which attributes would most closely align use of a debt-like instrument with the interest of debt holders and promote risk-taking that is not likely to lead to material financial loss?

*Question 7.13:* The Agencies invite comment on the restrictions on the use of options in incentive-based compensation in the proposed rule. Does the proposed 15 percent limit appropriately balance the benefits of using options (such as aligning the recipient's interests with that of shareholders) and drawbacks of using options (such as their emphasis on upside gains)? Should the percent limit be higher or lower and if so, what should the limit be and why? Should options be permitted to be used to meet the deferral requirements of the rule? Why or why not? Does the use of options by covered institutions create, reduce, or have no effect on the institution's risk of material financial loss?

*Question 7.14:* Are there alternative means of addressing the concerns raised by options as a form of incentive-based compensation other than those proposed?

*Question 7.15:* Should the rule limit the events that require a Level 1 or Level 2 covered institution to consider forfeiture and downward adjustment to adverse outcomes that occurred within a certain time period? If so, why and what would be an appropriate time period? For

example, should the events triggering forfeiture and downward adjustment reviews be limited to those events that occurred within the previous seven years?

*Question 7.16:* Should the rule limit forfeiture and downward adjustment reviews to reducing only the incentive-based compensation that is related to the performance period in which the triggering event(s) occurred? Why or why not? Is it appropriate to subject unvested or unawarded incentive-based compensation to the risk of forfeiture or downward adjustment, respectively, if the incentive-based compensation does not specifically relate to the performance in the period in which the relevant event occurred or manifested? Why or why not?

*Question 7.17:* Should the rule place all unvested deferred incentive-based compensation, including amounts voluntarily deferred by Level 1 and Level 2 covered institutions or senior executive officers or significant risk-takers, at risk of forfeiture? Should only that unvested deferred incentive-based compensation that is required to be deferred under section \_\_\_\_.7(a) be at risk of forfeiture? Why or why not?

*Question 7.18:* Are the events triggering a review that are identified in section \_\_\_\_.7(b)(2) comprehensive and appropriate? If not, why not? Should the Agencies add “repeated supervisory actions” as a forfeiture or downward adjustment review trigger and why? Should the Agencies add “final enforcement or legal action” instead of the proposed “enforcement or legal action” and why?

*Question 7.19:* Is the list of factors that a Level 1 or Level 2 covered institution must consider, at a minimum, in determining the amount of incentive-based compensation to be forfeited or downward adjusted by a covered institution appropriate? If not, why not? Are any of the factors proposed unnecessary? Should additional factors be included?

*Question 7.20:* Are the proposed parameters for forfeiture and downward adjustment review sufficient to provide an appropriate governance framework for making forfeiture decisions

while still permitting adequate discretion for covered institutions to consider specific facts and circumstances when making determinations related to a wide variety of possible outcomes? Why or why not?

*Question 7.21:* What protections should covered institutions employ when making forfeiture and downward adjustment determinations?

*Question 7.22:* In order to determine when forfeiture and downward adjustment should occur, should Level 1 and Level 2 covered institutions be required to establish a formal process that both looks for the occurrence of trigger events and fulfills the requirements of the forfeiture and downward adjustment reviews under the proposed rule? If not, why not? Should covered institutions be required as part of the forfeiture and downward adjustment review process to establish formal review committees including representatives of control functions and a specific timetable for such reviews? Should the answer to this question depend on the size of the institution considered?

*Question 7.23:* Is the clawback requirement an appropriate means to achieve the goals of section 956? If not, why not? Is the seven-year period appropriate? Why or why not? Are there methods for recoupment of vested incentive-based compensation payment amounts, aside from clawback, that are suited to achieving the goals of section 956? Would an alternative construct be effective in achieving the goals of section 956?

*Question 7.24:* Are there state contract or employment law requirements that would conflict with the proposed clawback requirement? Are there challenges that would be posed by overlapping Federal clawback regimes, such as Rule 10D-1 of the SEC regulations implementing section 954 of the Dodd-Frank Act? Why or why not? Should the proposed clawback provisions be modified to reduce the possibility of recovery that would duplicate recovery previously

obtained under Rule 10D-1? Should the proposed forfeiture and downward adjustment provisions be modified to facilitate harmonization with the Rule 10D-1 clawback requirements applicable to covered institutions with a class of listed securities?

*Question 7.25:* Should the triggers for clawback be aligned with the triggers for forfeiture and downward adjustment in § \_\_.7(b)? Are there other triggers the Agencies should consider for clawback, including those contained in section 954 of the Dodd-Frank Act?

*Question 7.26:* Do the prescribed triggers provide adequate clarity on the types of behavior that would constitute misconduct for the purposes of § \_\_.7(c)(1) and the types of reputational harm that might result? If not, why not?

*Question 7.27:* Are there practical or other considerations that would make application of the proposed rule's clawback requirements in these circumstances challenging or unduly burdensome? If so, are there additional changes we should make to address those challenges or burdens?

*Question 7.28:* Are the measurement period and duration of the clawback period appropriate? Why or why not? Should the measurement period begin on a date other than the date the incentive-based compensation is awarded?

*Question 7.29:* Should all incentive-based compensation remain subject to recovery for some defined period following discovery of the basis for recovery?

*Question 7.30:* Should the proposed rule prescribe who would determine whether the covered person had committed fraud or engaged in misconduct, and how that determination would be made? Should the proposed rule prescribe how the decision makers would determine the appropriate amount of incentive-based compensation to claw back?

*Question 7.31:* The Agencies also request data regarding the characteristics of voluntarily adopted clawback policies (for example, clawback triggers, scope of covered persons, scope of compensation covered, among other characteristics), and data regarding compensation structures that are used by covered institutions (for example, compensation instruments utilized, measures used to award/earn such compensation, among others). Has the voluntary adoption of clawback provisions resulted in a decline in inappropriate risks by covered institutions, or a decline in excessive compensation, fees, or benefits?

### **Section 8 – Additional Prohibitions for Level 1 and Level 2 Covered Institutions**

*Question 8.1:* Are there additional requirements that should be imposed on covered institutions with respect to hedging of the exposure of covered persons under incentive-based compensation arrangements?

*Question 8.2:* The Agencies invite comment on whether the proposed rule should establish different limitations on maximum incentive-based compensation opportunity for senior executive officers and significant risk-takers, or whether the proposed rule should impose the same percentage limitation on senior executive officers and significant risk-takers.

*Question 8.3:* The Agencies also seek comment on whether setting a limit on the amount that compensation can grow from the time the target is established until an award occurs would achieve the goals of section 956.

*Question 8.4:* The Agencies invite comment on the appropriateness of the limitation on maximum incentive-based compensation opportunity, i.e., 125 percent and 150 percent for senior executive officers and significant risk-takers, respectively. Should the limitations be set higher or lower and, if so, why?

*Question 8.5:* Should the proposed rule apply the limitation on maximum incentive-based

compensation opportunity to Level 3 institutions?

*Question 8.6:* The Agencies invite comment on whether the restriction on the use of relative performance measures for covered persons at Level 1 and Level 2 covered institutions in section \_\_.8(d) of the proposed rule is appropriate in deterring behavior that could put the covered institution at risk of material financial loss. Should this restriction be limited to a specific group of covered persons and why? What are the relative performance measures being used in industry?

*Question 8.7:* Should the proposed rule apply the restriction on the use of relative performance measures to Level 3 institutions?

*Question 8.8:* The Agencies invite comment on whether there are circumstances under which consideration of transaction or revenue volume as a sole performance measure goal, without consideration of risk, can be appropriate in incentive-based compensation arrangements for Level 1 or Level 2 covered institutions.

*Question 8.9:* The Agencies invite comment on whether the prohibition on volume-driven incentive-based compensation should be modified, and if so, how? Should the proposed rule apply this restriction on the use of volume-driven incentive-based compensation arrangements to Level 3 institutions? Are there additional requirements that should be imposed on covered institutions that would address the unbalanced use of incentive-based compensation based on transaction revenue or volume?

### **Section 9 – Risk Management and Controls Requirements for Level 1 and Level 2 Covered Institutions**

*Question 9.1:* Some Level 1 and Level 2 covered institutions are subject to separate risk management and controls requirements under other statutory or regulatory regimes. For example,

OCC-supervised Level 1 and Level 2 covered institution are subject to the OCC's Heightened Standards. Is it clear to commenters how the risk management and controls requirements under the proposed rule would interact, if at all, with requirements under other statutory or regulatory regimes?

### **Section 10 – Governance Requirements for Level 1 and Level 2 Covered Institutions**

*Question 10.1:* The Agencies invite comment on this provision generally and whether the written assessments required under sections \_\_\_\_.10(b)(2) and \_\_\_\_.10(b)(3) of the proposed rule should be provided to the compensation committee on an annual basis or at more or less frequent intervals?

*Question 10.2:* Are both reports required under § \_\_\_\_.10(b)(2) and (3) necessary to aid the compensation committee in carrying out its responsibilities under the proposed rule? Would one or the other be more helpful? Why or why not?

### **Section 11 – Policies and Procedures Requirements for Level 1 and Level 2 Covered Institutions**

*Question 11.1:* The Agencies invite general comment on the proposed policies and procedures requirements for Level 1 and Level 2 covered institutions under section \_\_\_\_.11 of the proposed rule.

### **Section 12 – Indirect Actions**

*Question 12.1:* Commenters are invited to address all aspects of section \_\_\_\_.12, including any examples of other indirect actions that the Agencies should consider.

### **Section 13 – Enforcement**

*Question 13.1:* The Agencies invite comment on all aspects of section \_\_\_\_.13.

## **B. Specific alternatives**

Based on experiences in reviewing and supervising incentive-based compensation at some covered institutions, as described above, the Agencies are considering alternative regulatory provisions, including the specific alternatives described in this section and the additional alternatives discussed in the questions in Section III.A of the Supplementary Information section. As discussed above, the Agencies invite comment on all aspects of the proposed rule, the alternatives under consideration, and specific requests for comment.

### **Section \_\_.1(c) - Compliance date & Section \_\_.3 – Applicability**

Section \_\_.1(c) of the 2024 Proposed Rule would establish a timeline for complying with the rule - generally, the compliance date would be the first day of the first calendar quarter that begins at least 540 days after the date on which the institution becomes a Level 1, Level 2, or Level 3 covered institution.<sup>85</sup> The Agencies are considering whether the compliance date of the proposed rule should instead be the start of the first calendar quarter that begins at least 365 days after a final rule is published in the Federal Register. Under this alternative, whether a covered institution is a Level 1, Level 2, or Level 3 covered institution on the compliance date would be determined based on the average total consolidated assets as of the beginning of the first calendar quarter that begins after a final rule is published in the Federal Register.

*Question A.1:* The Agencies are seeking feedback on reducing the compliance period from 540 days to 365 days.

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<sup>85</sup> Section \_\_.3 (Applicability) of the 2024 Proposed Rule sets forth when and how an institution would become a Level 1, Level 2, or Level 3 covered institution and would be required to comply with the proposed rule – generally, the first day of the first calendar quarter that begins at least 540 days after the date on which the institution becomes a Level 1, Level 2, or Level 3 covered institution. Section \_\_.3 also addresses incentive-based compensation plans with a performance period beginning before the proposed rule’s compliance date.



*Question A.2:* The Agencies also invite comment on whether the date described in section \_\_.3(a)(2) should be (a) the beginning of the first performance period that begins at least 365 days after the date on which the regulated institution becomes a Level 1, Level 2, or Level 3 covered institution, or (b) the first day of the first calendar quarter that begins at least 365 days after the date on which the regulated institution becomes a Level 1, Level 2, or Level 3 covered institution, in order to have the date on which the proposed rule’s corporate governance, policies, and procedures requirements coincide with the date on which the requirements applicable to plans begin. Why or why not?

**Section \_\_.2(a) – Including CUSOs in the definition of “affiliate”**

As noted, the NCUA has opted to not include CUSOs under the definition of affiliate, which is consistent with the 2016 Proposed Rule. The NCUA Board, however, is considering whether CUSOs should be included under the definition of affiliate for the final rule. The NCUA Board would include CUSOs under the authority conferred by section 956(e)(2)(G), which authorizes the Agencies to include “any other financial institution that the appropriate Federal regulators, jointly, by rule, determine should be treated as a covered financial institution for purposes of this section.” Since 2016, CUSOs have grown more complex and involved in routine credit union operations. For example, in 2019, the NCUA Board approved a final rule to permit CUSOs to originate, purchase, sell, and hold any type of loan permissible for Federal credit unions to originate, purchase, sell, and hold. Given the evolving landscape of CUSO operations and the degree of connectedness present between many federally insured credit unions (FICUs) and their CUSOs, the NCUA Board believes it is reasonable to subject CUSO employees to the same incentive-based compensation requirements as FICU employees.

*Question A.2:* The NCUA Board is seeking feedback on whether to include CUSOs under the definition of affiliate. Should the NCUA Board consider CUSOs as affiliates? Are there policy or legal considerations the NCUA Board should consider?

**Sections \_\_.2(v), \_\_.2(w), and \_\_.2(x) - Asset thresholds**

The 2024 Proposed Rule distinguishes covered institutions by their asset size, with general incentive-based compensation program prohibitions and requirements for the smallest covered institutions within the statutory scope, and progressively more rigorous requirements for the larger covered institutions. The 2024 Proposed Rule groups covered institutions into three levels. The requirements of the 2024 Proposed Rule are tailored to reflect the size and complexity of each of the three levels of covered institutions identified in the proposed rule.

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 in sections \_\_.4 and \_\_.6 could apply to all covered institutions, and the proposed additional prohibitions and requirements in sections \_\_.5 and \_\_.7 to \_\_.11 could apply only to institutions with average consolidated assets of more than \$50 billion.

The Agencies invite comment on this alternative:

*Question A.3:* Would a two-tier approach with one level including covered institutions with average total consolidated assets of more than \$1 billion but less than \$50 billion, and the second level including covered institutions with more than \$50 billion in average total consolidated assets be appropriate? Why or why not? What other asset thresholds would be appropriate to differentiate between levels in a two-level structure?

*Question A.4:* What are the advantages and disadvantages of using a two-level structure rather than a three-level structure?

*Question A.5:* If the Agencies adopt a two-level alternative, should the proposed minimum required deferral amounts and minimum required deferral periods in sections \_\_.7(a)(1) and \_\_.7(a)(2) of the 2024 Proposed Rule’s provisions be simplified by using a single deferral percentage of 60 percent and deferral period of 4 years for both senior executive officers and significant risk-takers at covered institutions with average total consolidated assets of more than \$50 billion?

**Section \_\_.2(hh) - Significant risk-taker**

The proposed defined term, “significant risk-taker,” would include two tests for determining whether a covered person is a significant risk-taker—a relative compensation test and an exposure test. Significant risk-takers at Level 1 and Level 2 institutions would be subject to additional requirements, including mandatory deferral.

The Agencies are considering, as an alternative, whether to simplify the significant risk-taker definition by replacing the relative compensation test and exposure test with a more flexible risk-based approach. Under this alternative approach, the Agencies would require a covered institution to identify its significant risk-takers and submit a notice of its identification methodology to its primary Federal regulator. Under this alternative, the term “significant risk taker” would be defined as any covered person at a Level 1 or Level 2 covered institution, other than a senior executive officer, identified by that institution because of that covered person’s ability to expose the covered institution to risks that could lead to material financial loss in relation to the covered institution’s size, capital, or overall risk tolerance. The definition would apply to covered persons who received annual base salary and incentive-based compensation of which at least one-third is incentive-based compensation (one-third threshold).

The Agencies are considering several options under this alternative definition of significant risk-taker. The first option could allow the self-identification methodology to be left to the discretion of the covered institution (subject to the Agency's authority to designate additional significant risk-takers, as described below).

As a second option under the alternative allowing for self-identification, the Agencies could 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 institution. Covered institutions would be allowed to exclude covered persons in particular roles or functions.

Under either option, the proposed alternative definition would allow the Agencies to designate a covered person as a significant risk-taker if the covered person has the ability to expose a covered institution to risks that could lead to material financial loss in relation to the covered institution's size, capital, or overall risk tolerance. Each Agency would use its own procedures for making such a designation.

Another alternative that the Agencies are considering is whether to remove the separate exposure test for determining who would be a significant risk-taker under the 2024 Proposed Rule, and thus only the relative compensation test applies.

The Agencies invite comment on these alternative significant risk-taker definitions.

*Question A.6:* Should the Agencies simplify the definition of significant risk-taker by removing the specific thresholds and instead requiring a covered institution to identify its significant risk-takers using risk-based criteria and submit a notice of its identification methodology to its regulator? How can the Agencies be sure there would be consistency among institutions related to this approach? Would a minimum “floor,” perhaps related to the relative compensation test, be appropriate?

*Question A.7:* Should the Agencies provide a specific bright line test for determining whether a covered person is a significant-risk taker (for example, relying solely on the relative compensation test)?

*Question A.8:* Should the Agencies adopt a definition that includes a single bright-line threshold for identifying significant-risk takers for both Level 1 and Level 2 covered institutions? Would a definition that scoped in the top 2 percent of high earners at a Level 1 or Level 2 covered institution accurately identify the individuals most likely to expose the covered institution to significant risk, or is it likely to be over- or under-inclusive?

*Question A.9:* If the Agencies do not adopt an alternative definition that allows covered institutions to designate significant risk-takers, should they instead adopt a definition that relies solely on the relative compensation test and eliminate the separate exposure test for determining who would be a significant risk-taker in the 2024 Proposed Rule?

**Section \_\_.4(d)(3) - Setting performance measures and targets before performance period begins**

The proposed rule would require that any amounts to be awarded under an incentive-based compensation arrangement be subject to adjustment to reflect actual losses, inappropriate risks taken, compliance deficiencies, or other measures or aspects of financial and non-financial performance. The Agencies are considering whether to also require covered institutions to

establish performance measures and targets before the beginning of a performance period. Under this alternative, covered institutions would be unable to make changes to any target after the performance period begins without documentation and approval of such actions from appropriate personnel (e.g., in the case of senior executive officers, such approval would need to come from the board of directors). Additionally, under this alternative, a covered institution's decisions about deferral, downward adjustment, or forfeiture would have to account for all performance measures.

*Question A.10:* The Agencies invite comment on whether this proposed alternative would help ensure that incentive-based compensation arrangements appropriately balance risk and reward.

#### **Section \_\_.7(a)(4)(ii) - Options**

The Agencies are considering whether to modify the limit on options provided in section \_\_.7(a)(4)(ii) from 15 percent to 10 percent. Under this alternative approach, for senior executive officers and significant risk-takers at Level 1 and Level 2 covered institutions that receive incentive-based compensation in the form of options, the total amount of such options would be limited 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.

*Question A.11:* The Agencies are seeking feedback on whether the alternative 10 percent limit on options would more effectively mitigate concerns about the use of options in incentive-based compensation while still allowing sufficient flexibility for covered institutions to use options in an appropriate manner.

#### **Section \_\_.7(b) - Forfeiture and downward adjustment**

The Agencies believe that forfeiture and downward adjustment under the proposed rule would play an important role in aligning incentive-based compensation payments with long-run

risk outcomes at the covered institution and also in reducing incentives for senior executive officers and significant risk-takers to take inappropriate risk that could lead to material financial loss at the covered institution, provided these tools are utilized. The Agencies are considering, as an alternative to the 2024 Proposed Rule, 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 section \_\_.7(b)(2) of the proposed rule. These covered institutions also would be required, through policies and procedures,<sup>86</sup> to formalize the governance and review processes surrounding such decision-making, and to document the decisions made.

*Question A.12:* The Agencies are seeking comment on whether this proposed alternative would reduce incentives for senior executive officers and significant risk-takers to take inappropriate risk that could lead to material financial loss at covered institutions.

#### **Section \_\_.7(c) - Clawback**

As used in the proposed rule, the term “clawback” means a mechanism by which a covered institution can recover vested incentive-based compensation from a covered person. The Agencies believe clawback is an important tool boards and compensation committees can employ to discourage misconduct and excessive risk-taking, provided it is exercised.

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 incentive-based compensation from a current or former senior executive officer or significant risk taker under the same circumstances as identified in the 2024 Proposed Rule. If the clawback provision is so revised, all vested incentive-based compensation would be subject to the required clawback for a period of no less than seven

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<sup>86</sup> See sections \_\_.11(b) and \_\_.11(c).

years following the date on which such incentive-based compensation vests. This alternative would include an exception to the recovery requirement if the Level 1 or Level 2 covered institution can document that clawback is impracticable or an equivalent amount of incentive-based compensation has been impacted through forfeiture or downward adjustment.

*Question A.13:* The Agencies are seeking comment on whether this alternative would effectively discourage excessive risk-taking.

### **Section \_\_.8(a) - Hedging**

The Agencies are considering whether to include an additional prohibition under section \_\_.8(a) to prohibit a Level 1 and Level 2 covered institution from offering 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.

*Question A.14:* The Agencies are requesting feedback on whether to expand the scope of section \_\_.8(a) to further address hedging activity that encourages inappropriate risk-taking. Additionally, should this prohibition apply to covered persons at all covered institutions?

### **Section \_\_.8(d) - Volume driven incentive-based compensation**

The Agencies are considering whether to expand the prohibition in section \_\_.8(d) of 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. Specifically, as an alternative, the Agencies are considering whether to prohibit Level 1 and Level 2 covered institutions from providing incentive-based compensation to



a covered person that is based on transaction revenue or volume without regard to transaction quality or compliance of the covered person with sound risk management.

Since the 2016 Proposed Rule was issued, the Agencies have observed that incentive-based compensation arrangements that are based in part on transaction revenue or volume may lead to inappropriate risk-taking that could lead to material financial loss, absent other factors designed to cause covered persons to be held accountable for the risks of their activities.

*Question A.15:* As such, the Agencies are requesting feedback on whether expanding section \_\_\_\_.8(d)'s scope would deter behavior that could put the covered institution at risk of material financial loss.

#### **Section \_\_\_\_.9 - Risk Management and Controls Requirements for Level 1 and Level 2 Covered Institutions**

With respect to section \_\_\_\_.9(a) of the proposed rule, the Agencies are considering adding a requirement for a Level 1 or Level 2 covered institution to include, as part of their risk management framework, a requirement that a risk management and controls assessment from the independent risk and control functions be considered when setting incentive-based compensation for senior executive officers and significant risk-takers. The Agencies are requesting feedback on whether this additional requirement would be helpful for Level 1 and Level 2 covered institutions to better monitor and control the risks that incentive-based compensation arrangements for senior executive officers and significant risk-taker may create for the covered institution.

*Question A.16:* The Agencies are requesting feedback as to whether this additional requirement would be appropriate.

#### **IV. ADMINISTRATIVE LAW MATTERS**

## A. Regulatory Flexibility Act

### 1. OCC

The Regulatory Flexibility Act (RFA), 5 U.S.C. 601 *et seq.*, requires an agency, in connection with a proposed rule, to prepare an Initial Regulatory Flexibility Analysis describing the impact of the rule on small entities (defined by the Small Business Administration (SBA) for purposes of the RFA to include commercial banks and savings institutions with total assets of \$850 million or less and trust companies with total assets of \$47 million or less) or to certify that the proposed rule would not have a significant economic impact on a substantial number of small entities. However, under section 605(b) of the RFA, this analysis is not required if an agency certifies that the rule would not have a significant economic impact on a substantial number of small entities and publishes its certification and a short explanatory statement in the **Federal Register** along with its rule.

As discussed in the SUPPLEMENTARY INFORMATION section above, section 956 of the Dodd-Frank Act does not apply to institutions with assets of less than \$1 billion. As a result, the proposed rule will not, if promulgated, apply to any OCC-supervised small entities. For this reason, the proposed rule will not, if promulgated, have a significant economic impact on a substantial number of OCC-supervised small entities. Therefore, the OCC certifies that the proposed rule will not, if promulgated, have a significant economic impact on a substantial number of small entities.

### 2. FDIC

The Regulatory Flexibility Act (RFA) generally requires an agency, in connection with a proposed rule, to prepare and make available for public comment an initial regulatory flexibility

analysis that describes the impact of the proposed rule on small entities.<sup>87</sup> However, an initial regulatory flexibility analysis is not required if the agency certifies that the proposed rule will not, if promulgated, have a significant economic impact on a substantial number of small entities. The Small Business Administration (SBA) has defined “small entities” to include banking organizations with total assets of less than or equal to \$850 million.<sup>88</sup> Generally, the FDIC considers a significant economic impact to be a quantified effect in excess of 5 percent of total annual salaries and benefits or 2.5 percent of total noninterest expenses. The FDIC believes that effects in excess of one or more of these thresholds typically represent significant economic impacts for FDIC-supervised institutions.

As of the quarter ending December 31, 2023, the FDIC-supervised 2,936 IDIs, of which 2,221 are considered “small” for the purposes of RFA.<sup>89</sup> As described in the SUPPLEMENTARY INFORMATION above, the proposed rule would establish general requirements applicable to the incentive-based compensation arrangements of all institutions defined as covered institutions under the proposed rule (i.e., covered institutions with average total consolidated assets of \$1 billion or more that offers incentive-based compensation to covered persons). Given that the SBA defines a small banking organization as having \$850 million or less in assets, the FDIC estimates that no small, FDIC-supervised IDI would be subject to the proposed rule. Based on the preceding information, the FDIC certifies that the proposed rule would not have a significant economic impact on a substantial number of small FDIC-supervised institutions.

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<sup>87</sup> 5 U.S.C. 601 *et seq.*

<sup>88</sup> The SBA defines a small banking organization as having \$850 million or less in assets, where an organization’s “assets are determined by averaging the assets reported on its four quarterly financial statements for the preceding year.” *See* 13 CFR 121.201 (as amended by 87 FR 69118, effective December 19, 2022). In its determination, the “SBA counts the receipts, employees, or other measure of size of the concern whose size is at issue and all of its domestic and foreign affiliates.” *See* 13 CFR 121.103. Following these regulations, the FDIC uses an IDI’s affiliated and acquired assets, averaged over the preceding four quarters, to determine whether the IDI is “small” for the purposes of the RFA.

<sup>89</sup> FDIC Call Report Data, as of December 31, 2023.

The FDIC invites comments on all aspects of the supporting information provided in this RFA section. In particular, would this proposed rule have any significant effects on a substantial number of small entities that the FDIC has not identified?

### 3. FHFA

The Regulatory Flexibility Act (RFA) requires that a regulation that has a significant economic impact on a substantial number of small entities, small businesses, or small organizations must include an initial regulatory flexibility analysis describing the regulation's impact on small entities. Such an analysis need not be undertaken if the agency has certified that the regulation will not have a significant economic impact on a substantial number of small entities. FHFA has considered the impact of the proposed rule under the RFA. [The General Counsel of FHFA certifies that the proposed rule will not have a significant economic impact on a substantial number of small entities because the regulation would apply only to the Enterprises and to the Federal Home Loan Banks, which are not small entities for purposes of the RFA.]

### 4. NCUA

The Regulatory Flexibility Act<sup>90</sup> generally requires an agency to conduct a regulatory flexibility analysis of any rule subject to notice and comment rulemaking requirements, unless the agency certifies that the rule will not have a significant economic impact on a substantial number of small entities. If the agency makes such a certification, it shall publish the certification at the time of publication of either the proposed rule or the final rule, along with a statement providing the factual basis for such certification.<sup>91</sup> For purposes of this analysis, the NCUA considers small credit unions to be those having under \$100 million in assets.<sup>92</sup>

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<sup>90</sup> 5 U.S.C. 601 *et seq.*

<sup>91</sup> 5 U.S.C. 605(b).

<sup>92</sup> 80 FR 57512 (Sept. 24, 2015).

Section 956 of the Dodd Frank Act and the NCUA’s proposed rule apply only to credit unions with \$1 billion or more in assets. To the extent the proposed regulatory amendments have an economic impact, it will be limited to larger credit unions with assets of at least \$1 billion.

The NCUA notes that these larger institutions comprise a small percentage of the total number of credit unions. As of the third quarter of 2023, there were 424 federally insured credit unions (FICUs) with assets of meeting the \$1 billion threshold, comprising approximately only 9 percent of the total number of 4.645 FICUs.<sup>93</sup>

Accordingly, the NCUA Board certifies that the proposed rule would not have a significant economic impact on a substantial number of small entities since the credit unions subject to NCUA’s proposed rule are not small entities for purposes of the Regulatory Flexibility Act.

#### **B. Paperwork Reduction Act**

Certain provisions of the proposed rule contain “collection of information” requirements within the meaning of the Paperwork Reduction Act of 1995 (PRA).<sup>94</sup> In accordance with the requirements of the PRA, the Agencies may not conduct or sponsor, and a respondent is not required to respond to, an information collection unless it displays a currently valid Office of Management and Budget (OMB) control number. The information collection requirements contained in this proposed rule have been submitted by the OCC, FDIC, and NCUA to OMB for review and approval under section 3507(d) of the PRA and section 1320.11 of OMB’s implementing regulations.<sup>95</sup> FHFA has found that, with respect to any regulated entity as defined in section 1303(20) of the Safety and Soundness Act,<sup>96</sup> the proposed rule does not contain any

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<sup>93</sup> NCUA, *Quarterly Credit Union Data Summary 2023 Q3*, available at: <https://ncua.gov/files/publications/analysis/quarterly-data-summary-2023-Q3.pdf>

<sup>94</sup> 44 U.S.C. 3501-3521.

<sup>95</sup> 5 CFR 1320.

<sup>96</sup> 12 U.S.C. 4502(20).

collection of information that requires the approval of the OMB under the PRA. The recordkeeping requirements are found in sections \_\_.4(f), \_\_.5, and \_\_.11.

Comments are invited on the following:

(a) whether the collections of information are necessary for the proper performance of the Agencies' functions, including whether the information has practical utility;

(b) the accuracy of the estimates of the burden of the information collections, including the validity of the methodology and assumptions used;

(c) ways to enhance the quality, utility, and clarity of the information to be collected;

(d) ways to minimize the burden of the information collections on respondents, including through the use of automated collection techniques or other forms of information technology; and

(e) estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

All comments will become a matter of public record. Comments on aspects of this notice that may affect reporting, recordkeeping, or disclosure requirements and burden estimates should be sent to the addresses listed in the **ADDRESSES** section. A copy of the comments may also be submitted to the OMB desk officer for the Agencies by mail to U.S. Office of Management and Budget, 725 17th Street NW., #10235, Washington, DC 20503, by facsimile to (202) 395-5806, or by email to [oir\\_submission@omb.eop.gov](mailto:oir_submission@omb.eop.gov), Attention, Commission and Federal Banking Agency Desk Officer.

*Proposed Information Collection*

*Title of Information Collection:* Recordkeeping Requirements Associated with Incentive-Based Compensation Arrangements.

*Frequency of Response:* Annual.

*Affected Public:* Businesses or other for-profit.

*Respondents:*

*OCC:* National banks, Federal savings associations, and Federal branches or agencies of a foreign bank, and certain subsidiaries thereof, with average total consolidated assets greater than or equal to \$1 billion.

*FDIC:* State nonmember banks, state savings associations, and state insured branches of a foreign bank, and certain subsidiaries thereof, with average total consolidated assets greater than or equal to \$1 billion.

*NCUA:* Credit unions with average total consolidated assets greater than or equal to \$1 billion.

*Abstract:* Section 956(e) of the Dodd-Frank Act requires that the Agencies prohibit incentive-based payment arrangements at a covered financial institution that encourage inappropriate risks by a financial institution by providing excessive compensation or that could lead to material financial loss. Under the Dodd-Frank Act, 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. The Dodd-Frank Act does not require a covered financial institution to disclose compensation of individuals as part of this requirement. Section \_\_.4(f) would require all covered institutions to create annually and maintain for a period of at least seven years records that document the structure of all its incentive-based compensation arrangements and demonstrate compliance with this part. A covered institution must disclose the records to the Agency upon request. At a minimum, the records must include copies of all incentive-based compensation plans, a record of who is subject to each plan,

and a description of how the incentive-based compensation program is compatible with effective risk management and controls. Section \_\_.5 would require a Level 1 or Level 2 covered institution to create annually and maintain for a period of at least seven years records that document: (1) The covered institution's senior executive officers and significant risk-takers, listed by legal entity, job function, organizational hierarchy, and line of business; (2) the incentive-based compensation arrangements for senior executive officers and significant risk-takers, including information on percentage of incentive-based compensation deferred and form of award; (3) any forfeiture and downward adjustment or clawback reviews and decisions for senior executive officers and significant risk-takers; and (4) any material changes to the covered institution's incentive-based compensation arrangements and policies. A Level 1 or Level 2 covered institution must create and maintain records in a manner that allows for an independent audit of incentive-based compensation arrangements, policies, and procedures, including, those required under section \_\_.11. A Level 1 or Level 2 covered institution must provide the records described above to the Agency in such form and with such frequency as requested by Agency. Section \_\_.11 would require a Level 1 or Level 2 covered institution to develop and implement policies and procedures for its incentive-based compensation program that, at a minimum (1) are consistent with the prohibitions and requirements of this part; (2) specify the substantive and procedural criteria for the application of forfeiture and clawback, including the process for determining the amount of incentive-based compensation to be clawed back; (3) require that the covered institution maintain documentation of final forfeiture, downward adjustment, and clawback decisions; (4) specify the substantive and procedural criteria for the acceleration of payments of deferred incentive-based compensation to a covered person, consistent with section \_\_.7(a)(1)(iii)(B) and section \_\_.7(a)(2)(iii)(B)); (5) identify and describe the role of any employees, committees, or groups authorized to make



incentive-based compensation decisions, including when discretion is authorized; (6) describe how discretion is expected to be exercised to appropriately balance risk and reward; (7) require that the covered institution maintain documentation of the establishment, implementation, modification, and monitoring of incentive-based compensation arrangements, sufficient to support the covered institution's decisions; (8) describe how incentive-based compensation arrangements will be monitored; (9) specify the substantive and procedural requirements of the independent compliance program consistent with section \_\_.9(a)(2); and (10) ensure appropriate roles for risk management, risk oversight, and other control function personnel in the covered institution's processes for designing incentive-based compensation arrangements and determining awards, deferral amounts, deferral periods, forfeiture, downward adjustment, clawback, and vesting; and assessing the effectiveness of incentive-based compensation arrangements in restraining inappropriate risk-taking.

#### *Collection of Information Is Mandatory*

The collection of information will be mandatory for any covered institution subject to the proposed rules.

#### *Confidentiality*

The information collected pursuant to the collection of information will be kept confidential, subject to the provisions of applicable law.

#### *Estimated Paperwork Burden*

In determining the method for estimating the paperwork burden the OCC and the FDIC made the assumption that covered institution subsidiaries of a covered institution subject to the OCC's or the FDIC's proposed rule, respectively, would act in concert with one another to take advantage of efficiencies that may exist. The OCC and the FDIC invite comment on whether it is

reasonable to assume that covered institutions that are affiliated entities would act jointly or whether they would act independently to implement programs tailored to each entity.

*Estimated Average Hours per Response*

*Recordkeeping Burden*

§ \_\_.4(f) – 20 hours (Initial setup 40 hours).

§§ \_\_.5 and \_\_.11 (Level 1 and Level 2) – 20 hours (Initial setup 40 hours).

OCC (OMB Control No. 1557-0252)

*Number of respondents:* 301 (Level 1–23, Level 2–36, and Level 3–242). Total estimated annual burden: 21,600 hours (14,400 hours for initial setup and 7,200 hours for ongoing compliance).

FDIC (3064-0206)

*Number of respondents:* 528 (Level 1–1, Level 2–5, and Level 3–522). Total estimated annual burden: 21,960 hours (21,600 hours for initial setup and 10,800 hours for ongoing compliance).

NCUA (OMB Control No. 3133-0194)

*Number of respondents:* 432 (Level 1– 0, Level 2–2, and Level 3–430). Total estimated annual burden: 25,920 hours (17,280 hours for initial setup and 8,640 hours for ongoing compliance).

**C. Providing Accountability Through Transparency Act of 2023**

The Providing Accountability Through Transparency Act of 2023<sup>97</sup> (Act) requires that a notice of proposed rulemaking include the internet address of a summary of not more than 100 words in length of a proposed rule, in plain language, that shall be posted on the internet website

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<sup>97</sup> 5 U.S.C. 553(b)(4).

[www.regulations.gov](http://www.regulations.gov). [The Act, under its terms, applies to notices of proposed rulemaking and does not expressly include other types of documents that the NCUA Board publishes voluntarily for public comment, such as notices and interim-final rules that request comment despite invoking “good cause” to forgo such notice and public procedure. The NCUA Board, however, has elected to address the Act's requirement in these types of documents in the interests of administrative consistency and transparency.]

The Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, Federal Housing Finance Agency, and National Credit Union Administration seek comment on a proposed rule to implement section 956 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The statute requires that the appropriate Federal regulators, jointly issue regulations or guidelines: (1) prohibiting incentive-based compensation arrangements at covered financial institutions that encourage inappropriate risks by providing excessive compensation or that could lead to material financial loss; and (2) requiring those covered financial institutions to disclose information concerning incentive-based compensation arrangements to the appropriate Federal regulator.

The proposal and the required summary can be found at <https://www.regulations.gov>, <https://occ.gov/topics/laws-and-regulations/occ-regulations/proposed-issuances/index-proposed-issuances.html>, and <https://www.fdic.gov/resources/regulations/federal-register-publications/index.html>.

#### **D. Riegle Community Development and Regulatory Improvement Act of 1994**

Pursuant to section 302(a) of the Riegle Community Development and Regulatory Improvement Act<sup>98</sup> (RCDRIA), in determining the effective date and administrative compliance requirements for new regulations that impose additional reporting, disclosure, or other requirements on IDIs, each Federal banking agency must consider, consistent with the principle of safety and soundness and the public interest, any administrative burdens that such regulations would place on depository institutions, including small depository institutions, and customers of depository institutions, as well as the benefits of such regulations. In addition, section 302(b) of RCDRIA, requires new regulations and amendments to regulations that impose additional reporting, disclosures, or other new requirements on IDIs generally to take effect on the first day of a calendar quarter that begins on or after the date on which the regulations are published in final form, with certain exceptions, including for good cause.<sup>99</sup>

The Agencies request comment on any administrative burdens that the proposed rule would place on depository institutions, including small depository institutions, and their customers, and the benefits of the proposed rule that the Agencies should consider in determining the effective date and administrative compliance requirements for a final rule.

#### **E. Plain Language**

Section 722 of the Gramm-Leach-Bliley Act<sup>100</sup> requires the Federal banking agencies to use plain language in all proposed and final rules published after January 1, 2000. The Agencies have sought to present the proposed rule in a simple and straightforward manner and invite comment on the use of plain language and whether any part of the proposed rule could be more clearly stated. For example:

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<sup>98</sup> 12 U.S.C. 4802(a).

<sup>99</sup> 12 U.S.C. 4802(b).

<sup>100</sup> Pub. L. 106-102, section 722, 113 Stat. 1338, 1471 (1999), 12 U.S.C. 4809.

- Have the Agencies presented the material in an organized manner that meets your needs? If not, how could this material be better organized?
- Are the requirements in the notice of proposed rule clearly stated? If not, how could the proposed rule be more clearly stated?
- Does the proposed rule contain language that is not clear? If so, which language requires clarification?
- Would a different format (grouping and order of sections, use of headings, paragraphing) make the proposed rule easier to understand? If so, what changes to the format would make the proposed rule easier to understand?
- What else could the Agencies do to make the proposed rule easier to understand?

**F. OCC Unfunded Mandates Reform Act of 1995 Determination**

Section 202 of the Unfunded Mandates Reform Act of 1995 (Unfunded Mandates Act) (2 U.S.C. 1532) requires that the OCC prepare a budgetary impact statement before promulgating a rule that includes any Federal mandate that may result in the expenditure by state, local, and Tribal governments, in the aggregate, or by the private sector, of \$100 million or more (adjusted annually for inflation, currently \$182 million) in any one year. If a budgetary impact statement is required, section 205 of the Unfunded Mandates Act (2 U.S.C. 1535) also requires the OCC to identify and consider a reasonable number of regulatory alternatives before promulgating a rule.

The OCC estimates that the maximum aggregate cost of the proposed rule in any one year would be \$80.7 million. Therefore, the OCC concludes that the proposed rule would not result in an expenditure of \$182 million or more annually by state, local, and tribal governments, or by the private sector.

### **G. Differences Between the Federal Home Loan Banks and the Enterprises**

The Federal Housing Finance Enterprise Safety and Soundness Act of 1992, as amended requires the Director of FHFA, when promulgating regulations relating to the Federal Home Loan Banks, to consider the differences between the Federal Home Loan Banks and the Enterprises as they relate to: the Federal Home Loan Banks' cooperative ownership structure; the mission of providing liquidity to members; the affordable housing and community development mission; their capital structure; and their joint and several liability on consolidated obligations.<sup>101</sup> The Director also may consider any other differences that are deemed appropriate.<sup>102</sup> In preparing this proposed rule, the Director considered the differences between the Federal Home Loan Banks and the Enterprises as they relate to the above factors, and determined that the rule is appropriate. FHFA requests comments regarding whether differences related to those factors should result in any revisions to the proposed rule.

### **H. NCUA Executive Order 13132 Determination**

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their actions on state and local interests. The NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the executive order to adhere to fundamental federalism principles. As noted, section 956(e)(1)(C) of the Dodd-Frank Act defines the term "credit union" as including "any insured credit union as defined in section 101 of the Federal Credit Union Act [12 U.S.C. 1752] or any credit union which is eligible to make application to become an insured credit union pursuant to section 201 of such Act [12 U.S.C.1781]." Under section 201 of the Federal Credit Union Act, state-chartered credit unions

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<sup>101</sup> 12 U.S.C. 4513(f).

<sup>102</sup> *Id.*

are eligible to apply for Federal insurance at any time. Accordingly, as required by statute, the proposed rule would apply to all credit unions, whether chartered under federal or state law and irrespective of whether they are federally insured. The rulemaking may therefore have an occasional direct effect on the states, the relationship between the national government and the states, or on the distribution of power and responsibilities among the various levels of government. However, the extent of any such effect will be as a consequence of statutory mandate, and not due to the NCUA's exercise of its policy discretion. Moreover, those state-chartered credit unions that are federally insured are already subject to numerous provisions of NCUA's rules, based on the agency's role as the insurer of member share accounts and the significant interest NCUA has in the safety and soundness of their operations. The NCUA Board specifically requests comment on ways to eliminate, or at least minimize, potential conflicts in this area. Based on the comments received, the final rule may modify the application of the incentive-based compensation requirements to the extent the changes are feasible given the statutory constraints and consistent with the purposes of this rulemaking.

#### **I. Assessment of Federal Regulations and Policies on Families**

The NCUA has determined that this proposed rule would not affect family well-being within the meaning of Section 654 of the Treasury and General Government Appropriations Act, 1999.<sup>103</sup> The proposed regulatory requirements are exclusively concerned with implementation of a statutory directive to prohibit incentive-based compensation arrangements at covered institutions that could encourage inappropriate risks. The potential positive effect on family well-being, including the financial well-being of families that include credit union officials subject to the rule is, at most, indirect.

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<sup>103</sup> Public Law 105-277, 112 Stat. 2681 (1998).

## **List of Subjects**

### *12 CFR Part 42*

Banks, banking, Compensation, National banks, Reporting and recordkeeping requirements.

### *12 CFR Part 372*

Banks, banking, Compensation, Foreign banking.

### *12 CFR Parts 741 and 751*

Compensation, Credit unions, Reporting and recording requirements.

### *12 CFR Part 1232*

Administrative practice and procedure, Banks, Compensation, Confidential business information, Government-sponsored enterprises, Reporting and recordkeeping requirements.

## **Department of the Treasury: Office of the Comptroller of the Currency 12 CFR Chapter I**

### **Authority and Issuance**

For the reasons set forth in the joint preamble, the OCC proposes to amend 12 CFR chapter I of the Code of Federal Regulations as follows:

#### **1. Add part 42 to read as follows:**

### **PART 42—INCENTIVE-BASED COMPENSATION ARRANGEMENTS**

Sec.

42.1 Authority, scope, and initial applicability.

42.2 Definitions.

42.3 Applicability.

42.4 Requirements and prohibitions applicable to all covered institutions.



42.5 Additional disclosure and recordkeeping requirements for Level 1 and Level 2 covered institutions.

42.6 Reservation of authority for Level 3 covered institutions.

42.7 Deferral, forfeiture and downward adjustment, and clawback requirements for Level 1 and Level 2 covered institutions.

42.8 Additional prohibitions for Level 1 and Level 2 covered institutions.

42.9 Risk management and controls requirements for Level 1 and Level 2 covered institutions.

42.10 Governance requirements for Level 1 and Level 2 covered institutions.

42.11 Policies and procedures requirements for Level 1 and Level 2 covered institutions.

42.12 Indirect actions.

42.13 Enforcement.

**Authority:** 12 U.S.C. 1 et seq. 1, 93a, 1462a, 1463, 1464, 1818, 1831p-1, and 5641.

#### **§ 42.1 Authority, scope, and initial applicability.**

- (a) Authority. This part is issued pursuant to section 956 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 5641), sections 8 and 39 of the Federal Deposit Insurance Act (12 U.S.C. 1818 and 1831p-1), sections 3, 4, and 5 of the Home Owners' Loan Act (12 U.S.C. 1462a, 1463, and 1464), and section 5239A of the Revised Statutes (12 U.S.C. 93a).
- (b) Scope. This part applies to a covered institution with average total consolidated assets greater than or equal to \$1 billion that offers incentive-based compensation to covered persons.
- (c) Initial applicability—(1) Compliance date. A covered institution must meet the requirements of this part no later than [Date of the beginning of the first calendar quarter that begins at least 540 days after a final rule is published in the Federal Register]. Whether a covered institution is a Level 1, Level 2, or Level 3 covered institution at that time will be determined based on average total consolidated assets as of [Date of the beginning of the first calendar quarter that begins after a final rule is published in the Federal Register].

- (2) Grandfathered plans. A covered institution is not required to comply with the requirements of this part with respect to any incentive-based compensation plan with a performance period that begins before [Compliance Date as described in § 42.1(c)(1)].
- (d) Preservation of authority. Nothing in this part in any way limits the authority of the OCC under other provisions of applicable law and regulations.

## § 42.2 Definitions.

For purposes of this part only, the following definitions apply unless otherwise specified:

- (a) *Affiliate* means any company that controls, is controlled by, or is under common control with another company.
- (b) *Average total consolidated assets* means the average of the total consolidated assets of a national bank; a Federal savings association; a Federal branch or agency of a foreign bank; a subsidiary of a national bank, Federal savings association, or Federal branch or agency; or a depository institution holding company, as reported on the national bank's, Federal savings association's, Federal branch or agency's, subsidiary's, or depository institution holding company's regulatory reports, for the four most recent consecutive quarters. If a national bank, Federal savings association, Federal branch or agency, subsidiary, or depository institution holding company has not filed a regulatory report for each of the four most recent consecutive quarters, the national bank, Federal savings association, Federal branch or agency, subsidiary, or depository institution holding company's average total consolidated assets means the average of its total consolidated assets, as reported on its regulatory reports, for the most recent quarter or consecutive quarters, as applicable. Average total consolidated assets are measured on the as-of date of the most recent regulatory report used in the calculation of the average.

- (c) *To award* incentive-based compensation means to make a final determination, conveyed to a covered person, of the amount of incentive-based compensation payable to the covered person for performance over a performance period.
- (d) *Board of directors* means the governing body of a covered institution that oversees the activities of the covered institution, often referred to as the board of directors or board of managers. For a Federal branch or agency of a foreign bank, “board of directors” refers to the relevant oversight body for the Federal branch or agency, consistent with its overall corporate and management structure.
- (e) *Clawback* means a mechanism by which a covered institution can recover vested incentive-based compensation from a covered person.
- (f) *Compensation, fees, or benefits* means all direct and indirect payments, both cash and non-cash, awarded to, granted to, or earned by or for the benefit of, any covered person in exchange for services rendered to a covered institution.
- (g) *Control* means that any company has control over a bank or over any company if—
- (1) The company directly or indirectly or acting through one or more other persons owns, controls, or has power to vote 25 percent or more of any class of voting securities of the bank or company;
  - (2) The company controls in any manner the election of a majority of the directors or trustees of the bank or company; or
  - (3) The OCC determines, after notice and opportunity for hearing, that the company directly or indirectly exercises a controlling influence over the management or policies of the bank or company.

- (h) *Control function* means a compliance, risk management, internal audit, legal, human resources, accounting, financial reporting, or finance role responsible for identifying, measuring, monitoring, or controlling risk-taking.
- (i) *Covered institution* means:
- (1) A national bank, Federal savings association, or Federal branch or agency of a foreign bank with average total consolidated assets greater than or equal to \$1 billion; and
  - (2) A subsidiary of a national bank, Federal savings association, or Federal branch or agency of a foreign bank that:
    - (i) Is not a broker, dealer, person providing insurance, investment company, or investment adviser; and
    - (ii) Has average total consolidated assets greater than or equal to \$1 billion.
- (j) *Covered person* means any executive officer, employee, director, or principal shareholder who receives incentive-based compensation at a covered institution.
- (k) *Deferral* means the delay of vesting of incentive-based compensation beyond the date on which the incentive-based compensation is awarded.
- (l) *Deferral period* means the period of time between the date a performance period ends and the last date on which the incentive-based compensation awarded for such performance period vests.
- (m) *Depository institution holding company* means a top-tier depository institution holding company, where “depository institution holding company” has the same meaning as in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813).

- (n) *Director* of a covered institution means a member of the board of directors.
- (o) *Downward adjustment* means a reduction of the amount of a covered person's incentive-based compensation not yet awarded for any performance period that has already begun, including amounts payable under long-term incentive plans, in accordance with a forfeiture and downward adjustment review under § 42.7(b).
- (p) *Equity-like instrument* means:
- (1) Equity in the covered institution or of any affiliate of the covered institution; or
  - (2) A form of compensation:
    - (i) Payable at least in part based on the price of the shares or other equity instruments of the covered institution or of any affiliate of the covered institution; or
    - (ii) That requires, or may require, settlement in the shares of the covered institution or of any affiliate of the covered institution.
- (q) *Forfeiture* means a reduction of the amount of deferred incentive-based compensation awarded to a covered person that has not vested.
- (r) *Incentive-based compensation* means any variable compensation, fees, or benefits that serve as an incentive or reward for performance.
- (s) *Incentive-based compensation arrangement* means an agreement between a covered institution and a covered person, under which the covered institution provides incentive-based compensation to the covered person, including incentive-based compensation delivered through one or more incentive-based compensation plans.

(t) *Incentive-based compensation plan* means a document setting forth terms and conditions governing the opportunity for and the payment of incentive-based compensation payments to one or more covered persons.

(u) *Incentive-based compensation program* means a covered institution's framework for incentive-based compensation that governs incentive-based compensation practices and establishes related controls.

(v) *Level 1 covered institution* means:

(1) A covered institution that is a subsidiary of a depository institution holding company with average total consolidated assets greater than or equal to \$250 billion;

(2) A covered institution with average total consolidated assets greater than or equal to \$250 billion that is not a subsidiary of a covered institution or of a depository institution holding company; and

(3) A covered institution that is a subsidiary of a covered institution with average total consolidated assets greater than or equal to \$250 billion.

(w) *Level 2 covered institution* means:

(1) A covered institution that is a subsidiary of a depository institution holding company with average total consolidated assets greater than or equal to \$50 billion but less than \$250 billion;

(2) A covered institution with average total consolidated assets greater than or equal to \$50 billion but less than \$250 billion that is not a subsidiary of a covered institution or of a depository institution holding company; and

(3) A covered institution that is a subsidiary of a covered institution with average total consolidated assets greater than or equal to \$50 billion but less than \$250 billion.

(x) *Level 3 covered institution* means:

(1) A covered institution with average total consolidated assets greater than or equal to \$1 billion but less than \$50 billion; and

(2) A covered institution that is a subsidiary of a covered institution with average total consolidated assets greater than or equal to \$1 billion but less than \$50 billion.

(y) *Long-term incentive plan* means a plan to provide incentive-based compensation that is based on a performance period of at least three years.

(z) *Option* means an instrument through which a covered institution provides a covered person the right, but not the obligation, to buy a specified number of shares representing an ownership stake in a company at a predetermined price within a set time period or on a date certain, or any similar instrument, such as a stock appreciation right.

(aa) *Performance period* means the period during which the performance of a covered person is assessed for purposes of determining incentive-based compensation.

(bb) *Principal shareholder* means a natural person who, directly or indirectly, or acting through or in concert with one or more persons, owns, controls, or has the power to vote 10 percent or more of any class of voting securities of a covered institution.

(cc) *Qualifying incentive-based compensation* means the amount of incentive-based compensation awarded to a covered person for a particular performance period, excluding amounts awarded to the covered person for that particular performance period under a long-term incentive plan.

(dd) [Reserved].

(ee) *Regulatory report* means:

- (1) For a national bank or Federal savings association, the consolidated Reports of Condition and Income (“Call Report”);
- (2) For a Federal branch or agency of a foreign bank, the Reports of Assets and Liabilities of U.S. Branches and Agencies of Foreign Banks—FFIEC 002;
- (3) For a depository institution holding company—
  - (i) The Consolidated Financial Statements for Bank Holding Companies (“FR Y-9C”);
  - (ii) In the case of a savings and loan holding company that is not required to file an FR Y-9C, the Quarterly Savings and Loan Holding Company Report (“FR 2320”), if the savings and loan holding company reports consolidated assets on the FR 2320, as applicable; or
  - (iii) In the case of a savings and loan holding company that does not file an FRY-9C or report consolidated assets on the FR2320, a report submitted to the Board of Governors of the Federal Reserve System pursuant to 12 CFR 236.2(ee); and
- (4) For a covered institution that is a subsidiary of a national bank, Federal savings association, or Federal branch or agency of a foreign bank, a report of the subsidiary’s



total consolidated assets prepared by the subsidiary, national bank, Federal savings association, or Federal branch or agency in a form that is acceptable to the OCC.

(ff) *Section 956 affiliate* means an affiliate that is an institution described in § 42.2(i), 12 CFR 236.2(i), 12 CFR 372.2(i), 12 CFR 741.2(i), 12 CFR 1232.2(i), or 17 CFR 303.2(i).

(gg) *Senior executive officer* means 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.

(hh) *Significant risk-taker* means:

(1) Any covered person at a Level 1 or Level 2 covered institution, other than a senior executive officer, who received annual base salary and incentive-based compensation for the last calendar year that ended at least 180 days before the beginning of the performance period of which at least one-third is incentive-based compensation and is—

(i) A covered person of a Level 1 covered institution who received annual base salary and incentive-based compensation for the last calendar year that ended at least 180 days before the beginning of the performance period that placed the covered person among the highest 5 percent in annual base salary and incentive-based compensation among all covered persons (excluding senior executive officers) of

- the Level 1 covered institution together with all individuals who receive incentive-based compensation at any section 956 affiliate of the Level 1 covered institution;
- (ii) A covered person of a Level 2 covered institution who received annual base salary and incentive-based compensation for the last calendar year that ended at least 180 days before the beginning of the performance period that placed the covered person among the highest 2 percent in annual base salary and incentive-based compensation among all covered persons (excluding senior executive officers) of the Level 2 covered institution together with all individuals who receive incentive-based compensation at any section 956 affiliate of the Level 2 covered institution;
- or
- (iii) A covered person of a covered institution who may commit or expose 0.5 percent or more of the common equity tier 1 capital, or in the case of a registered securities broker or dealer, 0.5 percent or more of the tentative net capital, of the covered institution or of any section 956 affiliate of the covered institution, whether or not the individual is a covered person of that specific legal entity; and
- (2) Any covered person at a Level 1 or Level 2 covered institution, other than a senior executive officer, who is designated as a “significant risk-taker” by the OCC because of that person’s ability to expose a covered institution to risks that could lead to material financial loss in relation to the covered institution’s size, capital, or overall risk tolerance, in accordance with procedures established by the OCC, or by the covered institution.
- (3) For purposes of this part, an individual who is an employee, director, senior executive officer, or principal shareholder of an affiliate of a Level 1 or Level 2 covered

institution, where such affiliate has less than \$1 billion in total consolidated assets, and who otherwise would meet the requirements for being a significant risk-taker under paragraph (hh)(1)(iii) of this section, shall be considered to be a significant risk-taker with respect to the Level 1 or Level 2 covered institution for which the individual may commit or expose 0.5 percent or more of common equity tier 1 capital or tentative net capital. The Level 1 or Level 2 covered institution for which the individual commits or exposes 0.5 percent or more of common equity tier 1 capital or tentative net capital shall ensure that the individual's incentive compensation arrangement complies with the requirements of this part.

(4) If the OCC determines, in accordance with procedures established by the OCC, that a Level 1 covered institution's activities, complexity of operations, risk profile, and compensation practices are similar to those of a Level 2 covered institution, the Level 1 covered institution may apply paragraph (hh)(1)(i) of this section to covered persons of the Level 1 covered institution by substituting "2 percent" for "5 percent".

(ii) *Subsidiary* means any company that is owned or controlled directly or indirectly by another company

(jj) *Vesting* of incentive-based compensation means the transfer of ownership of the incentive-based compensation to the covered person to whom the incentive-based compensation was awarded, such that the covered person's right to the incentive-based compensation is no longer contingent on the occurrence of any event.

### § 42.3 Applicability.

(a) When average total consolidated assets increase—(1) In general—(A) Covered institution subsidiaries of depository institution holding companies. A national bank or Federal

savings association that is a subsidiary of a depository institution holding company shall become a Level 1, Level 2, or Level 3 covered institution when the depository institution holding company's average total consolidated assets increase to an amount that equals or exceeds \$250 billion, \$50 billion, or \$1 billion, respectively.

(B) Covered institutions that are not subsidiaries of a depository institution holding company. A national bank, Federal savings association, or Federal branch or agency of a foreign bank that is not a subsidiary of a national bank, Federal savings association, Federal branch or agency, or depository institution holding company shall become a Level 1, Level 2, or Level 3 covered institution when the national bank, Federal savings association, or Federal branch or agency's average total consolidated assets increase to an amount that equals or exceeds \$250 billion, \$50 billion, or \$1 billion, respectively.

(C) Subsidiaries of covered institutions. A subsidiary of a national bank, Federal savings association, or Federal branch or agency of a foreign bank that is not a broker, dealer, person providing insurance, investment company, or investment adviser shall become a Level 1, Level 2, or Level 3 covered institution when the national bank, Federal savings association, or Federal branch or agency becomes a Level 1, Level 2, or Level 3 covered institution, respectively, pursuant to paragraph (a)(1)(A) or (B) of this section.

(2) Compliance date. A national bank, Federal savings association, Federal branch or agency of a foreign bank, or a subsidiary thereof, that becomes a Level 1, Level 2, or Level 3 covered institution pursuant to paragraph (a)(1) of this section shall comply with the requirements of this part for a Level 1, Level 2, or Level 3 covered institution,

respectively, not later than the first day of the first calendar quarter that begins not later than 540 days after the date on which the national bank, Federal savings association, Federal branch or agency, or subsidiary becomes a Level 1, Level 2, or Level 3 covered institution, respectively. Until that day, the Level 1, Level 2, or Level 3 covered institution will remain subject to the requirements of this part, if any, that applied to the institution on the day before the date on which it became a Level 1, Level 2, or Level 3 covered institution.

- (3) Grandfathered plans. A national bank, Federal savings association, Federal branch or agency of a foreign bank, or a subsidiary thereof, that becomes a Level 1, Level 2, or Level 3 covered institution under paragraph (a)(1) of this section is not required to comply with requirements of this part applicable to a Level 1, Level 2, or Level 3 covered institution, respectively, with respect to any incentive-based compensation plan with a performance period that begins before the date described in paragraph (a)(2) of this section. Any such incentive-based compensation plan shall remain subject to the requirements under this part, if any, that applied to the national bank, Federal savings association, Federal branch or agency of a foreign bank, or subsidiary at the beginning of the performance period.
- (b) When total consolidated assets decrease—(1) Covered institutions that are subsidiaries of depository institution holding companies. A Level 1, Level 2, or Level 3 covered institution that is a subsidiary of a depository institution holding company will remain subject to the requirements applicable to such covered institution at that level under this part unless and until the total consolidated assets of the depository institution holding company, as reported

on the depository institution holding company's regulatory reports, fall below \$250 billion, \$50 billion, or \$1 billion, respectively, for each of four consecutive quarters.

(2) Covered institutions that are not subsidiaries of depository institution holding companies. A Level 1, Level 2, or Level 3 covered institution that is a not subsidiary of a depository institution holding company will remain subject to the requirements applicable to such covered institution at that level under this part unless and until the total consolidated assets of the covered institution, as reported on the covered institution's regulatory reports, fall below \$250 billion, \$50 billion, or \$1 billion, respectively, for each of four consecutive quarters.

(3) Subsidiaries of covered institutions. A Level 1, Level 2, or Level 3 covered institution that is a subsidiary of a national bank, Federal savings association, or Federal branch or agency of a foreign bank that is a covered institution will remain subject to the requirements applicable to such national bank, Federal savings association, or Federal branch or agency at that level under this part unless and until the total consolidated assets of the national bank, Federal savings association, Federal branch or agency, or depository institution holding company of the national bank, Federal savings association, or Federal branch or agency, as reported on its regulatory reports, fall below \$250 billion, \$50 billion, or \$1 billion, respectively, for each of four consecutive quarters.

(4) Calculations. The calculations under this paragraph (b) of this section will be effective on the as-of date of the fourth consecutive regulatory report.

(c) Compliance of covered institutions that are subsidiaries of covered institutions. A covered institution that is a subsidiary of another covered institution may meet any requirement of

this part if the parent covered institution complies with that requirement in a way that causes the relevant portion of the incentive-based compensation program of the subsidiary covered institution to comply with that requirement.

**§ 42.4 Requirements and prohibitions applicable to all covered institutions.**

- (a) In general. A covered institution must not establish or maintain any type of incentive-based compensation arrangement, or any feature of any such arrangement, that encourages inappropriate risks by the covered institution:
- (1) By providing a covered person with excessive compensation, fees, or benefits; or
  - (2) That could lead to material financial loss to the covered institution.
- (b) Excessive compensation. Compensation, fees, and benefits are considered excessive for purposes of paragraph (a)(1) of this section 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.
- (c) Material financial loss. An incentive-based compensation arrangement at a covered institution encourages inappropriate risks that could lead to material financial loss to the covered institution, unless the arrangement:
- (1) Appropriately balances risk and reward;
  - (2) Is compatible with effective risk management and controls; and
  - (3) Is supported by effective governance.
- (d) Performance measures. An incentive-based compensation arrangement will not be considered to appropriately balance risk and reward for purposes of paragraph (c)(1) of this section unless:
- (1) The arrangement includes financial and non-financial measures of performance, including considerations of risk-taking, that are relevant to a covered person's role within a covered institution and to the type of business in which the covered person is engaged and that are appropriately weighted to reflect risk-taking;
  - (2) The arrangement is designed to allow non-financial measures of performance to override financial measures of performance when appropriate in determining incentive-based compensation; and



- (3) Any amounts to be awarded under the arrangement are subject to adjustment to reflect actual losses, inappropriate risks taken, compliance deficiencies, or other measures or aspects of financial and non-financial performance.
- (e) Board of directors. A covered institution's board of directors, or a committee thereof, must:
- (1) Conduct oversight of the covered institution's incentive-based compensation program;
  - (2) Approve incentive-based compensation arrangements for senior executive officers, including the amounts of all awards and, at the time of vesting, payouts under such arrangements; and
  - (3) Approve any material exceptions or adjustments to incentive-based compensation policies or arrangements for senior executive officers.
- (f) Disclosure and recordkeeping requirements. A covered institution must create annually and maintain for a period of at least seven years records that document the structure of all its incentive-based compensation arrangements and demonstrate compliance with this part. A covered institution must disclose the records to the OCC upon request. At a minimum, the records must include copies of all incentive-based compensation plans, a record of who is subject to each plan, and a description of how the incentive-based compensation program is compatible with effective risk management and controls.
- (g) Rule of construction. A covered institution is not required to report the actual amount of compensation, fees, or benefits of individual covered persons as part of the disclosure and recordkeeping requirements under this part.

**§ 42.5 Additional disclosure and recordkeeping requirements for Level 1 and Level 2 covered institutions.**

- (a) A Level 1 or Level 2 covered institution must create annually and maintain for a period of at least seven years records that document:
- (1) The covered institution's senior executive officers and significant risk-takers, listed by legal entity, job function, organizational hierarchy, and line of business;
  - (2) The incentive-based compensation arrangements for senior executive officers and significant risk-takers, including information on percentage of incentive-based compensation deferred and form of award;
  - (3) Any forfeiture and downward adjustment or clawback reviews and decisions for senior executive officers and significant risk-takers; and
  - (4) Any material changes to the covered institution's incentive-based compensation arrangements and policies.
- (b) A Level 1 or Level 2 covered institution must create and maintain records in a manner that allows for an independent audit of incentive-based compensation arrangements, policies, and procedures, including, those required under §42.11.
- (c) A Level 1 or Level 2 covered institution must provide the records described in paragraph (a) of this section to the OCC in such form and with such frequency as requested by the OCC.

**§ 42.6 Reservation of authority for Level 3 covered institutions.**

- (a) In general. The OCC may require a Level 3 covered institution with average total consolidated assets greater than or equal to \$10 billion and less than \$50 billion to comply

with some or all of the provisions of §§ 42.5 and 42.7 through 42.11 if the OCC determines that the Level 3 covered institution's complexity of operations or compensation practices are consistent with those of a Level 1 or Level 2 covered institution.

- (b) Factors considered. Any exercise of authority under this section will be in writing by the OCC in accordance with procedures established by the OCC and will consider the activities, complexity of operations, risk profile, and compensation practices of the Level 3 covered institution, in addition to any other relevant factors.

**§ 42.7 Deferral, forfeiture and downward adjustment, and clawback requirements for Level 1 and Level 2 covered institutions.**

An incentive-based compensation arrangement at a Level 1 or Level 2 covered institution will not be considered to appropriately balance risk and reward, for purposes of § 42.4(c)(1), unless the following requirements are met.

- (a) Deferral. (1) Qualifying incentive-based compensation must be deferred as follows:
- (i) Minimum required deferral amount. (A) A Level 1 covered institution must defer at least 60 percent of a senior executive officer's qualifying incentive-based compensation awarded for each performance period.
  - (B) A Level 1 covered institution must defer at least 50 percent of a significant risk-taker's qualifying incentive-based compensation awarded for each performance period.
  - (C) A Level 2 covered institution must defer at least 50 percent of a senior executive officer's qualifying incentive-based compensation awarded for each performance period.

(D) A Level 2 covered institution must defer at least 40 percent of a significant risk-taker's qualifying incentive-based compensation awarded for each performance period.

(ii) Minimum required deferral period. (A) For a senior executive officer or significant risk-taker of a Level 1 covered institution, the deferral period for deferred qualifying incentive-based compensation must be at least 4 years.

(B) For a senior executive officer or significant risk-taker of a Level 2 covered institution, the deferral period for deferred qualifying incentive-based compensation must be at least 3 years.

(iii) Vesting of amounts during deferral period—(A) Pro rata vesting. During a deferral period, deferred qualifying incentive-based compensation may not vest faster than on a pro rata annual basis beginning no earlier than the first anniversary of the end of the performance period for which the amounts were awarded.

(B) Acceleration of vesting. A Level 1 or Level 2 covered institution must not accelerate the vesting of a covered person's deferred qualifying incentive-based compensation that is required to be deferred under this part, except in the case of death or disability of such covered person.

(2) Incentive-based compensation awarded under a long-term incentive plan must be deferred as follows:

(i) Minimum required deferral amount. (A) A Level 1 covered institution must defer at least 60 percent of a senior executive officer's incentive-based compensation awarded under a long-term incentive plan for each performance period.

- (B) A Level 1 covered institution must defer at least 50 percent of a significant risk-taker's incentive-based compensation awarded under a long-term incentive plan for each performance period.
- (C) A Level 2 covered institution must defer at least 50 percent of a senior executive officer's incentive-based compensation awarded under a long-term incentive plan for each performance period.
- (D) A Level 2 covered institution must defer at least 40 percent of a significant risk-taker's incentive-based compensation awarded under a long-term incentive plan for each performance period.
- (ii) Minimum required deferral period. (A) For a senior executive officer or significant risk-taker of a Level 1 covered institution, the deferral period for deferred long-term incentive plan amounts must be at least 2 years.
- (B) For a senior executive officer or significant risk-taker of a Level 2 covered institution, the deferral period for deferred long-term incentive plan amounts must be at least 1 year.
- (iii) Vesting of amounts during deferral period—(A) Pro rata vesting. During a deferral period, deferred long-term incentive plan amounts may not vest faster than on a pro rata annual basis beginning no earlier than the first anniversary of the end of the performance period for which the amounts were awarded.
- (B) Acceleration of vesting. A Level 1 or Level 2 covered institution must not accelerate the vesting of a covered person's deferred long-term incentive plan

amounts that is required to be deferred under this part, except in the case of death or disability of such covered person.

(3) Adjustments of deferred qualifying incentive-based compensation and deferred long-term incentive plan compensation amounts. A Level 1 or Level 2 covered institution may not increase deferred qualifying incentive-based compensation or deferred long-term incentive plan amounts for a senior executive officer or significant risk-taker during the deferral period. For purposes of this paragraph, an increase in value attributable solely to a change in share value, a change in interest rates, or the payment of interest according to terms set out at the time of the award is not considered an increase in incentive-based compensation amounts.

(4) Composition of deferred qualifying incentive-based compensation and deferred long-term incentive plan compensation for Level 1 and Level 2 covered institutions—(i) Cash and equity-like instruments. For a senior executive officer or significant risk-taker of a Level 1 or Level 2 covered institution that issues equity or is an affiliate of a covered institution that issues equity, any deferred qualifying incentive-based compensation or deferred long-term incentive plan amounts must include substantial portions of both deferred cash and equity-like instruments throughout the deferral period.

(ii) Options. If a senior executive officer or significant risk-taker of a Level 1 or Level 2 covered institution receives incentive-based compensation for a performance period in the form of options, the total amount of such options that may be used to meet the minimum deferral amount requirements of paragraph (a)(1)(i) or (a)(2)(i) of this section is limited to no more than 15 percent of the amount of total

incentive-based compensation awarded to the senior executive officer or significant risk-taker for that performance period.

(b) Forfeiture and downward adjustment—(1) Compensation at risk—(i) A Level 1 or Level 2 covered institution must place at risk of forfeiture all unvested deferred incentive-based compensation of any senior executive officer or significant risk-taker, including unvested deferred amounts awarded under long-term incentive plans.

(ii) A Level 1 or Level 2 covered institution must place at risk of downward adjustment all of a senior executive officer's or significant risk-taker's incentive-based compensation amounts not yet awarded for the current performance period, including amounts payable under long-term incentive plans.

(2) Events triggering forfeiture and downward adjustment review. At a minimum, a Level 1 or Level 2 covered institution must consider forfeiture and downward adjustment of incentive-based compensation of senior executive officers and significant risk-takers described in paragraph (b)(3) of this section due to any of the following adverse outcomes at the covered institution:

(i) Poor financial performance attributable to a significant deviation from the risk parameters set forth in the covered institution's policies and procedures;

(ii) Inappropriate risk taking, regardless of the impact on financial performance;

(iii) Material risk management or control failures;

(iv) Non-compliance with statutory, regulatory, or supervisory standards that results in:

(A) Enforcement or legal action against the covered institution brought by a federal or state regulator or agency; or

(B) A requirement that the covered institution report a restatement of a financial statement to correct a material error; and

(v) Other aspects of conduct or poor performance as defined by the covered institution.

(3) Senior executive officers and significant risk-takers affected by forfeiture and downward adjustment. A Level 1 or Level 2 covered institution must consider forfeiture and downward adjustment for a senior executive officer or significant risk-taker with direct responsibility, or responsibility due to the senior executive officer's or significant risk-taker's role or position in the covered institution's organizational structure, for the events related to the forfeiture and downward adjustment review set forth in paragraph (b)(2) of this section.

(4) Determining forfeiture and downward adjustment amounts. A Level 1 or Level 2 covered institution must consider, at a minimum, the following factors when determining the amount or portion of a senior executive officer's or significant risk-taker's incentive-based compensation that should be forfeited or adjusted downward:

(i) The intent of the senior executive officer or significant risk-taker to operate outside the risk governance framework approved by the covered institution's board of directors or to depart from the covered institution's policies and procedures;

(ii) The senior executive officer's or significant risk-taker's level of participation in, awareness of, and responsibility for, the events triggering the forfeiture and downward adjustment review set forth in paragraph (b)(2) of this section;



- (iii) Any actions the senior executive officer or significant risk-taker took or could have taken to prevent the events triggering the forfeiture and downward adjustment review set forth in paragraph (b)(2) of this section;
  - (iv) The financial and reputational impact of the events triggering the forfeiture and downward adjustment review set forth in paragraph (b)(2) of this section to the covered institution, the line or sub-line of business, and individuals involved, as applicable, including the magnitude of any financial loss and the cost of known or potential subsequent fines, settlements, and litigation;
  - (v) The causes of the events triggering the forfeiture and downward adjustment review set forth in paragraph (b)(2) of this section, including any decision-making by other individuals; and
  - (vi) Any other relevant information, including past behavior and past risk outcomes attributable to the senior executive officer or significant risk-taker.
- (c) Clawback. A Level 1 or Level 2 covered institution must include clawback provisions in 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 from a current or former senior executive officer or significant risk-taker for seven years following the date on which such compensation vests, if the covered institution determines that the senior executive officer or significant risk-taker engaged in:
- (1) Misconduct that resulted in significant financial or reputational harm to the covered institution;
  - (2) Fraud; or

- (3) Intentional misrepresentation of information used to determine the senior executive officer or significant risk-taker's incentive-based compensation.

**§ 42.8 Additional prohibitions for Level 1 and Level 2 covered institutions.**

An incentive-based compensation arrangement at a Level 1 or Level 2 covered institution will be considered to provide incentives that appropriately balance risk and reward for purposes of § 42.4(c)(1) only if such institution complies with the following prohibitions.

- (a) Hedging. A Level 1 or Level 2 covered institution must not purchase a hedging instrument or similar instrument on behalf of a covered person to hedge or offset any decrease in the value of the covered person's incentive-based compensation.
- (b) Maximum incentive-based compensation opportunity. A Level 1 or Level 2 covered institution must not award incentive-based compensation to:
- (1) A senior executive officer in excess of 125 percent of the target amount for that incentive-based compensation; or
  - (2) A significant risk-taker in excess of 150 percent of the target amount for that incentive-based compensation.
- (c) Relative performance measures. A Level 1 or Level 2 covered institution must not use incentive-based compensation performance measures that are based solely on industry peer performance comparisons.
- (d) Volume driven incentive-based compensation. A Level 1 or Level 2 covered institution must not provide incentive-based compensation to a covered person that is based solely on transaction revenue or volume without regard to transaction quality or compliance of the covered person with sound risk management.

**§ 42.9 Risk management and controls requirements for Level 1 and Level 2 covered institutions.**

An incentive-based compensation arrangement at a Level 1 or Level 2 covered institution will be considered to be compatible with effective risk management and controls for purposes of § 42.4(c)(2) only if such institution meets the following requirements.

- (a) A Level 1 or Level 2 covered institution must have a risk management framework for its incentive-based compensation program that:
  - (1) Is independent of any lines of business;
  - (2) Includes an independent compliance program that provides for internal controls, testing, monitoring, and training with written policies and procedures consistent with § 42.11; and
  - (3) Is commensurate with the size and complexity of the covered institution's operations.
  
- (b) A Level 1 or Level 2 covered institution must:
  - (1) Provide individuals engaged in control functions with the authority to influence the risk-taking of the business areas they monitor; and
  - (2) Ensure that covered persons engaged in control functions are compensated in accordance with the achievement of performance objectives linked to their control functions and independent of the performance of those business areas.
  
- (c) A Level 1 or Level 2 covered institution must provide for the independent monitoring of:
  - (1) All incentive-based compensation plans in order to identify whether those plans provide incentives that appropriately balance risk and reward;

- (2) Events related to forfeiture and downward adjustment reviews and decisions of forfeiture and downward adjustment reviews in order to determine consistency with § 42.7(b); and
- (3) Compliance of the incentive-based compensation program with the covered institution's policies and procedures.

**§ 42.10 Governance requirements for Level 1 and Level 2 covered institutions.**

An incentive-based compensation arrangement at a Level 1 or Level 2 covered institution will not be considered to be supported by effective governance for purposes of § 42.4(c)(3), unless:

- (a) The covered institution establishes a compensation committee composed solely of directors who are not senior executive officers to assist the board of directors in carrying out its responsibilities under § 42.4(e); and
- (b) The compensation committee established pursuant to paragraph (a) of this section obtains:
  - (1) Input from the risk and audit committees of the covered institution's board of directors, or groups performing similar functions, and risk management function on the effectiveness of risk measures and adjustments used to balance risk and reward in incentive-based compensation arrangements;
  - (2) A written assessment of the effectiveness of the covered institution's incentive-based compensation program and related compliance and control processes in providing risk-taking incentives that are consistent with the risk profile of the covered institution, submitted on an annual or more frequent basis by the management of the covered institution and developed with input from the risk and audit committees of its board of directors, or groups performing similar functions, and from the covered institution's risk management and audit functions; and

- (3) An independent written assessment of the effectiveness of the covered institution's incentive-based compensation program and related compliance and control processes in providing risk-taking incentives that are consistent with the risk profile of the covered institution, submitted on an annual or more frequent basis by the internal audit or risk management function of the covered institution, developed independently of the covered institution's management.

**§ 42.11 Policies and procedures requirements for Level 1 and Level 2 covered institutions.**

A Level 1 or Level 2 covered institution must develop and implement policies and procedures for its incentive-based compensation program that, at a minimum:

- (a) Are consistent with the prohibitions and requirements of this part;
- (b) Specify the substantive and procedural criteria for the application of forfeiture and clawback, including the process for determining the amount of incentive-based compensation to be clawed back;
- (c) Require that the covered institution maintain documentation of final forfeiture, downward adjustment, and clawback decisions;
- (d) Specify the substantive and procedural criteria for the acceleration of payments of deferred incentive-based compensation to a covered person, consistent with § 42.7(a)(1)(iii)(B) and (a)(2)(iii)(B);
- (e) Identify and describe the role of any employees, committees, or groups authorized to make incentive-based compensation decisions, including when discretion is authorized;
- (f) Describe how discretion is expected to be exercised to appropriately balance risk and reward;

- (g) Require that the covered institution maintain documentation of the establishment, implementation, modification, and monitoring of incentive-based compensation arrangements, sufficient to support the covered institution's decisions;
- (h) Describe how incentive-based compensation arrangements will be monitored;
- (i) Specify the substantive and procedural requirements of the independent compliance program consistent with § 42.9(a)(2); and
- (j) Ensure appropriate roles for risk management, risk oversight, and other control function personnel in the covered institution's processes for:
  - (1) Designing incentive-based compensation arrangements and determining awards, deferral amounts, deferral periods, forfeiture, downward adjustment, clawback, and vesting; and
  - (2) Assessing the effectiveness of incentive-based compensation arrangements in restraining inappropriate risk-taking.

**§ 42.12 Indirect actions.**

A covered institution must not indirectly, or through or by any other person, do anything that would be unlawful for such covered institution to do directly under this part.

**§ 42.13 Enforcement.**

The provisions of this part shall be enforced under section 505 of the Gramm-Leach-Bliley Act and, for purposes of such section, a violation of this part shall be treated as a violation of subtitle A of title V of such Act.

Federal Deposit Insurance Corporation  
**12 CFR Chapter III**

**Authority and Issuance**

**For the reasons set forth in the joint preamble, the Federal Deposit Insurance Corporation proposes to amend chapter III of title 12 of the Code of Federal Regulations as follows:**

**3. Add part 372 to read as follows:**

**PART 372 - INCENTIVE-BASED COMPENSATION ARRANGEMENTS**

Sec.

372.1 Authority, scope, and initial applicability.

372.2 Definitions.

372.3 Applicability.

372.4 Requirements and prohibitions applicable to all covered institutions.

372.5 Additional disclosure and recordkeeping requirements for Level 1 and Level 2 covered institutions.

372.6 Reservation of authority for Level 3 covered institutions.

372.7 Deferral, forfeiture and downward adjustment, and clawback requirements for Level 1 and Level 2 covered institutions.

372.8 Additional prohibitions for Level 1 and Level 2 covered institutions.

372.9 Risk management and controls requirements for Level 1 and Level 2 covered institutions.

372.10 Governance requirements for Level 1 and Level 2 covered institutions.

372.11 Policies and procedures requirements for Level 1 and Level 2 covered institutions.

372.12 Indirect actions.

372.13 Enforcement.

**Authority:** 12 U.S.C. 5641, 12 U.S.C. 1818, 12 U.S.C. 1819 Tenth, 12 U.S.C. 1831p-1.

§ 372.1 Authority, scope, and initial applicability.

- (a) Authority. This part is issued pursuant to section 956 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 5641), and sections 8 (12 U.S.C. 1818), 9 (12 U.S.C. 1819 Tenth), and 39 (12 U.S.C. 1831p-1) of the Federal Deposit Insurance Act.
- (b) Scope. This part applies to a covered institution with average total consolidated assets greater than or equal to \$1 billion that offers incentive-based compensation to covered persons.
- (c) Initial applicability—(1) Compliance date. A covered institution must meet the requirements of this part no later than [Date of the beginning of the first calendar quarter that begins at least 540 days after a final rule is published in the Federal Register]. Whether a covered institution is a Level 1, Level 2, or Level 3 covered institution at that time will be determined based on average total consolidated assets as of [Date of the beginning of the first calendar quarter that begins after a final rule is published in the Federal Register].
- (2) Grandfathered plans. A covered institution is not required to comply with the requirements of this part with respect to any incentive-based compensation plan with a performance period that begins before [Compliance Date as described in § 372.1(c)(1)].
- (d) Preservation of authority. Nothing in this part in any way limits the authority of the Corporation under other provisions of applicable law and regulations.

§ 372.2 **Definitions.**

For purposes of this part only, the following definitions apply unless otherwise specified:

- (a) *Affiliate* means any company that controls, is controlled by, or is under common control with another company.



(b) *Average total consolidated assets* means the average of the total consolidated assets of a state nonmember bank; state savings association; state insured branch of a foreign bank; a subsidiary of a state nonmember bank, state savings association, or state insured branch of a foreign bank; or a depository institution holding company, as reported on the state nonmember bank's, state savings association's, state insured branch of a foreign bank's, subsidiary's, or depository institution holding company's regulatory reports, for the four most recent consecutive quarters. If a state nonmember bank, state savings association, state insured branch of a foreign bank, subsidiary, or depository institution holding company has not filed a regulatory report for each of the four most recent consecutive quarters, the state nonmember bank, state savings association, state insured branch of a foreign bank, subsidiary, or depository institution holding company's average total consolidated assets means the average of its total consolidated assets, as reported on its regulatory reports, for the most recent quarter or consecutive quarters, as applicable. Average total consolidated assets are measured on the as-of date of the most recent regulatory report used in the calculation of the average.

(c) *To award* incentive-based compensation means to make a final determination, conveyed to a covered person, of the amount of incentive-based compensation payable to the covered person for performance over a performance period.

(d) *Board of directors* means the governing body of a covered institution that oversees the activities of the covered institution, often referred to as the board of directors or board of managers. For a state insured branch of a foreign bank, "board of directors" refers to the relevant oversight body for the state insured branch consistent with the foreign bank's overall corporate and management structure.

(e) *Clawback* means a mechanism by which a covered institution can recover vested incentive-based compensation from a covered person.

(f) *Compensation, fees, or benefits* means all direct and indirect payments, both cash and non-cash, awarded to, granted to, or earned by or for the benefit of, any covered person in exchange for services rendered to a covered institution.

(g) *Control* means that any company has control over a bank or over any company if—

(1) The company directly or indirectly or acting through one or more other persons owns, controls, or has power to vote 25 percent or more of any class of voting securities of the bank or company;

(2) The company controls in any manner the election of a majority of the directors or trustees of the bank or company; or

(3) The Corporation determines, after notice and opportunity for hearing, that the company directly or indirectly exercises a controlling influence over the management or policies of the bank or company.

(h) *Control function* means a compliance, risk management, internal audit, legal, human resources, accounting, financial reporting, or finance role responsible for identifying, measuring, monitoring, or controlling risk-taking.

(i) *Covered institution* means

(1) A state nonmember bank, state savings association, or a state insured branch of a foreign bank, as such terms are defined in section 3 of the Federal Deposit Insurance Act, 12 U.S.C. 1813, with average total consolidated assets greater than or equal to \$1 billion; and

- (2) A subsidiary of a state nonmember bank, state savings association, or a state insured branch of a foreign bank, as such terms are defined in section 3 of the Federal Deposit Insurance Act, 12 U.S.C. 1813, that:
- (i) Is not a broker, dealer, person providing insurance, investment company, or investment adviser; and
  - (ii) Has average total consolidated assets greater than or equal to \$1 billion.
- (j) *Covered person* means any executive officer, employee, director, or principal shareholder who receives incentive-based compensation at a covered institution.
- (k) *Deferral* means the delay of vesting of incentive-based compensation beyond the date on which the incentive-based compensation is awarded.
- (l) *Deferral period* means the period of time between the date a performance period ends and the last date on which the incentive-based compensation awarded for such performance period vests.
- (m) *Depository institution holding company* means a top-tier depository institution holding company, where “depository institution holding company” has the same meaning as in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813).
- (n) *Director* of a covered institution means a member of the board of directors.
- (o) *Downward adjustment* means a reduction of the amount of a covered person’s incentive-based compensation not yet awarded for any performance period that has already begun, including amounts payable under long-term incentive plans, in accordance with a forfeiture and downward adjustment review under § 372.7(b).
- (p) *Equity-like instrument* means:

- (1) Equity in the covered institution or of any affiliate of the covered institution; or
- (2) A form of compensation:
- (i) Payable at least in part based on the price of the shares or other equity instruments of the covered institution or of any affiliate of the covered institution; or
  - (ii) That requires, or may require, settlement in the shares of the covered institution or of any affiliate of the covered institution.
- (q) *Forfeiture* means a reduction of the amount of deferred incentive-based compensation awarded to a covered person that has not vested.
- (r) *Incentive-based compensation* means any variable compensation, fees, or benefits that serve as an incentive or reward for performance.
- (s) *Incentive-based compensation arrangement* means an agreement between a covered institution and a covered person, under which the covered institution provides incentive-based compensation to the covered person, including incentive-based compensation delivered through one or more incentive-based compensation plans.
- (t) *Incentive-based compensation plan* means a document setting forth terms and conditions governing the opportunity for and the payment of incentive-based compensation payments to one or more covered persons.
- (u) *Incentive-based compensation program* means a covered institution's framework for incentive-based compensation that governs incentive-based compensation practices and establishes related controls.
- (v) *Level 1 covered institution* means

- (1) A covered institution that is a subsidiary of a depository institution holding company with average total consolidated assets greater than or equal to \$250 billion;
- (2) A covered institution with average total consolidated assets greater than or equal to \$250 billion that is not a subsidiary of a covered institution or of a depository institution holding company; and
- (3) A covered institution that is a subsidiary of a covered institution with average total consolidated assets greater than or equal to \$250 billion.

(w) *Level 2 covered institution* means

- (1) A covered institution that is a subsidiary of a depository institution holding company with average total consolidated assets greater than or equal to \$50 billion but less than \$250 billion;
- (2) A covered institution with average total consolidated assets greater than or equal to \$50 billion but less than \$250 billion that is not a subsidiary of a covered institution or of a depository institution holding company; and
- (3) A covered institution that is a subsidiary of a covered institution with average total consolidated assets greater than or equal to \$50 billion but less than \$250 billion.

(x) *Level 3 covered institution* means

- (1) A covered institution that is a subsidiary of a depository institution holding company with average total consolidated assets greater than or equal to \$1 billion but less than \$50 billion;

- (2) A covered institution with average total consolidated assets greater than or equal to \$1 billion but less than \$50 billion that is not a subsidiary of a covered institution or of a depository institution holding company; and
- (3) A covered institution that is a subsidiary of a covered institution with average total consolidated assets greater than or equal to \$1 billion but less than \$50 billion.
- (y) *Long-term incentive plan* means a plan to provide incentive-based compensation that is based on a performance period of at least three years.
- (z) *Option* means an instrument through which a covered institution provides a covered person the right, but not the obligation, to buy a specified number of shares representing an ownership stake in a company at a predetermined price within a set time period or on a date certain, or any similar instrument, such as a stock appreciation right.
- (aa) *Performance period* means the period during which the performance of a covered person is assessed for purposes of determining incentive-based compensation.
- (bb) *Principal shareholder* means a natural person who, directly or indirectly, or acting through or in concert with one or more persons, owns, controls, or has the power to vote 10 percent or more of any class of voting securities of a covered institution.
- (cc) *Qualifying incentive-based compensation* means the amount of incentive-based compensation awarded to a covered person for a particular performance period, excluding amounts awarded to the covered person for that particular performance period under a long-term incentive plan.
- (dd) [Reserved].
- (ee) *Regulatory report* means

- (1) For a state nonmember bank and state savings association, Consolidated Reports of Condition and Income;
  - (2) For an state insured branch of a foreign bank, the Reports of Assets and Liabilities of U.S. Branches and Agencies of Foreign Banks—FFIEC 002; and
  - (3) For a depository institution holding company:
    - (i) The Consolidated Financial Statements for Bank Holding Companies (“FR Y-9C”);
    - (ii) In the case of a savings and loan holding company that is not required to file an FR Y-9C, the Quarterly Savings and Loan Holding Company Report (“FR 2320”), if the savings and loan holding company reports consolidated assets on the FR 2320, as applicable; and
    - (iii) In the case of a savings and loan holding company that does not file an FRY-9C or report consolidated assets on the FR2320, a report submitted to the Board of Governors of the Federal Reserve System pursuant to 12 CFR 236.2(ee).
- (ff) *Section 956 affiliate* means an affiliate that is an institution described in § 372.2(i), 12 CFR 42.2(i), 12 CFR 236.2(i), 12 CFR 741.2(i), 12 CFR 1232.2(i), or 17 CFR 303.2(i).
- (gg) *Senior executive officer* means 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.

(hh) *Significant risk-taker* means:

- (1) Any covered person at a Level 1 or Level 2 covered institution, other than a senior executive officer, who received annual base salary and incentive-based compensation for the last calendar year that ended at least 180 days before the beginning of the performance period of which at least one-third is incentive-based compensation and is—
  - (i) A covered person of a Level 1 covered institution who received annual base salary and incentive-based compensation for the last calendar year that ended at least 180 days before the beginning of the performance period that placed the covered person among the highest 5 percent in annual base salary and incentive-based compensation among all covered persons (excluding senior executive officers) of the Level 1 covered institution together with all individuals who receive incentive-based compensation at any section 956 affiliate of the Level 1 covered institution;
  - (ii) A covered person of a Level 2 covered institution who received annual base salary and incentive-based compensation for the last calendar year that ended at least 180 days before the beginning of the performance period that placed the covered person among the highest 2 percent in annual base salary and incentive-based compensation among all covered persons (excluding senior executive officers) of the Level 2 covered institution together with all individuals who receive incentive-based compensation at any section 956 affiliate of the Level 2 covered institution;or
  - (iii) A covered person of a covered institution who may commit or expose 0.5 percent or more of the common equity tier 1 capital, or in the case of a registered securities



broker or dealer, 0.5 percent or more of the tentative net capital, of the covered institution or of any section 956 affiliate of the covered institution, whether or not the individual is a covered person of that specific legal entity; and

- (2) Any covered person at a Level 1 or Level 2 covered institution, other than a senior executive officer, who is designated as a “significant risk-taker” by the Corporation because of that person’s ability to expose a covered institution to risks that could lead to material financial loss in relation to the covered institution’s size, capital, or overall risk tolerance, in accordance with procedures established by the Corporation, or by the covered institution.
- (3) For purposes of this part, an individual who is an employee, director, senior executive officer, or principal shareholder of an affiliate of a Level 1 or Level 2 covered institution, where such affiliate has less than \$1 billion in total consolidated assets, and who otherwise would meet the requirements for being a significant risk-taker under paragraph (hh)(1)(iii) of this section, shall be considered to be a significant risk-taker with respect to the Level 1 or Level 2 covered institution for which the individual may commit or expose 0.5 percent or more of common equity tier 1 capital or tentative net capital. The Level 1 or Level 2 covered institution for which the individual commits or exposes 0.5 percent or more of common equity tier 1 capital or tentative net capital shall ensure that the individual’s incentive compensation arrangement complies with the requirements of this part.
- (4) If the Corporation determines, in accordance with procedures established by the Corporation, that a Level 1 covered institution’s activities, complexity of operations, risk profile, and compensation practices are similar to those of a Level 2 covered

institution, the Level 1 covered institution may apply paragraph (hh)(1)(i) of this section to covered persons of the Level 1 covered institution by substituting “2 percent” for “5 percent”.

(ii) *Subsidiary* means any company that is owned or controlled directly or indirectly by another company.

(jj) *Vesting* of incentive-based compensation means the transfer of ownership of the incentive-based compensation to the covered person to whom the incentive-based compensation was awarded, such that the covered person’s right to the incentive-based compensation is no longer contingent on the occurrence of any event.

**§ 372.3      *Applicability.***

(a) When average total consolidated assets increase—(1) In general—(i) Covered institution subsidiaries of depository institution holding companies. A state nonmember bank or state savings association that is a subsidiary of a depository institution holding company shall become a Level 1, Level 2, or Level 3 covered institution when the depository institution holding company’s average total consolidated assets increase to an amount that equals or exceeds \$250 billion, \$50 billion, or \$1 billion, respectively.

(ii) Covered institutions that are not subsidiaries of a depository institution holding company. A state nonmember bank, state savings association, or state insured branch of a foreign bank that is not a subsidiary of a state nonmember bank, state savings association, or state insured branch of a foreign bank, or depository institution holding company shall become a Level 1, Level 2, or Level 3 covered institution when such state nonmember bank, state savings association, or state insured branch of a foreign

bank's average total consolidated assets increase to an amount that equals or exceeds \$250 billion, \$50 billion, or \$1 billion, respectively.

(iii) Subsidiaries of covered institutions. A subsidiary of a state nonmember bank, state savings association, or state insured branch of a foreign bank, as described under § 372.2(i)(2), shall become a Level 1, Level 2, or Level 3 covered institution when the state nonmember bank, state savings association, or state insured branch of a foreign bank becomes a Level 1, Level 2, or Level 3 covered institution, respectively, under paragraph (a)(1)(i) or (ii) of this section.

(2) Compliance date. A state nonmember bank, state savings association, state insured branch of a foreign bank, or subsidiary thereof, that becomes a Level 1, Level 2, or Level 3 covered institution pursuant to paragraph (a)(1) of this section shall comply with the requirements of this part for a Level 1, Level 2, or Level 3 covered institution, respectively, not later than the first day of the first calendar quarter that begins at least 540 days after the date on which such state nonmember bank, state savings association, state insured branch of a foreign bank, or subsidiary thereof becomes a Level 1, Level 2, or Level 3 covered institution, respectively. Until that day, the Level 1, Level 2, or Level 3 covered institution will remain subject to the requirements of this part, if any, that applied to the institution on the day before the date on which it became a Level 1, Level 2, or Level 3 covered institution.

(3) Grandfathered plans. A state nonmember bank, state savings association, state insured branch of a foreign bank, or subsidiary thereof, that becomes a Level 1, Level 2, or Level 3 covered institution under paragraph (a)(1) of this section is not required to comply with requirements of this part applicable to a Level 1, Level 2, or Level 3

covered institution, respectively, with respect to any incentive-based compensation plan with a performance period that begins before the date described in paragraph (a)(2) of this section. Any such incentive-based compensation plan shall remain subject to the requirements under this part, if any, that applied to such state nonmember bank, state savings association, state insured branch of a foreign bank, or subsidiary thereof at the beginning of the performance period.

- (b) When total consolidated assets decrease—(1) Covered institutions that are subsidiaries of depository institution holding companies. A Level 1, Level 2, or Level 3 covered institution that is a subsidiary of a depository institution holding company will remain subject to the requirements applicable to such covered institution at that level under this part unless and until the total consolidated assets of the depository institution holding company, as reported on the depository institution holding company's regulatory reports, fall below \$250 billion, \$50 billion, or \$1 billion, respectively, for each of four consecutive quarters.
- (2) Covered institutions that are not subsidiaries of depository institution holding companies. A Level 1, Level 2, or Level 3 covered institution that is not a subsidiary of a depository institution holding company will remain subject to the requirements applicable to such covered institution at that level under this part unless and until the total consolidated assets of the covered institution, as reported on the covered institution's regulatory reports, fall below \$250 billion, \$50 billion, or \$1 billion, respectively, for each of four consecutive quarters.
- (3) Subsidiaries of covered institutions. A Level 1, Level 2, or Level 3 covered institution that is a subsidiary of a state nonmember bank, state savings association, or state

insured branch of a foreign bank that is a covered institution will remain subject to the requirements applicable to such state nonmember bank, state savings association, or state insured branch of a foreign bank at that level under this part unless and until the total consolidated assets of the state nonmember bank, state savings association, state insured branch of a foreign bank, or depository holding company of the state nonmember bank or state savings association, as reported on its regulatory reports, fall below \$250 billion, \$50 billion, or \$1 billion, respectively, for each of four consecutive quarters.

(4) The calculations under this paragraph (b) of this section will be effective on the as-of date of the fourth consecutive regulatory report.

(c) Compliance of covered institutions that are subsidiaries of covered institutions. A covered institution that is a subsidiary of another covered institution may meet any requirement of this part if the parent covered institution complies with that requirement in a way that causes the relevant portion of the incentive-based compensation program of the subsidiary covered institution to comply with that requirement.

**§ 372.4 Requirements and prohibitions applicable to all covered institutions.**

(a) In general. A covered institution must not establish or maintain any type of incentive-based compensation arrangement, or any feature of any such arrangement, that encourages inappropriate risks by the covered institution:

- (1) By providing a covered person with excessive compensation, fees, or benefits; or
- (2) That could lead to material financial loss to the covered institution.

(b) Excessive compensation. Compensation, fees, and benefits are considered excessive for purposes of paragraph (a)(1) of this section 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.
- (c) Material financial loss. An incentive-based compensation arrangement at a covered institution encourages inappropriate risks that could lead to material financial loss to the covered institution, unless the arrangement:
- (1) Appropriately balances risk and reward;
  - (2) Is compatible with effective risk management and controls; and
  - (3) Is supported by effective governance.

(d) Performance measures. An incentive-based compensation arrangement will not be considered to appropriately balance risk and reward for purposes of paragraph (c)(1) of this section unless:

- (1) The arrangement includes financial and non-financial measures of performance, including considerations of risk-taking, that are relevant to a covered person's role within a covered institution and to the type of business in which the covered person is engaged and that are appropriately weighted to reflect risk-taking;
- (2) The arrangement is designed to allow non-financial measures of performance to override financial measures of performance when appropriate in determining incentive-based compensation; and
- (3) Any amounts to be awarded under the arrangement are subject to adjustment to reflect actual losses, inappropriate risks taken, compliance deficiencies, or other measures or aspects of financial and non-financial performance.

(e) Board of directors. A covered institution's board of directors, or a committee thereof, must:

- (1) Conduct oversight of the covered institution's incentive-based compensation program;
- (2) Approve incentive-based compensation arrangements for senior executive officers, including the amounts of all awards and, at the time of vesting, payouts under such arrangements; and
- (3) Approve any material exceptions or adjustments to incentive-based compensation policies or arrangements for senior executive officers.

- (f) Disclosure and recordkeeping requirements. A covered institution must create annually and maintain for a period of at least seven years records that document the structure of all its incentive-based compensation arrangements and demonstrate compliance with this part. A covered institution must disclose the records to the Corporation upon request. At a minimum, the records must include copies of all incentive-based compensation plans, a record of who is subject to each plan, and a description of how the incentive-based compensation program is compatible with effective risk management and controls.
- (g) Rule of construction. A covered institution is not required to report the actual amount of compensation, fees, or benefits of individual covered persons as part of the disclosure and recordkeeping requirements under this part.

**§ 372.5 Additional disclosure and recordkeeping requirements for Level 1 and Level 2 covered institutions.**

- (a) A Level 1 or Level 2 covered institution must create annually and maintain for a period of at least seven years records that document:
- (1) The covered institution's senior executive officers and significant risk-takers, listed by legal entity, job function, organizational hierarchy, and line of business;
  - (2) The incentive-based compensation arrangements for senior executive officers and significant risk-takers, including information on percentage of incentive-based compensation deferred and form of award;
  - (3) Any forfeiture and downward adjustment or clawback reviews and decisions for senior executive officers and significant risk-takers; and
  - (4) Any material changes to the covered institution's incentive-based compensation arrangements and policies.



- (b) A Level 1 or Level 2 covered institution must create and maintain records in a manner that allows for an independent audit of incentive-based compensation arrangements, policies, and procedures, including, those required under § 372.11.
- (c) A Level 1 or Level 2 covered institution must provide the records described in paragraph (a) of this section to the Corporation in such form and with such frequency as requested by the Corporation.

**§ 372.6          Reservation of authority for Level 3 covered institutions.**

- (a) In general. The Corporation may require a Level 3 covered institution with average total consolidated assets greater than or equal to \$10 billion and less than \$50 billion to comply with some or all of the provisions of §§ 372.5 and 372.7 through 372.11 if the Corporation determines that the Level 3 covered institution's complexity of operations or compensation practices are consistent with those of a Level 1 or Level 2 covered institution.
- (b) Factors considered. Any exercise of authority under this section will be in writing by the Corporation in accordance with procedures established by the Corporation and will consider the activities, complexity of operations, risk profile, and compensation practices of the Level 3 covered institution, in addition to any other relevant factors.

**§ 372.7          Deferral, forfeiture and downward adjustment, and clawback requirements for Level 1 and Level 2 covered institutions.**

An incentive-based compensation arrangement at a Level 1 or Level 2 covered institution will not be considered to appropriately balance risk and reward, for purposes of § 372.4(c)(1), unless the following requirements are met.

- (a) Deferral. (1) Qualifying incentive-based compensation must be deferred as follows:
  - (i) Minimum required deferral amount.

- (A) A Level 1 covered institution must defer at least 60 percent of a senior executive officer's qualifying incentive-based compensation awarded for each performance period.
- (B) A Level 1 covered institution must defer at least 50 percent of a significant risk-taker's qualifying incentive-based compensation awarded for each performance period.
- (C) A Level 2 covered institution must defer at least 50 percent of a senior executive officer's qualifying incentive-based compensation awarded for each performance period.
- (D) A Level 2 covered institution must defer at least 40 percent of a significant risk-taker's qualifying incentive-based compensation awarded for each performance period.
- (ii) Minimum required deferral period. (A) For a senior executive officer or significant risk-taker of a Level 1 covered institution, the deferral period for deferred qualifying incentive-based compensation must be at least 4 years.
- (B) For a senior executive officer or significant risk-taker of a Level 2 covered institution, the deferral period for deferred qualifying incentive-based compensation must be at least 3 years.
- (iii) Vesting of amounts during deferral period—(A) Pro rata vesting. During a deferral period, deferred qualifying incentive-based compensation may not vest faster than on a pro rata annual basis beginning no earlier than the first anniversary of the end of the performance period for which the amounts were awarded.

(B) Acceleration of vesting. A Level 1 or Level 2 covered institution must not accelerate the vesting of a covered person's deferred qualifying incentive-based compensation that is required to be deferred under this part, except in the case of death or disability of such covered person.

(2) Incentive-based compensation awarded under a long-term incentive plan must be deferred as follows:

(i) Minimum required deferral amount. (A) A Level 1 covered institution must defer at least 60 percent of a senior executive officer's incentive-based compensation awarded under a long-term incentive plan for each performance period.

(B) A Level 1 covered institution must defer at least 50 percent of a significant risk-taker's incentive-based compensation awarded under a long-term incentive plan for each performance period.

(C) A Level 2 covered institution must defer at least 50 percent of a senior executive officer's incentive-based compensation awarded under a long-term incentive plan for each performance period.

(D) A Level 2 covered institution must defer at least 40 percent of a significant risk-taker's incentive-based compensation awarded under a long-term incentive plan for each performance period.

(ii) Minimum required deferral period. (A) For a senior executive officer or significant risk-taker of a Level 1 covered institution, the deferral period for deferred long-term incentive plan amounts must be at least 2 years.

(B) For a senior executive officer or significant risk-taker of a Level 2 covered institution, the deferral period for deferred long-term incentive plan amounts must be at least 1 year.

(iii) Vesting of amounts during deferral period--(A) Pro rata vesting. During a deferral period, deferred long-term incentive plan amounts may not vest faster than on a pro rata annual basis beginning no earlier than the first anniversary of the end of the performance period for which the amounts were awarded.

(B) Acceleration of vesting. A Level 1 or Level 2 covered institution must not accelerate the vesting of a covered person's deferred long-term incentive plan amounts that is required to be deferred under this part, except in the case of death or disability of such covered person.

(3) Adjustments of deferred qualifying incentive-based compensation and deferred long-term incentive plan compensation amounts. A Level 1 or Level 2 covered institution may not increase deferred qualifying incentive-based compensation or deferred long-term incentive plan amounts for a senior executive officer or significant risk-taker during the deferral period. For purposes of this paragraph, an increase in value attributable solely to a change in share value, a change in interest rates, or the payment of interest according to terms set out at the time of the award is not considered an increase in incentive-based compensation amounts.

(4) Composition of deferred qualifying incentive-based compensation and deferred long-term incentive plan compensation for Level 1 and Level 2 covered institutions—(i) Cash and equity-like instruments. For a senior executive officer or significant risk-taker of a Level 1 or Level 2 covered institution that issues equity or is an affiliate of a

covered institution that issues equity, any deferred qualifying incentive-based compensation or deferred long-term incentive plan amounts must include substantial portions of both deferred cash and equity-like instruments throughout the deferral period.

(ii) Options. If a senior executive officer or significant risk-taker of a Level 1 or Level 2 covered institution receives incentive-based compensation for a performance period in the form of options, the total amount of such options that may be used to meet the minimum deferral amount requirements of paragraph (a)(1)(i) or (a)(2)(i) of this section is limited to no more than 15 percent of the amount of total incentive-based compensation awarded to the senior executive officer or significant risk-taker for that performance period.

(b) Forfeiture and downward adjustment—(1) Compensation at risk. (i) A Level 1 or Level 2 covered institution must place at risk of forfeiture all unvested deferred incentive-based compensation of any senior executive officer or significant risk-taker, including unvested deferred amounts awarded under long-term incentive plans.

(ii) A Level 1 or Level 2 covered institution must place at risk of downward adjustment all of a senior executive officer's or significant risk-taker's incentive-based compensation amounts not yet awarded for the current performance period, including amounts payable under long-term incentive plans.

(2) Events triggering forfeiture and downward adjustment review. At a minimum, a Level 1 or Level 2 covered institution must consider forfeiture and downward adjustment of incentive-based compensation of senior executive officers and significant risk-takers

described in paragraph (b)(3) of this section due to any of the following adverse outcomes at the covered institution:

- (i) Poor financial performance attributable to a significant deviation from the risk parameters set forth in the covered institution's policies and procedures;
  - (ii) Inappropriate risk taking, regardless of the impact on financial performance;
  - (iii) Material risk management or control failures;
  - (iv) Non-compliance with statutory, regulatory, or supervisory standards that results in:
    - (A) Enforcement or legal action against the covered institution brought by a federal or state regulator or agency; or
    - (B) A requirement that the covered institution report a restatement of a financial statement to correct a material error; and
  - (v) Other aspects of conduct or poor performance as defined by the covered institution.
- (3) Senior executive officers and significant risk-takers affected by forfeiture and downward adjustment. A Level 1 or Level 2 covered institution must consider forfeiture and downward adjustment for a senior executive officer or significant risk-taker with direct responsibility, or responsibility due to the senior executive officer's or significant risk-taker's role or position in the covered institution's organizational structure, for the events related to the forfeiture and downward adjustment review set forth in paragraph (b)(2) of this section.
- (4) Determining forfeiture and downward adjustment amounts. A Level 1 or Level 2 covered institution must consider, at a minimum, the following factors when

determining the amount or portion of a senior executive officer's or significant risk-taker's incentive-based compensation that should be forfeited or adjusted downward:

- (i) The intent of the senior executive officer or significant risk-taker to operate outside the risk governance framework approved by the covered institution's board of directors or to depart from the covered institution's policies and procedures;
- (ii) The senior executive officer's or significant risk-taker's level of participation in, awareness of, and responsibility for, the events triggering the forfeiture and downward adjustment review set forth in paragraph (b)(2) of this section;
- (iii) Any actions the senior executive officer or significant risk-taker took or could have taken to prevent the events triggering the forfeiture and downward adjustment review set forth in paragraph (b)(2) of this section;
- (iv) The financial and reputational impact of the events triggering the forfeiture and downward adjustment review set forth in paragraph (b)(2) of this section to the covered institution, the line or sub-line of business, and individuals involved, as applicable, including the magnitude of any financial loss and the cost of known or potential subsequent fines, settlements, and litigation;
- (v) The causes of the events triggering the forfeiture and downward adjustment review set forth in paragraph (b)(2) of this section, including any decision-making by other individuals; and
- (vi) Any other relevant information, including past behavior and past risk outcomes attributable to the senior executive officer or significant risk-taker.

(c) Clawback. A Level 1 or Level 2 covered institution must include clawback provisions in 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 from a current or former senior executive officer or significant risk-taker for seven years following the date on which such compensation vests, if the covered institution determines that the senior executive officer or significant risk-taker engaged in:

- (1) Misconduct that resulted in significant financial or reputational harm to the covered institution;
- (2) Fraud; or
- (3) Intentional misrepresentation of information used to determine the senior executive officer or significant risk-taker's incentive-based compensation.

**§ 372.8 Additional prohibitions for Level 1 and Level 2 covered institutions.**

An incentive-based compensation arrangement at a Level 1 or Level 2 covered institution will be considered to provide incentives that appropriately balance risk and reward for purposes of § 372.4(c)(1) only if such institution complies with the following prohibitions.

- (a) Hedging. A Level 1 or Level 2 covered institution must not purchase a hedging instrument or similar instrument on behalf of a covered person to hedge or offset any decrease in the value of the covered person's incentive-based compensation.
- (b) Maximum incentive-based compensation opportunity. A Level 1 or Level 2 covered institution must not award incentive-based compensation to:
  - (1) A senior executive officer in excess of 125 percent of the target amount for that incentive-based compensation; or



- (2) A significant risk-taker in excess of 150 percent of the target amount for that incentive-based compensation.
- (c) Relative performance measures. A Level 1 or Level 2 covered institution must not use incentive-based compensation performance measures that are based solely on industry peer performance comparisons.
- (d) Volume driven incentive-based compensation. A Level 1 or Level 2 covered institution must not provide incentive-based compensation to a covered person that is based solely on transaction revenue or volume without regard to transaction quality or compliance of the covered person with sound risk management.

**§ 372.9 Risk management and controls requirements for Level 1 and Level 2 covered institutions.**

An incentive-based compensation arrangement at a Level 1 or Level 2 covered institution will be considered to be compatible with effective risk management and controls for purposes of § 372.4(c)(2) only if such institution meets the following requirements.

- (a) A Level 1 or Level 2 covered institution must have a risk management framework for its incentive-based compensation program that:
  - (1) Is independent of any lines of business;
  - (2) Includes an independent compliance program that provides for internal controls, testing, monitoring, and training with written policies and procedures consistent with § 372.11; and
  - (3) Is commensurate with the size and complexity of the covered institution's operations.
- (b) A Level 1 or Level 2 covered institution must:

- (1) Provide individuals engaged in control functions with the authority to influence the risk-taking of the business areas they monitor; and
  - (2) Ensure that covered persons engaged in control functions are compensated in accordance with the achievement of performance objectives linked to their control functions and independent of the performance of those business areas.
- (c) A Level 1 or Level 2 covered institution must provide for the independent monitoring of:
- (1) All incentive-based compensation plans in order to identify whether those plans provide incentives that appropriately balance risk and reward;
  - (2) Events related to forfeiture and downward adjustment reviews and decisions of forfeiture and downward adjustment reviews in order to determine consistency with § 372.7(b); and
  - (3) Compliance of the incentive-based compensation program with the covered institution's policies and procedures.

**§ 372.10 Governance requirements for Level 1 and Level 2 covered institutions.**

An incentive-based compensation arrangement at a Level 1 or Level 2 covered institution will not be considered to be supported by effective governance for purposes of § 372.4(c)(3), unless:

- (a) The covered institution establishes a compensation committee composed solely of directors who are not senior executive officers to assist the board of directors in carrying out its responsibilities under § 372.4(e); and
- (b) The compensation committee established pursuant to paragraph (a) of this section obtains:

- (1) Input from the risk and audit committees of the covered institution's board of directors, or groups performing similar functions, and risk management function on the effectiveness of risk measures and adjustments used to balance risk and reward in incentive-based compensation arrangements;
- (2) A written assessment of the effectiveness of the covered institution's incentive-based compensation program and related compliance and control processes in providing risk-taking incentives that are consistent with the risk profile of the covered institution, submitted on an annual or more frequent basis by the management of the covered institution and developed with input from the risk and audit committees of its board of directors, or groups performing similar functions, and from the covered institution's risk management and audit functions; and
- (3) An independent written assessment of the effectiveness of the covered institution's incentive-based compensation program and related compliance and control processes in providing risk-taking incentives that are consistent with the risk profile of the covered institution, submitted on an annual or more frequent basis by the internal audit or risk management function of the covered institution, developed independently of the covered institution's management.

**§ 372.11 Policies and procedures requirements for Level 1 and Level 2 covered institutions.**

A Level 1 or Level 2 covered institution must develop and implement policies and procedures for its incentive-based compensation program that, at a minimum:

- (a) Are consistent with the prohibitions and requirements of this part;

- (b) Specify the substantive and procedural criteria for the application of forfeiture and clawback, including the process for determining the amount of incentive-based compensation to be clawed back;
- (c) Require that the covered institution maintain documentation of final forfeiture, downward adjustment, and clawback decisions;
- (d) Specify the substantive and procedural criteria for the acceleration of payments of deferred incentive-based compensation to a covered person, consistent with § 372.7(a)(1)(iii)(B) and (a)(2)(iii)(B);
- (e) Identify and describe the role of any employees, committees, or groups authorized to make incentive-based compensation decisions, including when discretion is authorized;
- (f) Describe how discretion is expected to be exercised to appropriately balance risk and reward;
- (g) Require that the covered institution maintain documentation of the establishment, implementation, modification, and monitoring of incentive-based compensation arrangements, sufficient to support the covered institution's decisions;
- (h) Describe how incentive-based compensation arrangements will be monitored;
- (i) Specify the substantive and procedural requirements of the independent compliance program consistent with § 372.9(a)(2); and
- (j) Ensure appropriate roles for risk management, risk oversight, and other control function personnel in the covered institution's processes for:

- (1) Designing incentive-based compensation arrangements and determining awards, deferral amounts, deferral periods, forfeiture, downward adjustment, clawback, and vesting; and
- (2) Assessing the effectiveness of incentive-based compensation arrangements in restraining inappropriate risk-taking.

**§ 372.12 Indirect actions.**

A covered institution must not indirectly, or through or by any other person, do anything that would be unlawful for such covered institution to do directly under this part.

**§ 372.13 Enforcement.**

The provisions of this part shall be enforced under section 505 of the Gramm-Leach-Bliley Act and, for purposes of such section, a violation of this part shall be treated as a violation of subtitle A of title V of such Act.

**National Credit Union Administration  
12 CFR Chapter VII**

**Authority and Issuance**

**For the reasons stated in the joint preamble, the National Credit Union Administration proposes to amend chapter VII of title 12 of the Code of Federal Regulations as follows:**

**PART 741—REQUIREMENTS FOR INSURANCE**

**4. The authority citation for part 741 continues to read as follows:**

**Authority: 12 U.S.C. 1757, 1766, 1781-1790, and 1790d; 31 U.S.C. 3717.**

**5. Add § 741.226 to read as follows:**

**§741.226 Incentive-based compensation arrangements.**

**Any credit union which is insured pursuant to Title II of the Act must adhere to the requirements stated in part 751 of this chapter.**

**6. Add part 751 to subchapter A to read as follows.**

**PART 751 INCENTIVE-BASED COMPENSATION ARRANGEMENTS**

Sec.

751.1 Authority, scope, and initial applicability.

751.2 Definitions.

751.3 Applicability.

751.4 Requirements and prohibitions applicable to all credit unions subject to this part.

751.5 Additional disclosure and recordkeeping requirements for Level 1 and Level 2 credit unions.

751.6 Reservation of authority for Level 3 credit unions.

751.7 Deferral, forfeiture and downward adjustment, and clawback requirements for Level 1 and Level 2 credit unions.

751.8 Additional prohibitions for Level 1 and Level 2 credit unions.

751.9 Risk management and controls requirements for Level 1 and Level 2 credit unions.

751.10 Governance requirements for Level 1 and Level 2 credit unions.

751.11 Policies and procedures requirements for Level 1 and Level 2 credit unions.

751.12 Indirect actions.

751.13 Enforcement.

751.14 Credit unions in conservatorship or liquidation.

**Authority: 12 U.S.C. 1751 et seq. and 5641.**

§ 751.1 Authority, scope, and initial applicability.

(a) Authority. This part is issued pursuant to section 956 of the Dodd-Frank Wall Street

Reform and Consumer Protection Act (12 U.S.C. 5641) and the Federal Credit Union Act

(12 U.S.C. 1751 et seq.)

(b) Scope. This part applies to any federally insured credit union, or any credit union eligible to make application to become an insured credit union under 12 U.S.C. 1781, with average

total consolidated assets greater than or equal to \$1 billion that offers incentive-based compensation to covered persons.

- (c) Initial applicability—(1) Compliance date. A credit union must meet the requirements of this part no later than [Date of the beginning of the first calendar quarter that begins at least 540 days after a final rule is published in the Federal Register]. Whether a credit union is a Level 1, Level 2, or Level 3 credit union at that time will be determined based on average total consolidated assets as of [Date of the beginning of the first calendar quarter that begins after a final rule is published in the Federal Register].
- (2) Grandfathered plans. A credit union is not required to comply with the requirements of this part with respect to any incentive-based compensation plan with a performance period that begins before [Compliance Date as described in paragraph (c)(1) of this section].
- (d) Preservation of authority. Nothing in this part in any way limits the authority of NCUA under other provisions of applicable law and regulations.

## **§ 751.2 Definitions.**

For purposes of this part only, the following definitions apply unless otherwise specified:

- (a) [Reserved]
- (b) Average total consolidated assets means the average of a credit union's total consolidated assets, as reported on the credit union's regulatory reports, for the four most recent consecutive quarters. If a credit union has not filed a regulatory report for each of the four most recent consecutive quarters, the credit union's average total consolidated assets means the average of its total consolidated assets, as reported on its regulatory reports, for the most recent quarter or consecutive quarters, as applicable. Average total consolidated assets

are measured on the as-of date of the most recent regulatory report used in the calculation of the average.

- (c) To award incentive-based compensation means to make a final determination, conveyed to a covered person, of the amount of incentive-based compensation payable to the covered person for performance over a performance period.
- (d) Board of directors means the governing body of a credit union that oversees the activities of the credit union.
- (e) Clawback means a mechanism by which a credit union can recover vested incentive-based compensation from a covered person.
- (f) Compensation, fees, or benefits means all direct and indirect payments, both cash and non-cash, awarded to, granted to, or earned by or for the benefit of, any covered person in exchange for services rendered to a credit union.
- (g) [Reserved]
- (h) Control function means a compliance, risk management, internal audit, legal, human resources, accounting, financial reporting, or finance role responsible for identifying, measuring, monitoring, or controlling risk-taking.
- (i) [Reserved]
- (j) Covered person means any executive officer, employee, or director who receives incentive-based compensation at a credit union.
- (k) Deferral means the delay of vesting of incentive-based compensation beyond the date on which the incentive-based compensation is awarded.



- (l) Deferral period means the period of time between the date a performance period ends and the last date on which the incentive-based compensation awarded for such performance period vests.
- (m) [Reserved]
- (n) Director of a credit union means a member of the board of directors.
- (o) Downward adjustment means a reduction of the amount of a covered person's incentive-based compensation not yet awarded for any performance period that has already begun, including amounts payable under long-term incentive plans, in accordance with a forfeiture and downward adjustment review under § 751.7(b).
- (p) [Reserved]
- (q) Forfeiture means a reduction of the amount of deferred incentive-based compensation awarded to a covered person that has not vested.
- (r) Incentive-based compensation means any variable compensation, fees, or benefits that serve as an incentive or reward for performance.
- (s) Incentive-based compensation arrangement means an agreement between a credit union and a covered person, under which the credit union provides incentive-based compensation to the covered person, including incentive-based compensation delivered through one or more incentive-based compensation plans.
- (t) Incentive-based compensation plan means a document setting forth terms and conditions governing the opportunity for and the payment of incentive-based compensation payments to one or more covered persons.

- (u) Incentive-based compensation program means a credit union's framework for incentive-based compensation that governs incentive-based compensation practices and establishes related controls.
- (v) Level 1 credit union means a credit union with average total consolidated assets greater than or equal to \$250 billion.
- (w) Level 2 credit union means a credit union with average total consolidated assets greater than or equal to \$50 billion that is not a Level 1 credit union.
- (x) Level 3 credit union means a credit union with average total consolidated assets greater than or equal to \$1 billion that is not a Level 1 credit union or Level 2 credit union.
- (y) Long-term incentive plan means a plan to provide incentive-based compensation that is based on a performance period of at least three years.
- (z) [Reserved]
- (aa) Performance period means the period during which the performance of a covered person is assessed for purposes of determining incentive-based compensation.
- (bb) [Reserved]
- (cc) Qualifying incentive-based compensation means the amount of incentive-based compensation awarded to a covered person for a particular performance period, excluding amounts awarded to the covered person for that particular performance period under a long-term incentive plan.
- (dd) [Reserved]
- (ee) Regulatory report means NCUA form 5300 or 5310 call report.

(ff) [Reserved]

(gg) Senior executive officer means 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 credit union 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.

(hh) Significant risk-taker means:

(1) Any covered person at a Level 1 or Level 2 credit union, other than a senior executive officer, who received annual base salary and incentive-based compensation for the last calendar year that ended at least 180 days before the beginning of the performance period of which at least one-third is incentive-based compensation and is—

(i) A covered person of a Level 1 credit union who received annual base salary and incentive-based compensation for the last calendar year that ended at least 180 days before the beginning of the performance period that placed the covered person among the highest 5 percent in annual base salary and incentive-based compensation among all covered persons (excluding senior executive officers) of the Level 1 credit union;

(ii) A covered person of a Level 2 credit union who received annual base salary and incentive-based compensation for the last calendar year that ended at least 180 days before the beginning of the performance period that placed the covered person

among the highest 2 percent in annual base salary and incentive-based compensation among all covered persons (excluding senior executive officers) of the Level 2 credit union; or

(iii) A covered person of a credit union who may commit or expose 0.5 percent or more of the net worth or total capital of the credit union; and

(2) Any covered person at a Level 1 or Level 2 credit union, other than a senior executive officer, who is designated as a “significant risk-taker” by NCUA because of that person’s ability to expose a credit union to risks that could lead to material financial loss in relation to the credit union’s size, capital, or overall risk tolerance, in accordance with procedures established by NCUA, or by the credit union.

(3) [Reserved]

(4) If NCUA determines, in accordance with procedures established by NCUA, that a Level 1 credit union’s activities, complexity of operations, risk profile, and compensation practices are similar to those of a Level 2 credit union, the Level 1 credit union may apply paragraph (hh)(1)(i) of this section to covered persons of the Level 1 credit union by substituting “2 percent” for “5 percent”.

(ii) [Reserved]

(jj) Vesting of incentive-based compensation means the transfer of ownership of the incentive-based compensation to the covered person to whom the incentive-based compensation was awarded, such that the covered person’s right to the incentive-based compensation is no longer contingent on the occurrence of any event.

**§ 751.3 Applicability.**

- (a) When average total consolidated assets increase—(1) In general. A credit union shall become a Level 1, Level 2, or Level 3 credit union when its average total consolidated assets increase to an amount that equals or exceeds \$250 billion, \$50 billion, or \$1 billion, respectively.
- (2) Compliance date. A credit union that becomes a Level 1, Level 2, or Level 3 credit union pursuant to paragraph (a)(1) of this section shall comply with the requirements of this part for a Level 1, Level 2, or Level 3 credit union, respectively, not later than the first day of the first calendar quarter that begins at least 540 days after the date on which the credit union becomes a Level 1, Level 2, or Level 3 credit union, respectively. Until that day, the Level 1, Level 2, or Level 3 credit union will remain subject to the requirements of this part, if any, that applied to the credit union on the day before the date on which it became a Level 1, Level 2, or Level 3 credit union.
- (3) Grandfathered plans. A credit union that becomes a Level 1, Level 2, or Level 3 credit union under paragraph (a)(1) of this section is not required to comply with requirements of this part applicable to a Level 1, Level 2, or Level 3 credit union, respectively, with respect to any incentive-based compensation plan with a performance period that begins before the date described in paragraph (a)(2) of this section.
- (b) When total consolidated assets decrease. A Level 1, Level 2, or Level 3 credit union will remain subject to the requirements applicable to such credit union under this part unless and until the total consolidated assets of the credit union, as reported on the credit union's regulatory reports, fall below \$250 billion, \$50 billion, or \$1 billion, respectively, for each

of four consecutive quarters. The calculation will be effective on the as-of date of the fourth consecutive regulatory report.

**§ 751. 4 Requirements and prohibitions applicable to all credit unions subject to this part.**

(a) In general. A credit union must not establish or maintain any type of incentive-based compensation arrangement, or any feature of any such arrangement, that encourages inappropriate risks by the credit union:

- (1) By providing a covered person with excessive compensation, fees, or benefits; or
- (2) That could lead to material financial loss to the credit union.

(b) Excessive compensation. Compensation, fees, and benefits are considered excessive for purposes of paragraph (a)(1) of this section 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 credit union;
  - (3) The financial condition of the credit union;
  - (4) Compensation practices at comparable credit unions, based upon such factors as asset size, geographic location, and the complexity of the credit union's operations and assets;
  - (5) For post-employment benefits, the projected total cost and benefit to the credit union;
- 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 credit union.
- (c) Material financial loss. An incentive-based compensation arrangement at a credit union encourages inappropriate risks that could lead to material financial loss to the credit union, unless the arrangement:
- (1) Appropriately balances risk and reward;
  - (2) Is compatible with effective risk management and controls; and
  - (3) Is supported by effective governance.
- (d) Performance measures. An incentive-based compensation arrangement will not be considered to appropriately balance risk and reward for purposes of paragraph (c)(1) of this section unless:
- (1) The arrangement includes financial and non-financial measures of performance, including considerations of risk-taking, that are relevant to a covered person's role within a credit union and to the type of business in which the covered person is engaged and that are appropriately weighted to reflect risk-taking;
  - (2) The arrangement is designed to allow non-financial measures of performance to override financial measures of performance when appropriate in determining incentive-based compensation; and
  - (3) Any amounts to be awarded under the arrangement are subject to adjustment to reflect actual losses, inappropriate risks taken, compliance deficiencies, or other measures or aspects of financial and non-financial performance.

- (e) Board of directors. A credit union's board of directors, or a committee thereof, must:
- (1) Conduct oversight of the credit union's incentive-based compensation program;
  - (2) Approve incentive-based compensation arrangements for senior executive officers, including the amounts of all awards and, at the time of vesting, payouts under such arrangements; and
  - (3) Approve any material exceptions or adjustments to incentive-based compensation policies or arrangements for senior executive officers.
- (f) Disclosure and recordkeeping requirements. A credit union must create annually and maintain for a period of at least seven years records that document the structure of all its incentive-based compensation arrangements and demonstrate compliance with this part. A credit union must disclose the records to NCUA upon request. At a minimum, the records must include copies of all incentive-based compensation plans, a record of who is subject to each plan, and a description of how the incentive-based compensation program is compatible with effective risk management and controls.
- (g) Rule of construction. A credit union is not required to report the actual amount of compensation, fees, or benefits of individual covered persons as part of the disclosure and recordkeeping requirements under this part.

**§ 751.5 Additional disclosure and recordkeeping requirements for Level 1 and Level 2 credit unions.**

- (a) A Level 1 or Level 2 credit union must create annually and maintain for a period of at least seven years records that document:
- (1) The credit union's senior executive officers and significant risk-takers, listed by legal entity, job function, organizational hierarchy, and line of business;



- (2) The incentive-based compensation arrangements for senior executive officers and significant risk-takers, including information on percentage of incentive-based compensation deferred and form of award;
  - (3) Any forfeiture and downward adjustment or clawback reviews and decisions for senior executive officers and significant risk-takers; and
  - (4) Any material changes to the credit union's incentive-based compensation arrangements and policies.
- (b) A Level 1 or Level 2 credit union must create and maintain records in a manner that allows for an independent audit of incentive-based compensation arrangements, policies, and procedures, including, those required under § 751.11.
- (c) A Level 1 or Level 2 credit union must provide the records described in paragraph (a) of this section to NCUA in such form and with such frequency as requested by NCUA.

**§ 751.6      Reservation of authority for Level 3 credit unions.**

- (a) In general. NCUA may require a Level 3 credit union with average total consolidated assets greater than or equal to \$10 billion and less than \$50 billion to comply with some or all of the provisions of §§ 751.5 and 751.7 through 751.11 if NCUA determines that the Level 3 credit union's complexity of operations or compensation practices are consistent with those of a Level 1 or Level 2 credit union.
- (b) Factors considered. Any exercise of authority under this section will be in writing by the NCUA Board in accordance with procedures established by the NCUA Board and will consider the activities, complexity of operations, risk profile, and compensation practices of the Level 3 credit union, in addition to any other relevant factors.

**§ 751.7 Deferral, forfeiture and downward adjustment, and clawback requirements for Level 1 and Level 2 credit unions.**

An incentive-based compensation arrangement at a Level 1 or Level 2 credit union will not be considered to appropriately balance risk and reward, for purposes of § 751.4(c)(1), unless the following requirements are met.

(a) Deferral. (1) Qualifying incentive-based compensation must be deferred as follows:

(i) Minimum required deferral amount. (A) A Level 1 credit union must defer at least 60 percent of a senior executive officer's qualifying incentive-based compensation awarded for each performance period.

(B) A Level 1 credit union must defer at least 50 percent of a significant risk-taker's qualifying incentive-based compensation awarded for each performance period.

(C) A Level 2 credit union must defer at least 50 percent of a senior executive officer's qualifying incentive-based compensation awarded for each performance period.

(D) A Level 2 credit union must defer at least 40 percent of a significant risk-taker's qualifying incentive-based compensation awarded for each performance period.

(ii) Minimum required deferral period. (A) For a senior executive officer or significant risk-taker of a Level 1 credit union, the deferral period for deferred qualifying incentive-based compensation must be at least 4 years.

(B) For a senior executive officer or significant risk-taker of a Level 2 credit union, the deferral period for deferred qualifying incentive-based compensation must be at least 3 years.

(iii) Vesting of amounts during deferral period—(A) Pro rata vesting. During a deferral period, deferred qualifying incentive-based compensation may not vest faster than on a pro rata annual basis beginning no earlier than the first anniversary of the end of the performance period for which the amounts were awarded.

(B) Acceleration of vesting. A Level 1 or Level 2 credit union must not accelerate the vesting of a covered person's deferred qualifying incentive-based compensation that is required to be deferred under this part, except in the case of:

(1) Death or disability of such covered person; or

(2) The payment of income taxes that become due on deferred amounts before the covered person is vested in the deferred amount. For purposes of this paragraph, any accelerated vesting must be deducted from the scheduled deferred amounts proportionally to the deferral schedule.

(2) Incentive-based compensation awarded under a long-term incentive plan must be deferred as follows:

(i) Minimum required deferral amount. (A) A Level 1 credit union must defer at least 60 percent of a senior executive officer's incentive-based compensation awarded under a long-term incentive plan for each performance period.

(B) A Level 1 credit union must defer at least 50 percent of a significant risk-taker's incentive-based compensation awarded under a long-term incentive plan for each performance period.

(C) A Level 2 credit union must defer at least 50 percent of a senior executive officer's incentive-based compensation awarded under a long-term incentive plan for each performance period.

(D) A Level 2 credit union must defer at least 40 percent of a significant risk-taker's incentive-based compensation awarded under a long-term incentive plan for each performance period.

(ii) Minimum required deferral period. (A) For a senior executive officer or significant risk-taker of a Level 1 credit union, the deferral period for deferred long-term incentive plan amounts must be at least 2 years.

(B) For a senior executive officer or significant risk-taker of a Level 2 credit union, the deferral period for deferred long-term incentive plan amounts must be at least 1 year.

(iii) Vesting of amounts during deferral period—(A) Pro rata vesting. During a deferral period, deferred long-term incentive plan amounts may not vest faster than on a pro rata annual basis beginning no earlier than the first anniversary of the end of the performance period for which the amounts were awarded.

(B) Acceleration of vesting. A Level 1 or Level 2 credit union must not accelerate the vesting of a covered person's deferred long-term incentive plan amounts that is required to be deferred under this part, except in the case of:

(1) Death or disability of such covered person; or

(2) The payment of income taxes that become due on deferred amounts before the covered person is vested in the deferred amount. For purposes of this

paragraph, any accelerated vesting must be deducted from the scheduled deferred amounts proportionally to the deferral schedule.

(3) Adjustments of deferred qualifying incentive-based compensation and deferred long-term incentive plan compensation amounts. A Level 1 or Level 2 credit union may not increase deferred qualifying incentive-based compensation or deferred long-term incentive plan amounts for a senior executive officer or significant risk-taker during the deferral period. For purposes of this paragraph, an increase in value attributable solely to a change in share value, a change in interest rates, or the payment of interest according to terms set out at the time of the award is not considered an increase in incentive-based compensation amounts.

(4) [Reserved]

(b) Forfeiture and downward adjustment—(1) Compensation at risk. (i) A Level 1 or Level 2 credit union must place at risk of forfeiture all unvested deferred incentive-based compensation of any senior executive officer or significant risk-taker, including unvested deferred amounts awarded under long-term incentive plans.

(ii) A Level 1 or Level 2 credit union must place at risk of downward adjustment all of a senior executive officer's or significant risk-taker's incentive-based compensation amounts not yet awarded for the current performance period, including amounts payable under long-term incentive plans.

(2) Events triggering forfeiture and downward adjustment review. At a minimum, a Level 1 or Level 2 credit union must consider forfeiture and downward adjustment of incentive-based compensation of senior executive officers and significant risk-takers

described in paragraph (b)(3) of this section due to any of the following adverse outcomes at the credit union:

- (i) Poor financial performance attributable to a significant deviation from the risk parameters set forth in the credit union's policies and procedures;
  - (ii) Inappropriate risk taking, regardless of the impact on financial performance;
  - (iii) Material risk management or control failures;
  - (iv) Non-compliance with statutory, regulatory, or supervisory standards that results in:
    - (A) Enforcement or legal action against the credit union brought by a federal or state regulator or agency; or
    - (B) A requirement that the credit union report a restatement of a financial statement to correct a material error; and
  - (v) Other aspects of conduct or poor performance as defined by the credit union.
- (3) Senior executive officers and significant risk-takers affected by forfeiture and downward adjustment. A Level 1 or Level 2 credit union must consider forfeiture and downward adjustment for a senior executive officer or significant risk-taker with direct responsibility, or responsibility due to the senior executive officer's or significant risk-taker's role or position in the credit union's organizational structure, for the events related to the forfeiture and downward adjustment review set forth in paragraph (b)(2) of this section.
- (4) Determining forfeiture and downward adjustment amounts. A Level 1 or Level 2 credit union must consider, at a minimum, the following factors when determining the amount

or portion of a senior executive officer's or significant risk-taker's incentive-based compensation that should be forfeited or adjusted downward:

- (i) The intent of the senior executive officer or significant risk-taker to operate outside the risk governance framework approved by the credit union's board of directors or to depart from the credit union's policies and procedures;
- (ii) The senior executive officer's or significant risk-taker's level of participation in, awareness of, and responsibility for, the events triggering the forfeiture and downward adjustment review set forth in paragraph (b)(2) of this section;
- (iii) Any actions the senior executive officer or significant risk-taker took or could have taken to prevent the events triggering the forfeiture and downward adjustment review set forth in paragraph (b)(2) of this section;
- (iv) The financial and reputational impact of the events triggering the forfeiture and downward adjustment review set forth in paragraph (b)(2) of this section to the credit union, the line or sub-line of business, and individuals involved, as applicable, including the magnitude of any financial loss and the cost of known or potential subsequent fines, settlements, and litigation;
- (v) The causes of the events triggering the forfeiture and downward adjustment review set forth in paragraph (b)(2) of this section, including any decision-making by other individuals; and
- (vi) Any other relevant information, including past behavior and past risk outcomes attributable to the senior executive officer or significant risk-taker.

(c) Clawback. A Level 1 or Level 2 credit union must include clawback provisions in incentive-based compensation arrangements for senior executive officers and significant risk-takers that, at a minimum, allow the credit union to recover incentive-based compensation from a current or former senior executive officer or significant risk-taker for seven years following the date on which such compensation vests, if the credit union determines that the senior executive officer or significant risk-taker engaged in:

- (1) Misconduct that resulted in significant financial or reputational harm to the credit union;
- (2) Fraud; or
- (3) Intentional misrepresentation of information used to determine the senior executive officer or significant risk-taker's incentive-based compensation.

**§ 751.8 Additional prohibitions for Level 1 and Level 2 credit unions.**

An incentive-based compensation arrangement at a Level 1 or Level 2 credit union will be considered to provide incentives that appropriately balance risk and reward for purposes of § 751.4(c)(1) only if such credit union complies with the following prohibitions.

- (a) Hedging. A Level 1 or Level 2 credit union must not purchase a hedging instrument or similar instrument on behalf of a covered person to hedge or offset any decrease in the value of the covered person's incentive-based compensation.
- (b) Maximum incentive-based compensation opportunity. A Level 1 or Level 2 credit union must not award incentive-based compensation to:
  - (1) A senior executive officer in excess of 125 percent of the target amount for that incentive-based compensation; or



- (2) A significant risk-taker in excess of 150 percent of the target amount for that incentive-based compensation.
- (c) Relative performance measures. A Level 1 or Level 2 credit union must not use incentive-based compensation performance measures that are based solely on industry peer performance comparisons.
- (d) Volume driven incentive-based compensation. A Level 1 or Level 2 credit union must not provide incentive-based compensation to a covered person that is based solely on transaction revenue or volume without regard to transaction quality or compliance of the covered person with sound risk management.

**§ 751.9 Risk management and controls requirements for Level 1 and Level 2 credit unions.**

An incentive-based compensation arrangement at a Level 1 or Level 2 credit union will be considered to be compatible with effective risk management and controls for purposes of § 751.4(c)(2) only if such credit union meets the following requirements.

- (a) A Level 1 or Level 2 credit union must have a risk management framework for its incentive-based compensation program that:
  - (1) Is independent of any lines of business;
  - (2) Includes an independent compliance program that provides for internal controls, testing, monitoring, and training with written policies and procedures consistent with § 751.11; and
  - (3) Is commensurate with the size and complexity of the credit union's operations.
- (b) A Level 1 or Level 2 credit union must:

- (1) Provide individuals engaged in control functions with the authority to influence the risk-taking of the business areas they monitor; and
  - (2) Ensure that covered persons engaged in control functions are compensated in accordance with the achievement of performance objectives linked to their control functions and independent of the performance of those business areas.
- (c) A Level 1 or Level 2 credit union must provide for the independent monitoring of:
- (1) All incentive-based compensation plans in order to identify whether those plans provide incentives that appropriately balance risk and reward;
  - (2) Events related to forfeiture and downward adjustment reviews and decisions of forfeiture and downward adjustment reviews in order to determine consistency with § 751.7(b); and
  - (3) Compliance of the incentive-based compensation program with the credit union's policies and procedures.

**§ 751.10 Governance requirements for Level 1 and Level 2 credit unions.**

An incentive-based compensation arrangement at a Level 1 or Level 2 credit union will not be considered to be supported by effective governance for purposes of § 751.4(c)(3), unless:

- (a) The credit union establishes a compensation committee composed solely of directors who are not senior executive officers to assist the board of directors in carrying out its responsibilities under § 751.4(e); and
- (b) The compensation committee established pursuant to paragraph (a) of this section obtains:
  - (1) Input from the risk and audit committees of the credit union's board of directors, or groups performing similar functions, and risk management function on the

effectiveness of risk measures and adjustments used to balance risk and reward in incentive-based compensation arrangements;

- (2) A written assessment of the effectiveness of the credit union's incentive-based compensation program and related compliance and control processes in providing risk-taking incentives that are consistent with the risk profile of the credit union, submitted on an annual or more frequent basis by the management of the credit union and developed with input from the risk and audit committees of its board of directors, or groups performing similar functions, and from the credit union's risk management and audit functions; and
- (3) An independent written assessment of the effectiveness of the credit union's incentive-based compensation program and related compliance and control processes in providing risk-taking incentives that are consistent with the risk profile of the credit union, submitted on an annual or more frequent basis by the internal audit or risk management function of the credit union, developed independently of the credit union's management.

**§ 751.11 Policies and procedures requirements for Level 1 and Level 2 credit unions.**

A Level 1 or Level 2 credit union must develop and implement policies and procedures for its incentive-based compensation program that, at a minimum:

- (a) Are consistent with the prohibitions and requirements of this part;
- (b) Specify the substantive and procedural criteria for the application of forfeiture and clawback, including the process for determining the amount of incentive-based compensation to be clawed back;

- (c) Require that the credit union maintain documentation of final forfeiture, downward adjustment, and clawback decisions;
- (d) Specify the substantive and procedural criteria for the acceleration of payments of deferred incentive-based compensation to a covered person, consistent with § 751.7(a)(1)(iii)(B) and (a)(2)(iii)(B);
- (e) Identify and describe the role of any employees, committees, or groups authorized to make incentive-based compensation decisions, including when discretion is authorized;
- (f) Describe how discretion is expected to be exercised to appropriately balance risk and reward;
- (g) Require that the credit union maintain documentation of the establishment, implementation, modification, and monitoring of incentive-based compensation arrangements, sufficient to support the credit union's decisions;
- (h) Describe how incentive-based compensation arrangements will be monitored;
- (i) Specify the substantive and procedural requirements of the independent compliance program consistent with § 751.9(a)(2); and
- (j) Ensure appropriate roles for risk management, risk oversight, and other control function personnel in the credit union's processes for:
  - (1) Designing incentive-based compensation arrangements and determining awards, deferral amounts, deferral periods, forfeiture, downward adjustment, clawback, and vesting; and
  - (2) Assessing the effectiveness of incentive-based compensation arrangements in restraining inappropriate risk-taking.

**§ 751.12 Indirect actions.**

A credit union must not indirectly, or through or by any other person, do anything that would be unlawful for such credit union to do directly under this part. The term “any other person” includes a credit union service organization described in 12 U.S.C. 1757(7)(I) or established under similar state law.

**§ 751.13 Enforcement.**

The provisions of this part shall be enforced under section 505 of the Gramm-Leach-Bliley Act and, for purposes of such section, a violation of this part shall be treated as a violation of subtitle A of title V of such Act.

**§ 751.14 Credit unions in conservatorship or liquidation.**

(a) Scope. This section applies to federally insured credit unions for which any one or more of the following parties are acting as conservator or liquidating agent:

- (1) The National Credit Union Administration Board;
- (2) The appropriate state supervisory authority; or
- (3) Any party designated by the National Credit Union Administration Board or by the appropriate state supervisory authority.

(b) Compensation requirements. For a credit union subject to this section, the requirements of this part do not apply. Instead, the conservator or liquidating agent, in its discretion and according to the circumstances deemed relevant in the judgment of the conservator or liquidating agent, will determine the requirements that best fulfill the requirements and purposes of 12 U.S.C. 5641. The conservator or liquidating agent may determine appropriate transition terms and provisions in the event that the credit union ceases to be within the scope of this section.

**Federal Housing Finance Agency  
Authority and Issuance**

Accordingly, for the reasons stated in the joint preamble, under the authority of 12 U.S.C. 4526 and 5641, FHFA proposes to amend chapter XII of title 12 of the Code of Federal Regulation as follows:

7. Add part 1232 to subchapter B to read as follows:

**PART 1232—INCENTIVE-BASED COMPENSATION ARRANGEMENTS**

Sec.

- 1232.1 Authority, scope, and initial applicability.
- 1232.2 Definitions.
- 1232.3 Applicability.
- 1232.4 Requirements and prohibitions applicable to all covered institutions.
- 1232.5 Additional disclosure and recordkeeping requirements for Level 1 and Level 2 covered institutions.
- 1232.6 Reservation of authority for Level 3 covered institutions.
- 1232.7 Deferral, forfeiture and downward adjustment, and clawback requirements for Level 1 and Level 2 covered institutions.
- 1232.8 Additional prohibitions for Level 1 and Level 2 covered institutions.
- 1232.9 Risk management and controls requirements for Level 1 and Level 2 covered institutions.
- 1232.10 Governance requirements for Level 1 and Level 2 covered institutions.
- 1232.11 Policies and procedures requirements for Level 1 and Level 2 covered institutions.
- 1232.12 Indirect actions.
- 1232.13 Enforcement.
- 1232.14 Covered institutions in conservatorship or receivership.

**Authority:** 12 U.S.C. 4511(b), 4513, 4514, 4518, 4526, ch. 46 subch. III, and 5641.

§ 1232.1 Authority, scope, and initial applicability.

- (a) Authority. This part is issued pursuant to section 956 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 5641) and sections 1311, 1313, 1314, 1318, and 1319G and Subtitle C of the Safety and Soundness Act (12 U.S.C. 4511(b), 4513, 4514, 4518, 4526, and ch. 46 subch. III).
- (b) Scope. This part applies to a covered institution with average total consolidated assets greater than or equal to \$1 billion that offers incentive-based compensation to covered persons.
- (c) Initial applicability—(1) Compliance date. A covered institution must meet the requirements of this part no later than [Date of the beginning of the first calendar quarter that begins at least 540 days after a final rule is published in the Federal Register]. Whether a covered institution other than a Federal Home Loan Bank is a Level 1, Level 2, or Level 3 covered institution at that time will be determined based on average total consolidated assets as of [Date of the beginning of the first calendar quarter that begins after a final rule is published in the Federal Register].
- (2) Grandfathered plans. A covered institution is not required to comply with the requirements of this part with respect to any incentive-based compensation plan with a performance period that begins before [Compliance Date as described in paragraph (c)(1) of this section].
- (d) Preservation of authority. Nothing in this part in any way limits the authority of the Federal Housing Finance Agency under other provisions of applicable law and regulations.

**§ 1232.2 Definitions.**

For purposes of this part only, the following definitions apply unless otherwise specified:

- (a) [Reserved].
- (b) Average total consolidated assets means the average of a regulated institution's total consolidated assets, as reported on the regulated institution's regulatory reports, for the four most recent consecutive quarters. If a regulated institution has not filed a regulatory report for each of the four most recent consecutive quarters, the regulated institution's average total consolidated assets means the average of its total consolidated assets, as reported on its regulatory reports, for the most recent quarter or consecutive quarters, as applicable. Average total consolidated assets are measured on the as-of date of the most recent regulatory report used in the calculation of the average.
- (c) To award incentive-based compensation means to make a final determination, conveyed to a covered person, of the amount of incentive-based compensation payable to the covered person for performance over a performance period.
- (d) Board of directors means the governing body of a covered institution that oversees the activities of the covered institution, often referred to as the board of directors or board of managers.
- (e) Clawback means a mechanism by which a covered institution can recover vested incentive-based compensation from a covered person.
- (f) Compensation, fees, or benefits means all direct and indirect payments, both cash and non-cash, awarded to, granted to, or earned by or for the benefit of, any covered person in exchange for services rendered to a covered institution.
- (g) [Reserved.]



- (h) Control function means a compliance, risk management, internal audit, legal, human resources, accounting, financial reporting, or finance role responsible for identifying, measuring, monitoring, or controlling risk-taking.
- (i) Covered institution means a regulated institution with average total consolidated assets greater than or equal to \$1 billion.
- (j) Covered person means any executive officer, employee, director, or principal shareholder who receives incentive-based compensation at a covered institution.
- (k) Deferral means the delay of vesting of incentive-based compensation beyond the date on which the incentive-based compensation is awarded.
- (l) Deferral period means the period of time between the date a performance period ends and the last date on which the incentive-based compensation awarded for such performance period vests.
- (m) [Reserved]
- (n) Director of a covered institution means a member of the board of directors.
- (o) Downward adjustment means a reduction of the amount of a covered person's incentive-based compensation not yet awarded for any performance period that has already begun, including amounts payable under long-term incentive plans, in accordance with a forfeiture and downward adjustment review under § 1232.7(b).
- (p) Equity-like instrument means:

- (1) Equity in the covered institution or of any affiliate of the covered institution; or
- (2) A form of compensation:
- (i) Payable at least in part based on the price of the shares or other equity instruments of the covered institution or of any affiliate of the covered institution; or
  - (ii) That requires, or may require, settlement in the shares of the covered institution or of any affiliate of the covered institution.
- (q) Forfeiture means a reduction of the amount of deferred incentive-based compensation awarded to a covered person that has not vested.
- (r) Incentive-based compensation means any variable compensation, fees, or benefits that serve as an incentive or reward for performance.
- (s) Incentive-based compensation arrangement means an agreement between a covered institution and a covered person, under which the covered institution provides incentive-based compensation to the covered person, including incentive-based compensation delivered through one or more incentive-based compensation plans.
- (t) Incentive-based compensation plan means a document setting forth terms and conditions governing the opportunity for and the payment of incentive-based compensation payments to one or more covered persons.
- (u) Incentive-based compensation program means a covered institution's framework for incentive-based compensation that governs incentive-based compensation practices and establishes related controls.

- (v) Level 1 covered institution means a covered institution with average total consolidated assets greater than or equal to \$250 billion that is not a Federal Home Loan Bank.
- (w) Level 2 covered institution means a covered institution with average total consolidated assets greater than or equal to \$50 billion that is not a Level 1 covered institution and any Federal Home Loan Bank that is a covered institution.
- (x) Level 3 covered institution means a covered institution with average total consolidated assets greater than or equal to \$1 billion that is not a Level 1 covered institution or Level 2 covered institution.
- (y) Long-term incentive plan means a plan to provide incentive-based compensation that is based on a performance period of at least three years.
- (z) Option means an instrument through which a covered institution provides a covered person the right, but not the obligation, to buy a specified number of shares representing an ownership stake in a company at a predetermined price within a set time period or on a date certain, or any similar instrument, such as a stock appreciation right.
- (aa) Performance period means the period during which the performance of a covered person is assessed for purposes of determining incentive-based compensation.
- (bb) Principal shareholder means a natural person who, directly or indirectly, or acting through or in concert with one or more persons, owns, controls, or has the power to vote 10 percent or more of any class of voting securities of a covered institution.
- (cc) Qualifying incentive-based compensation means the amount of incentive-based compensation awarded to a covered person for a particular performance period, excluding

amounts awarded to the covered person for that particular performance period under a long-term incentive plan.

(dd) Regulated institution means an Enterprise, as defined in 12 U.S.C. 4502(10), and a Federal Home Loan Bank.

(ee) Regulatory report means the Call Report Statement of Condition.

(ff) [Reserved].

(gg) Senior executive officer means 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.

(hh) Significant risk-taker means:

(1) Any covered person at a Level 1 or Level 2 covered institution, other than a senior executive officer, who received annual base salary and incentive-based compensation for the last calendar year that ended at least 180 days before the beginning of the performance period of which at least one-third is incentive-based compensation and is—

(i) A covered person of a Level 1 covered institution who received annual base salary and incentive-based compensation for the last calendar year that ended at least 180 days before the beginning of the performance period that placed the covered person

among the highest 5 percent in annual base salary and incentive-based compensation among all covered persons (excluding senior executive officers) of the Level 1 covered institution;

(ii) A covered person of a Level 2 covered institution who received annual base salary and incentive-based compensation for the last calendar year that ended at least 180 days before the beginning of the performance period that placed the covered person among the highest 2 percent in annual base salary and incentive-based compensation among all covered persons (excluding senior executive officers) of the Level 2 covered institution; or

(iii) A covered person of a covered institution who may commit or expose 0.5 percent or more of the regulatory capital, in the case of a Federal Home Loan Bank, or the minimum capital, in the case of an Enterprise, of the covered institution; and

(2) Any covered person at a Level 1 or Level 2 covered institution, other than a senior executive officer, who is designated as a “significant risk-taker” by the Federal Housing Finance Agency because of that person’s ability to expose a covered institution to risks that could lead to material financial loss in relation to the covered institution’s size, capital, or overall risk tolerance, in accordance with procedures established by the Federal Housing Finance Agency, or by the covered institution.

(3) [Reserved].

(4) If the Federal Housing Finance Agency determines, in accordance with procedures established by the Federal Housing Finance Agency, that a Level 1 covered institution’s activities, complexity of operations, risk profile, and compensation practices are similar

to those of a Level 2 covered institution, the Level 1 covered institution may apply paragraph (hh)(1)(i) of this section to covered persons of the Level 1 covered institution by substituting “2 percent” for “5 percent”.

(ii) [Reserved].

(jj) Vesting of incentive-based compensation means the transfer of ownership of the incentive-based compensation to the covered person to whom the incentive-based compensation was awarded, such that the covered person’s right to the incentive-based compensation is no longer contingent on the occurrence of any event.

### **§ 1232.3      Applicability.**

(a) When average total consolidated assets increase—(1) In general. A regulated institution other than a Federal Home Loan Bank shall become a Level 1, Level 2, or Level 3 covered institution when its average total consolidated assets increase to an amount that equals or exceeds \$250 billion, \$50 billion, or \$1 billion, respectively.

(2) Compliance date. A regulated institution that becomes a Level 1, Level 2, or Level 3 covered institution pursuant to paragraph (a)(1) of this section shall comply with the requirements of this part for a Level 1, Level 2, or Level 3 covered institution, respectively, not later than the first day of the first calendar quarter that begins at least 540 days after the date on which the regulated institution becomes a Level 1, Level 2, or Level 3 covered institution, respectively. Until that day, the Level 1, Level 2, or Level 3 covered institution will remain subject to the requirements of this part, if any, that applied to the regulated institution on the day before the date on which it became a Level 1, Level 2, or Level 3 covered institution.

- (3) Grandfathered plans. A regulated institution that becomes a Level 1, Level 2, or Level 3 covered institution under paragraph (a)(1) of this section is not required to comply with requirements of this part applicable to a Level 1, Level 2, or Level 3 covered institution, respectively, with respect to any incentive-based compensation plan with a performance period that begins before the date described in paragraph (a)(2) of this section. Any such incentive-based compensation plan shall remain subject to the requirements under this part, if any, that applied to the regulated institution at the beginning of the performance period.
- (b) When total consolidated assets decrease. A Level 1, Level 2, or Level 3 covered institution other than a Federal Home Loan Bank will remain subject to the requirements applicable to such covered institution under this part unless and until the total consolidated assets of the covered institution, as reported on the covered institution's regulatory reports, fall below \$250 billion, \$50 billion, or \$1 billion, respectively, for each of four consecutive quarters. A Federal Home Loan Bank will remain subject to the requirements of a Level 2 covered institution under this part unless and until the total consolidated assets of the Federal Home Loan Bank, as reported on the Federal Home Loan Bank's regulatory reports, fall below \$1 billion for each of four consecutive quarters. The calculation will be effective on the as-of date of the fourth consecutive regulatory report.

**§ 1232.4 Requirements and prohibitions applicable to all covered institutions.**

- (a) In general. A covered institution must not establish or maintain any type of incentive-based compensation arrangement, or any feature of any such arrangement, that encourages inappropriate risks by the covered institution:
- (1) By providing a covered person with excessive compensation, fees, or benefits; or

- (2) That could lead to material financial loss to the covered institution.
- (b) Excessive compensation. Compensation, fees, and benefits are considered excessive for purposes of paragraph (a)(1) of this section 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.
- (c) Material financial loss. An incentive-based compensation arrangement at a covered institution encourages inappropriate risks that could lead to material financial loss to the covered institution, unless the arrangement:
- (1) Appropriately balances risk and reward;



- (2) Is compatible with effective risk management and controls; and
  - (3) Is supported by effective governance.
- (d) Performance measures. An incentive-based compensation arrangement will not be considered to appropriately balance risk and reward for purposes of paragraph (c)(1) of this section unless:
- (1) The arrangement includes financial and non-financial measures of performance, including considerations of risk-taking, that are relevant to a covered person's role within a covered institution and to the type of business in which the covered person is engaged and that are appropriately weighted to reflect risk-taking;
  - (2) The arrangement is designed to allow non-financial measures of performance to override financial measures of performance when appropriate in determining incentive-based compensation; and
  - (3) Any amounts to be awarded under the arrangement are subject to adjustment to reflect actual losses, inappropriate risks taken, compliance deficiencies, or other measures or aspects of financial and non-financial performance.
- (e) Board of directors. A covered institution's board of directors, or a committee thereof, must:
- (1) Conduct oversight of the covered institution's incentive-based compensation program;
  - (2) Approve incentive-based compensation arrangements for senior executive officers, including the amounts of all awards and, at the time of vesting, payouts under such arrangements; and

- (3) Approve any material exceptions or adjustments to incentive-based compensation policies or arrangements for senior executive officers.
- (f) Disclosure and recordkeeping requirements. A covered institution must create annually and maintain for a period of at least seven years records that document the structure of all its incentive-based compensation arrangements and demonstrate compliance with this part. A covered institution must disclose the records to the Federal Housing Finance Agency upon request. At a minimum, the records must include copies of all incentive-based compensation plans, a record of who is subject to each plan, and a description of how the incentive-based compensation program is compatible with effective risk management and controls.
- (g) Rule of construction. A covered institution is not required to report the actual amount of compensation, fees, or benefits of individual covered persons as part of the disclosure and recordkeeping requirements under this part, though it may be required to do so under other applicable regulations of the Federal Housing Finance Agency.

**§ 1232.5 Additional disclosure and recordkeeping requirements for Level 1 and Level 2 covered institutions.**

- (a) A Level 1 or Level 2 covered institution must create annually and maintain for a period of at least seven years records that document:
- (1) The covered institution's senior executive officers and significant risk-takers, listed by legal entity, job function, organizational hierarchy, and line of business;
  - (2) The incentive-based compensation arrangements for senior executive officers and significant risk-takers, including information on percentage of incentive-based compensation deferred and form of award;

- (3) Any forfeiture and downward adjustment or clawback reviews and decisions for senior executive officers and significant risk-takers; and
  - (4) Any material changes to the covered institution's incentive-based compensation arrangements and policies.
- (b) A Level 1 or Level 2 covered institution must create and maintain records in a manner that allows for an independent audit of incentive-based compensation arrangements, policies, and procedures, including those required under § 1232.11.
- (c) A Level 1 or Level 2 covered institution must provide the records described in paragraph (a) of this section to the Federal Housing Finance Agency in such form and with such frequency as requested by the Federal Housing Finance Agency.

**§ 1232.6      Reservation of authority for Level 3 covered institutions.**

- (a) In general. The Federal Housing Finance Agency may require a Level 3 covered institution with average total consolidated assets greater than or equal to \$10 billion and less than \$50 billion to comply with some or all of the provisions of §§ 1232.5 and 1232.7 through 1232.11 if the Federal Housing Finance Agency determines that the Level 3 covered institution's complexity of operations or compensation practices are consistent with those of a Level 1 or Level 2 covered institution.
- (b) Factors considered. Any exercise of authority under this section will be in writing by the Federal Housing Finance Agency in accordance with procedures established by the Federal Housing Finance Agency and will consider the activities, complexity of operations, risk profile, and compensation practices of the Level 3 covered institution, in addition to any other relevant factors.

**§ 1232.7 Deferral, forfeiture and downward adjustment, and clawback requirements for Level 1 and Level 2 covered institutions.**

An incentive-based compensation arrangement at a Level 1 or Level 2 covered institution will not be considered to appropriately balance risk and reward, for purposes of § 1232.4(c)(1), unless the following requirements are met.

(a) Deferral. (1) Qualifying incentive-based compensation must be deferred as follows:

(i) Minimum required deferral amount. (A) A Level 1 covered institution must defer at least 60 percent of a senior executive officer's qualifying incentive-based compensation awarded for each performance period.

(B) A Level 1 covered institution must defer at least 50 percent of a significant risk-taker's qualifying incentive-based compensation awarded for each performance period.

(C) A Level 2 covered institution must defer at least 50 percent of a senior executive officer's qualifying incentive-based compensation awarded for each performance period.

(D) A Level 2 covered institution must defer at least 40 percent of a significant risk-taker's qualifying incentive-based compensation awarded for each performance period.

(ii) Minimum required deferral period. (A) For a senior executive officer or significant risk-taker of a Level 1 covered institution, the deferral period for deferred qualifying incentive-based compensation must be at least 4 years.

(B) For a senior executive officer or significant risk-taker of a Level 2 covered institution, the deferral period for deferred qualifying incentive-based compensation must be at least 3 years.

(iii) Vesting of amounts during deferral period—(A) Pro rata vesting. During a deferral period, deferred qualifying incentive-based compensation may not vest faster than on a pro rata annual basis beginning no earlier than the first anniversary of the end of the performance period for which the amounts were awarded.

(B) Acceleration of vesting. A Level 1 or Level 2 covered institution must not accelerate the vesting of a covered person's deferred qualifying incentive-based compensation that is required to be deferred under this part, except in the case of death or disability of such covered person.

(2) Incentive-based compensation awarded under a long-term incentive plan must be deferred as follows:

(i) Minimum required deferral amount.

(A) A Level 1 covered institution must defer at least 60 percent of a senior executive officer's incentive-based compensation awarded under a long-term incentive plan for each performance period.

(B) A Level 1 covered institution must defer at least 50 percent of a significant risk-taker's incentive-based compensation awarded under a long-term incentive plan for each performance period.

- (C) A Level 2 covered institution must defer at least 50 percent of a senior executive officer's incentive-based compensation awarded under a long-term incentive plan for each performance period.
- (D) A Level 2 covered institution must defer at least 40 percent of a significant risk-taker's incentive-based compensation awarded under a long-term incentive plan for each performance period.
- (ii) Minimum required deferral period. (A) For a senior executive officer or significant risk-taker of a Level 1 covered institution, the deferral period for deferred long-term incentive plan amounts must be at least 2 years.
- (B) For a senior executive officer or significant risk-taker of a Level 2 covered institution, the deferral period for deferred long-term incentive plan amounts must be at least 1 year.
- (iii) Vesting of amounts during deferral period—(A) Pro rata vesting. During a deferral period, deferred long-term incentive plan amounts may not vest faster than on a pro rata annual basis beginning no earlier than the first anniversary of the end of the performance period for which the amounts were awarded.
- (B) Acceleration of vesting. A Level 1 or Level 2 covered institution must not accelerate the vesting of a covered person's deferred long-term incentive plan amounts that is required to be deferred under this part, except in the case of death or disability of such covered person.
- (3) Adjustments of deferred qualifying incentive-based compensation and deferred long-term incentive plan compensation amounts. A Level 1 or Level 2 covered institution

may not increase deferred qualifying incentive-based compensation or deferred long-term incentive plan amounts for a senior executive officer or significant risk-taker during the deferral period. For purposes of this paragraph, an increase in value attributable solely to a change in share value, a change in interest rates, or the payment of interest according to terms set out at the time of the award is not considered an increase in incentive-based compensation amounts.

(4) Composition of deferred qualifying incentive-based compensation and deferred long-

term incentive plan compensation for Level 1 and Level 2 covered institutions—(i)

Cash and equity-like instruments. For a senior executive officer or significant risk-

taker of a Level 1 or Level 2 covered institution, any deferred qualifying incentive-

based compensation or deferred long-term incentive plan amounts must include

substantial portions of both deferred cash and, in the case of a covered institution that

issues equity instruments and is permitted by the Federal Housing Finance Agency to

use equity-like instruments as compensation for senior executive officers and

significant risk-takers, equity-like instruments throughout the deferral period.

(ii) Options. If a senior executive officer or significant risk-taker of a Level 1 or Level

2 covered institution receives incentive-based compensation for a performance

period in the form of options, the total amount of such options that may be used to

meet the minimum deferral amount requirements of paragraph (a)(1)(i) or (a)(2)(i)

of this section is limited to no more than 15 percent of the amount of total

incentive-based compensation awarded to the senior executive officer or significant

risk-taker for that performance period.

(b) Forfeiture and downward adjustment—(1) Compensation at risk. (i) A Level 1 or Level 2 covered institution must place at risk of forfeiture all unvested deferred incentive-based compensation of any senior executive officer or significant risk-taker, including unvested deferred amounts awarded under long-term incentive plans.

(ii) A Level 1 or Level 2 covered institution must place at risk of downward adjustment all of a senior executive officer's or significant risk-taker's incentive-based compensation amounts not yet awarded for the current performance period, including amounts payable under long-term incentive plans.

(2) Events triggering forfeiture and downward adjustment review. At a minimum, a Level 1 or Level 2 covered institution must consider forfeiture and downward adjustment of incentive-based compensation of senior executive officers and significant risk-takers described in paragraph (b)(3) of this section due to any of the following adverse outcomes at the covered institution:

(i) Poor financial performance attributable to a significant deviation from the risk parameters set forth in the covered institution's policies and procedures;

(ii) Inappropriate risk taking, regardless of the impact on financial performance;

(iii) Material risk management or control failures;

(iv) Non-compliance with statutory, regulatory, or supervisory standards that results in:

(A) Enforcement or legal action against the covered institution brought by a federal or state regulator or agency; or

(B) A requirement that the covered institution report a restatement of a financial statement to correct a material error; and



(v) Other aspects of conduct or poor performance as defined by the covered institution.

(3) Senior executive officers and significant risk-takers affected by forfeiture and downward adjustment. A Level 1 or Level 2 covered institution must consider forfeiture and downward adjustment for a senior executive officer or significant risk-taker with direct responsibility, or responsibility due to the senior executive officer's or significant risk-taker's role or position in the covered institution's organizational structure, for the events related to the forfeiture and downward adjustment review set forth in paragraph (b)(2) of this section.

(4) Determining forfeiture and downward adjustment amounts. A Level 1 or Level 2 covered institution must consider, at a minimum, the following factors when determining the amount or portion of a senior executive officer's or significant risk-taker's incentive-based compensation that should be forfeited or adjusted downward:

(i) The intent of the senior executive officer or significant risk-taker to operate outside the risk governance framework approved by the covered institution's board of directors or to depart from the covered institution's policies and procedures;

(ii) The senior executive officer's or significant risk-taker's level of participation in, awareness of, and responsibility for, the events triggering the forfeiture and downward adjustment review set forth in paragraph (b)(2) of this section;

(iii) Any actions the senior executive officer or significant risk-taker took or could have taken to prevent the events triggering the forfeiture and downward adjustment review set forth in paragraph (b)(2) of this section;

- (iv) The financial and reputational impact of the events triggering the forfeiture and downward adjustment review set forth in paragraph (b)(2) of this section to the covered institution, the line or sub-line of business, and individuals involved, as applicable, including the magnitude of any financial loss and the cost of known or potential subsequent fines, settlements, and litigation;
  - (v) The causes of the events triggering the forfeiture and downward adjustment review set forth in paragraph (b)(2) of this section, including any decision-making by other individuals; and
  - (vi) Any other relevant information, including past behavior and past risk outcomes attributable to the senior executive officer or significant risk-taker.
- (c) Clawback. A Level 1 or Level 2 covered institution must include clawback provisions in 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 from a current or former senior executive officer or significant risk-taker for seven years following the date on which such compensation vests, if the covered institution determines that the senior executive officer or significant risk-taker engaged in:
- (1) Misconduct that resulted in significant financial or reputational harm to the covered institution;
  - (2) Fraud; or
  - (3) Intentional misrepresentation of information used to determine the senior executive officer or significant risk-taker's incentive-based compensation.

**§ 1232.8 Additional prohibitions for Level 1 and Level 2 covered institutions.**

An incentive-based compensation arrangement at a Level 1 or Level 2 covered institution will be considered to provide incentives that appropriately balance risk and reward for purposes of § 1232.4(c)(1) only if such institution complies with the following prohibitions.

- (a) Hedging. A Level 1 or Level 2 covered institution must not purchase a hedging instrument or similar instrument on behalf of a covered person to hedge or offset any decrease in the value of the covered person's incentive-based compensation.
- (b) Maximum incentive-based compensation opportunity. A Level 1 or Level 2 covered institution must not award incentive-based compensation to:
  - (1) A senior executive officer in excess of 125 percent of the target amount for that incentive-based compensation; or
  - (2) A significant risk-taker in excess of 150 percent of the target amount for that incentive-based compensation.
- (c) Relative performance measures. A Level 1 or Level 2 covered institution must not use incentive-based compensation performance measures that are based solely on industry peer performance comparisons.
- (d) Volume driven incentive-based compensation. A Level 1 or Level 2 covered institution must not provide incentive-based compensation to a covered person that is based solely on transaction revenue or volume without regard to transaction quality or compliance of the covered person with sound risk management.

**§ 1232.9 Risk management and controls requirements for Level 1 and Level 2 covered institutions.**

An incentive-based compensation arrangement at a Level 1 or Level 2 covered institution will be considered to be compatible with effective risk management and controls for purposes of § 1232.4(c)(2) only if such institution meets the following requirements.

- (a) A Level 1 or Level 2 covered institution must have a risk management framework for its incentive-based compensation program that:
  - (1) Is independent of any lines of business;
  - (2) Includes an independent compliance program that provides for internal controls, testing, monitoring, and training with written policies and procedures consistent with § 1232.11; and
  - (3) Is commensurate with the size and complexity of the covered institution's operations.
  
- (b) A Level 1 or Level 2 covered institution must:
  - (1) Provide individuals engaged in control functions with the authority to influence the risk-taking of the business areas they monitor; and
  - (2) Ensure that covered persons engaged in control functions are compensated in accordance with the achievement of performance objectives linked to their control functions and independent of the performance of those business areas.
  
- (c) A Level 1 or Level 2 covered institution must provide for the independent monitoring of:

- (1) All incentive-based compensation plans in order to identify whether those plans provide incentives that appropriately balance risk and reward;
- (2) Events related to forfeiture and downward adjustment reviews and decisions of forfeiture and downward adjustment reviews in order to determine consistency with § 1232.7(b); and
- (3) Compliance of the incentive-based compensation program with the covered institution's policies and procedures.

**§ 1232.10 Governance requirements for Level 1 and Level 2 covered institutions.**

An incentive-based compensation arrangement at a Level 1 or Level 2 covered institution will not be considered to be supported by effective governance for purposes of § 1232.4(c)(3), unless:

- (a) The covered institution establishes a compensation committee composed solely of directors who are not senior executive officers to assist the board of directors in carrying out its responsibilities under § 1232.4(e); and
- (b) The compensation committee established pursuant to paragraph (a) of this section obtains:
  - (1) Input from the risk and audit committees of the covered institution's board of directors, or groups performing similar functions, and risk management function on the effectiveness of risk measures and adjustments used to balance risk and reward in incentive-based compensation arrangements;
  - (2) A written assessment of the effectiveness of the covered institution's incentive-based compensation program and related compliance and control processes in providing risk-taking incentives that are consistent with the risk profile of the covered institution, submitted on an annual or more frequent basis by the

management of the covered institution and developed with input from the risk and audit committees of its board of directors, or groups performing similar functions, and from the covered institution's risk management and audit functions; and

- (3) An independent written assessment of the effectiveness of the covered institution's incentive-based compensation program and related compliance and control processes in providing risk-taking incentives that are consistent with the risk profile of the covered institution, submitted on an annual or more frequent basis by the internal audit or risk management function of the covered institution, developed independently of the covered institution's management.

**§ 1232.11 Policies and procedures requirements for Level 1 and Level 2 covered institutions.**

A Level 1 or Level 2 covered institution must develop and implement policies and procedures for its incentive-based compensation program that, at a minimum:

- (a) Are consistent with the prohibitions and requirements of this part;
- (b) Specify the substantive and procedural criteria for the application of forfeiture and clawback, including the process for determining the amount of incentive-based compensation to be clawed back;
- (c) Require that the covered institution maintain documentation of final forfeiture, downward adjustment, and clawback decisions;
- (d) Specify the substantive and procedural criteria for the acceleration of payments of deferred incentive-based compensation to a covered person, consistent with § 1232.7(a)(1)(iii)(B) and (a)(2)(iii)(B));

- (e) Identify and describe the role of any employees, committees, or groups authorized to make incentive-based compensation decisions, including when discretion is authorized;
- (f) Describe how discretion is expected to be exercised to appropriately balance risk and reward;
- (g) Require that the covered institution maintain documentation of the establishment, implementation, modification, and monitoring of incentive-based compensation arrangements, sufficient to support the covered institution's decisions;
- (h) Describe how incentive-based compensation arrangements will be monitored;
- (i) Specify the substantive and procedural requirements of the independent compliance program consistent with § 1232.9(a)(2); and
- (j) Ensure appropriate roles for risk management, risk oversight, and other control function personnel in the covered institution's processes for:
  - (1) Designing incentive-based compensation arrangements and determining awards, deferral amounts, deferral periods, forfeiture, downward adjustment, clawback, and vesting; and
  - (2) Assessing the effectiveness of incentive-based compensation arrangements in restraining inappropriate risk-taking.

**§ 1232.12 Indirect actions.**

A covered institution must not indirectly, or through or by any other person, do anything that would be unlawful for such covered institution to do directly under this part.

**§ 1232.13 Enforcement.**

The provisions of this part shall be enforced under subtitle C of the Safety and Soundness Act (12 U.S.C. ch. 46 subch. III).

**§ 1232.14 Covered institutions in conservatorship or receivership.**

- (a) Scope. This section applies to covered institutions that are in conservatorship or receivership, or are limited-life regulated entities, under the Safety and Soundness Act.
  
- (b) Compensation requirements. For a covered institution subject to this section, the requirements that would otherwise apply under this part shall be those that are determined by the Agency to best fulfill the requirements and purposes of 12 U.S.C. 5641, taking into consideration the possible duration of the covered institution's conservatorship or receivership, the nature of the institution's governance while under conservatorship or receivership, the need to attract and retain management and other talent to such an institution, the limitations on such an institution's ability to employ equity-like instruments as incentive-based compensation, and any other circumstances deemed relevant in the judgment of the Agency. The Agency may determine appropriate transition terms and provisions in the event that the covered institution ceases to be within the scope of this section.