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**M E M O R A N D U M**

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To Our Clients and Friends

Re: Proposed Rule on Incentive-Based Compensation

The Federal financial regulatory agencies (“Agencies”)<sup>1</sup> are requesting comment on a proposed rule that prohibits certain incentive-based payment arrangements that encourage inappropriate risks by financial institutions. The proposed rule is required by the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”). Comments are due 45 days after publication in the *Federal Register*.

The proposed rule, which applies to financial institutions with assets of \$1 billion or more, provides the following:

- Prohibits incentive-based compensation arrangements that encourage inappropriate risks that could lead to material financial loss  
Compensation is excessive when it is unreasonable or disproportionate to the services performed
- Requires compensation arrangements that balance risks and rewards, such as deferral of payments and extended performance periods
- Requires annual reports to the appropriate Federal regulator describing the institution’s incentive-based compensation arrangements

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<sup>1</sup> The Dodd-Frank Act compensation provisions cover depository institutions, depository institution holding companies, U.S. branches and agencies of foreign banks, credit unions, registered broker-dealers, investment advisors, Fannie Mae, Freddie Mac and any other financial institution the Agencies determine should be covered.

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The proposed rule establishes heightened standards for institutions with assets of \$50 billion or more. These include the following:

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

The Agencies propose to make the terms of the proposed rule effective six months after it is adopted.

A copy of the 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.