Press Release

FEDERAL RESERVE press release

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**For immediate release**

The Federal Reserve Board on Thursday issued a proposal designed to ensure that the incentive compensation policies of banking organizations do not undermine the safety and soundness of their organizations.

The proposal includes two supervisory initiatives. One, applicable to 28 large, complex banking organizations, will review each firm's policies and practices to determine their consistency with the principles for risk-appropriate incentive compensation set forth in the proposal. These firm-specific policies will be assessed by supervisors in a special "horizontal review," a coordinated examination of practices at the 28 firms. The policies and implementing practices adopted by these firms in response to the final supervisory principles will become a part of the supervisory expectations for each firm and will be monitored for compliance.

Second, supervisors will review compensation practices at regional, community, and other banking organizations not classified as large and complex as part of the regular, risk-focused examination process. These reviews will be tailored to take account of the size, complexity, and other characteristics of the banking organization.

"Compensation practices at some banking organizations have led to misaligned incentives and excessive risk-taking, contributing to bank losses and financial instability," Federal Reserve Chairman Ben S. Bernanke said. "The Federal Reserve is working to ensure that compensation packages appropriately tie rewards to longer-term performance and do not create undue risk for the firm or the financial system."

Federal Reserve Governor Daniel K. Tarullo noted that the proposal on compensation practices is an important part of the Federal Reserve's ongoing effort to improve financial regulation.

"Today's proposal is but one part of a broad program by the Federal Reserve to strengthen supervision of banks and bank holding companies in the wake of the financial crisis," Tarullo said. "In customizing the implementation of our compensation principles to the specific activities and risks of banking organizations, we advance our goal of an effective, efficient regulatory system."

Flaws in incentive compensation practices were one of many factors contributing to the financial crisis. Inappropriate bonus or other compensation practices can incent senior executives or lower level employees, such as traders or mortgage officers, to take imprudent risks that significantly and adversely affect the firm. With that in mind, the Federal Reserve's guidance and supervisory reviews cover all employees who have the ability to materially affect the risk profile of an organization, either individually, or as part of a group.

The findings from these reviews will be incorporated into the banking organization's supervisory ratings. In appropriate circumstances, the Federal Reserve may require an organization to develop a corrective action plan to rectify deficiencies in its incentive compensation programs and processes.

To monitor and encourage improvements, Federal Reserve staff will prepare a report after the conclusion of 2010 on trends and developments in compensation practices at banking organizations.

Comments will be accepted on the proposed guidance for 30 days after publication in the *Federal Register*, which is expected shortly. The *Federal Register* notice is attached.

*Federal Register* notice: HTML | 91KB PDF

Questions and answers (25 KB PDF)