

**Supporting Statement for the
Recordkeeping Requirements Associated with the
Guidance on Sound Incentive Compensation Policies
(FR 4027; OMB No. 7100-0327)**

Summary

The Board of Governors of the Federal Reserve System, under delegated authority from the Office of Management and Budget (OMB), proposes to extend, without revision, the voluntary Recordkeeping Requirements Associated with the Guidance on Sound Incentive Compensation Policies (the Guidance) (FR 4027; OMB No. 7100-0327). The guidance is based on three key principles. These principles provide that incentive compensation arrangements at a banking organization should 1) provide employees incentives that appropriately balance risk and reward, 2) be compatible with effective controls and risk-management, and 3) be supported by strong corporate governance, including active and effective oversight by the organization's board of directors. The Paperwork Reduction Act (PRA) classifies recordkeeping requirements contained in agency guidance as an information collection.¹

The Board identified certain aspects of the guidance (policies and procedures) that constitute a collection of information. Under Principle 2 of the Guidance (*Compatibility with Effective Controls and Risk Management*) a banking organization should establish strong controls governing its process for designing, implementing, and monitoring incentive compensation arrangements. Under Principle 3 of the Guidance (*Strong Corporate Governance*) a banking organization's board of directors should review and approve the overall goals and purposes of the firm's incentive compensation system. The board of directors should provide clear direction to management to ensure that its policies and procedures are carried out in a manner that achieves balance and is consistent with safety and soundness.

The Board's annual burden is estimated to be 231,200 hours for the 5,710 banking organizations that are likely to be subject to the Guidance.² There are no required reporting forms associated with the Guidance.

Background and Justification

Incentive compensation practices in the financial services industry were one of many factors contributing to the financial crisis that began in 2007. Banking organizations too often rewarded employees for increasing the firm's short-term revenue or profit without adequate recognition of the risks the employees' activities posed for the firm. More importantly, problematic compensation practices were not limited to the most senior executives at financial firms. Compensation practices can encourage employees at various levels of a banking organization, either individually or as a group, to undertake imprudent risks that can significantly and adversely affect the risk profile of the firm.

¹ 44 U.S.C. § 3501 *et seq.*

² As used in the guidance, the term "banking organization" includes U.S. bank holding companies, savings and loan holding companies, state member banks, Edge Act and agreement corporations, and the U.S. operations of foreign banks with a branch, agency, or commercial lending company subsidiary in the United States.

The Guidance was developed to help protect the safety and soundness of banking organizations and promote the prompt improvement of incentive compensation practices throughout the banking industry. In addition, the guidance is 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.

On June 25, 2010, the Federal Reserve published a joint³ final notice in the *Federal Register* (75 FR 36395) implementing the recordkeeping provisions associated with the Guidance, effective June 25, 2010.

Description of Information Collection

Compatibility with Effective Controls and Risk Management

Principle 2 of the Guidance states that a banking organization should have strong controls governing its process for designing, implementing, and monitoring incentive compensation arrangements. An organization's policies and procedures should:

- identify and describe the role(s) of the personnel, business units, and control units authorized to be involved in the design, implementation, and monitoring of incentive compensation arrangements;
- identify the source of significant risk-related inputs into these processes and establish appropriate controls governing the development and approval of these inputs to help ensure their integrity; and
- identify the individual(s) and control unit(s) whose approval is necessary for the establishment of new incentive compensation arrangements or modification of existing arrangements. Banking organizations also should create and maintain sufficient documentation to permit an audit of the organization's processes for establishing, modifying, and monitoring incentive compensation arrangements.

The Guidance also states that a banking organization should conduct regular internal reviews to ensure that its processes for achieving and maintaining balanced incentive compensation arrangements are consistently followed. Such reviews should be conducted by audit, compliance, or other personnel in a manner consistent with the organization's overall framework for compliance monitoring. An organization's internal audit department also should separately conduct regular audits of the organization's compliance with its established policies and controls relating to incentive compensation arrangements. The results should be reported to appropriate levels of management and, where appropriate, the organization's board of directors.

³ The proposed guidance was developed initially by the Federal Reserve; however, it was subsequently finalized jointly with the Office of the Comptroller of the Currency (OCC) (Guidance on Sound Incentive Compensation Practices (OMB No. 1557-0245)), the Federal Deposit Insurance Corporation (FDIC) (Interagency Guidance on Sound Incentive Compensation Practices (OMB No. 3064-0175)), and the Office of Thrift Supervision (OTS) (the agencies). Note: As part of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the OTS was abolished and its functions and powers were transferred to the OCC, FDIC, and the Federal Reserve.

Strong Corporate Governance

Principle 3 of the Guidance states that the board of directors should review and approve the overall goals and purposes of the firm's incentive compensation system. The board of directors should provide clear direction to management to ensure that its policies and procedures are carried out in a manner that achieves balance and is consistent with safety and soundness.

The board of directors should approve and document any material exceptions or adjustments to the incentive compensation arrangements established for senior executives and should carefully consider and monitor the effects of any approved exceptions or adjustments on the balance of the arrangement, the risk-taking incentives of the senior executive, and the safety and soundness of the organization.

The board of directors should receive and review, on an annual or more frequent basis, an assessment by management, with appropriate input from risk management personnel, 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. These reports should include an evaluation of whether or how incentive compensation practices may be encouraging excessive risk taking. These reviews and reports should be appropriately scoped to reflect the size and complexity of the banking organization's activities and the prevalence and scope of its incentive compensation arrangements. In addition, at banking organizations that are significant users of incentive compensation arrangements, the board should receive periodic reports that review incentive compensation awards and payments relative to risk outcomes on a backward-looking basis to determine whether the organization's incentive compensation arrangements may be promoting excessive risk-taking.

Respondent Panel

The guidance applies to all the banking organizations supervised by the agencies, including national banks, state member banks, state nonmember banks, savings associations, U.S. bank holding companies, savings and loan holding companies, the U.S. operations of foreign banks with a branch, agency or commercial lending company in the United States, and Edge Act and agreement corporations.

Time Schedule for Information Collection

The recordkeeping requirements are documented on occasion. Bank examiners would verify compliance with this recordkeeping requirement during examinations. The documentation required by the Guidance is maintained by each institution; therefore, are not collected or published by the Federal Reserve System.

Legal Status

The Board's Legal Division has determined that this information collection is authorized pursuant to sections 9, 11(a), 11(i), 25, and 25A of the Federal Reserve Act (12 U.S.C. §§ 248(a), 248(i), 324, 602, and 625), section 5 of the Bank Holding Company Act (12 U.S.C. §

1844), section 7(c) of the International Banking Act (12 U.S.C. § 3105(c)), and section 10(b)(2) of the Home Owners' Loan Act (12 U.S.C. § 1467a(b)(2)). Because the recordkeeping requirements are contained within guidance (and not a statute or regulation) they are voluntary.

Because the records will be maintained by each banking institution, the Freedom of Information Act (FOIA) would only be implicated if the Board's examiners retained a copy of the records as part of an examination or supervision of the banking institution. To the extent the Board collects this information during the course of an examination or supervision of a banking institution, the information is considered confidential under exemption 8 of the FOIA (5 U.S.C. § 552(b)(8)). In addition, the information may also be kept confidential under exemption 4 of the FOIA which protects commercial or financial information obtained from a person that is privileged or confidential (5 U.S.C. § 552(b)(4)).

Consultation Outside the Agency

On June 23, 2015, the Federal Reserve published a notice in the *Federal Register* (80 FR 35953) requesting public comment for 60 days on the extension, without revision, of the FR 4027. The comment period for this notice expired on August 24, 2015. The Federal Reserve did not receive any comments. On September 11, 2015, the Federal Reserve published a final notice in the *Federal Register* (80 FR 54790) for the FR 4027.

Estimate of Respondent Burden

The Federal Reserve estimates that 5 large respondents would take, on average, 480 hours (two months) to modify policies and procedures to monitor incentive compensation. The Federal Reserve estimates that 5 small respondents would take, on average, 80 hours (two business weeks) to establish or modify policies and procedures to monitor incentive compensation. The total one-time burden is estimated to be 2,800 hours. In addition, the Federal Reserve estimates that, on a continuing basis, respondents would take, on average, 40 hours (one business week) each year to maintain policies and procedures to monitor incentive compensation arrangements and estimates the annual burden to be 228,400 hours. The total annual burden for the FR 4027 represents 1.75 percent of total Federal Reserve System paperwork burden.

FR 4027	<i>Number of respondents⁴</i>	<i>Annual frequency</i>	<i>Estimated average hours per response</i>	<i>Estimated annual burden hours</i>
One-time Implementation				
Large institutions	5	1	480	2,400
Small institutions	5	1	80	400
Ongoing maintenance	5,710	1	40	228,400
<i>Total</i>				231,200

⁴ Of these respondents, 5,058 are estimated to be small entities as defined by the Small Business Administration (i.e., entities with less than \$550 million in total assets) www.sba.gov/content/table-small-business-size-standards.

The estimated cost to the public for this information collection is \$11,964,600.⁵

Sensitive Questions

This collection of information contains no questions of a sensitive nature, as defined by OMB guidelines.

Estimate of Cost to the Federal Reserve System

Since records are maintained at the banking organization, the cost to the Federal Reserve System is negligible.

⁵ Total cost to the public was estimated using the following formula: percent of staff time, multiplied by annual burden hours, multiplied by hourly rates (30% Office & Administrative Support at \$17, 45% Financial Managers at \$63, 15% Lawyers at \$64, and 10% Chief Executives at \$87). Hourly rates for each occupational group are the (rounded) mean hourly wages from the Bureau of Labor and Statistics (BLS), *Occupational Employment and Wages May 2014*, published March 25, 2015, www.bls.gov/news.release/ocwage.nr0.htm. Occupations are defined using the BLS Occupational Classification System, www.bls.gov/soc/.