Supporting Statement
Guidance on Sound Incentive Compensation Practices
(OMB No. 3064-NEW)

A. Justification.

1. Circumstances that make the collection necessary:

The Federal Deposit Insurance Corporation (FDIC) requests emergency approval from the Office of Management and Budget (OMB) to implement the Guidance on Sound Incentive Compensation Policies (Guidance) (OMB No. 3064-NEW). The Paperwork Reduction Act (PRA) classifies recordkeeping requirements of agency guidance as an information collection.[1]

Incentive compensation practices in the financial services industry contributed to the financial crisis that began in 2007. Bank employees too often were rewarded for increasing short-term revenue or profit without adequate regard to the risks taken to achieve those results. These practices exacerbated the risks and losses at a number of banking organizations and resulted in the misalignment of the interests of employees with the long-term safety and soundness of their organizations. It is urgent that incentive compensation practices be brought under control through supervisory action.

The Guidance is based on three key principles that are designed to ensure that incentive compensation arrangements at a banking organization do not encourage employees to take excessive risks. These principles provide that incentive compensation arrangements should:

- Provide employees incentives that do not encourage excessive risk-taking beyond the organization's ability to effectively identify and manage risk;
- Be compatible with effective controls and risk management; and
- Be supported by strong corporate governance, including active and effective oversight by the organization's board of directors.

These principles and the Guidance are consistent with the Principles for Sound Compensation Practices adopted by the Financial Stability Board (FSB) in April 2009, as well as the Implementation Standards for those principles issued by the FSB in September 2009.

This Guidance would promote the prompt improvement of incentive compensation practices in the banking industry by providing a common prudential foundation for incentive compensation arrangements across banking organizations and promoting the overall movement of the industry towards better practices. Supervisory action could play a critical role in addressing misaligned compensation incentives, especially where issues of competition may make it difficult for individual firms to act alone. Through their actions, supervisors could help to better align the interests of managers and other

[1] 44 U.S.C. § 3501 et seq.

employees with organizations' long-term health and reduce concerns that making prudent modifications to incentive compensation arrangements might have adverse competitive consequences.

On October 27, 2009, the Board of Governors of the Federal Reserve System (FRB) published proposed guidance in the *Federal Register* for public comment titled Proposed Guidance on Sound Incentive Compensation Policies.[2] The comment period for this notice expired on November 27, 2009. The FRB received 31 comments and after review of the comments is now prepared to issue the Guidance in final form. The FDIC seeks approval to issue the Guidance jointly with the FRB. The Office of the Comptroller of the Currency (OCC) and the Office of Thrift Supervision (OTS) are also issuing the Guidance jointly with the FRB.

Given the issues of compensation competition within the financial services industry, the FDIC believes that the Guidance would have a greater effect on the industry if issued jointly with the FRB, OCC, and OTS. Joint guidance also would promote the consistent treatment of incentive compensation practices within institutions themselves. Acting together under the same Guidance, supervisors from the FDIC, the FRB, OCC and OTS could work to effectively rationalize the compensation policies within all banking organizations.

2. Use of the information:

The Guidance would help ensure that incentive compensation policies at insured state non-member banks do not encourage excessive risk-taking and are consistent with the safety and soundness of the organization. Under the Guidance, banks would be required to: (i) have policies and procedures that identify and describe the role(s) of the personnel and units authorized to be involved in incentive compensation arrangements, identify the source of significant risk-related inputs, establish appropriate controls governing these inputs to help ensure their integrity, and identify the individual(s) and unit(s) whose approval is necessary for the establishment or modification of incentive compensation arrangements; (ii) create and maintain sufficient documentation to permit an audit of the organization's processes for incentive compensation arrangements; (iii) have any material exceptions or adjustments to the incentive compensation arrangements established for senior executives approved and documented by its board of directors; and (iv) have its board of directors receive and review, on an annual or more frequent basis, an assessment by management of the effectiveness of the design and operation of the organization's incentive compensation system in providing risk-taking incentives that are consistent with the organization's safety and soundness.

3. Consideration of the use of improved information technology:

Insured state non-member banks may use any information technology that permits review by FDIC examiners.

4. Efforts to identify duplication:

[2] (74 FR 55227) (OP 1374)

The required information is unique and is not duplicative of any other information already collected.

5. Methods used to minimize burden if the collection has a significant impact on a substantial number of small entities:

The collection does not have a significant impact on a substantial number of small entities. Smaller institutions have less complex compensation incentives, if any, placing less burden on them.

6. Consequences to the Federal program if the collection were conducted less frequently:

Conducting the collection less frequently would present safety and soundness risks.

7. Special circumstances that would cause an information collection to be conducted in a manner inconsistent with 5 CFR Part 1320:

The information collection will be conducted in a manner consistent with 5 CFR Part 1320.

8. Efforts to consult with persons outside the agency:

FDIC has taken all practicable steps to consult with members of the public and interested agencies to minimize burden. The FDIC has worked extensively with the other Agencies and has taken into consideration all of the comments received by the FRB in response to their October 2009 proposed guidance.

9. Payment or gift to respondents:

None.

10. Any assurance of confidentiality:

To the extent that the FDIC collects the information during an examination, confidential treatment may be afforded to the records under exemption 8 of the Freedom of Information Act, 5 U.S.C. 552(b)(8).

11. Justification for questions of a sensitive nature:

There are no questions of a sensitive nature.

12. Burden estimate:

Estimated *Number of Respondents*: *Implementation of policies and procedures – large banks – 20; Implementation of policies and procedures – small banks -- 4,870; Maintenance of policies and procedures – 4,890.*

Estimated Burden per Respondent: Implementation of policies and procedures – large banks – 480 hours; Implementation of policies and procedures – small banks – 80 hours; Maintenance of policies and procedures – 40 hours.

Frequency of Response: Annually.

Total Annual Burden: 594,800 hours (399,200 hours for implementing policies and procedures is a one-time burden).

13. Estimate of total annual costs to respondents (excluding cost of hour burden in Item #12):

Not applicable.

14. Estimate of annualized costs to the Federal government:

Not applicable.

15. Change in burden:

Former Burden:
N/A

New Burden:
4,890 respondents; 594,800 burden hours

Difference:
+4,890 respondents; +594,800 burden hours

The program change (increase) is due to the implementation of a new collection.

16. Information regarding collections whose results are to be published for statistical use:

The FDIC has no plans to publish the information for statistical purposes.

17. Reasons for not displaying OMB approval expiration date:

If approved, the FDIC would display the OMB approval expiration date.

18. Exceptions to the certification statement in Item 19 of OMB Form 83-I:

There are no exceptions to the certification statement in item 19 of OMB Form 83-I.

B. Collections of Information Employing Statistical Methods.

This information collection does not employ statistical methods.