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MEMORANDUM

February 8, 2011

To Our Clients and Friends

Re: Proposed Rule on Incentive-Based Compensation

The Federal Deposit Insurance Corporation (“FDIC”) has proposed a rule (“Proposed Rule”) to implement the provision of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”) which prohibits certain incentive-based payment arrangements. The Proposed Rule will be issued jointly by the Federal banking agencies and the Securities and Exchange Commission.¹ Comments are due 45 days after publication in the *Federal Register*.

The Proposed Rule applies to financial institutions with assets of \$1 billion or more. The Proposed Rule provides as follows:

- Prohibits incentive-based compensation arrangements that encourage inappropriate risks by providing excessive compensation; Compensation is excessive when it is unreasonable or disproportionate to the services performed, taking into account several enumerated factors
- Prohibits incentive-based compensation arrangements that would encourage inappropriate risks that could lead to material financial loss
- Requires compensation arrangements that balance risks and rewards, such as deferral of payments and extended performance periods
- Requires annual reports on incentive-based compensation arrangements to the appropriate Federal regulator

¹ Institutions covered by the Dodd-Frank Act compensation provision include depository institutions and their holding companies, registered broker-dealers, credit unions, investment advisors, Fannie Mae, Freddie Mac and any other financial institution the Federal agencies determine should be covered.

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The Proposed Rule contains heightened standards for institutions with assets of \$50 billion or more.

- At least 50 percent of annual incentive-based payments for executive officers must be deferred and paid over three years, and adjusted to reflect losses or other performance measures during the deferral period
- The institution's board is required to identify employees who have the ability to expose the institution to substantial losses (e.g., traders with large position limits) and establish incentive compensation that balances risks and rewards

A copy of the Proposed Rule can be found on our website at <http://www.schwartzandballen.com/news.html>

If you have any questions, please call Gilbert Schwartz, Robert Ballen, Tom Fox Heidi Wicker or Lauren Bianchini at (202) 776-0700.