

# Coming Soon to a Bank Near You: Expanded Compensation Disclosure

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On October 19, we [posted](#) about the Federal Reserve's recently released [report](#) detailing its horizontal review of incentive compensation practices at 25 large banking organizations. The report notes that the Fed intends to implement the Pillar 3 compensation disclosure [requirements](#) adopted in July by the Basel Committee on Banking Supervision. The required disclosures are quite extensive (e.g., compared to the disclosures currently required for U.S. public companies). As the disclosures will be public, banks may be criticized for their compensation practices. On the plus side, banks will have a window into their peers' practices.

The Pillar 3 requirements are limited to disclosure and do not mandate particular forms or amounts of compensation. But if the impact of other disclosure regimes is any guide, the requirements may cause banks to modify their compensation practices. (Separately, the Fed, jointly with six other federal agencies, has proposed a rule under Section 956 of Dodd-Frank that would subject financial institutions to substantive compensation requirements—see our March 3 [memo](#)).

The Basel Committee expects banks to comply with the Pillar 3 requirements from January 1, 2012. But as the Fed's report does not specify when it intends to propose rules implementing the requirements, it is not clear when the requirements will apply to Fed-regulated banks. Nor is it clear how closely the Fed's rules will adhere to the letter of Pillar 3 or whether the Fed will propose its rules jointly with the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation (as it has for rules implementing previous Basel regulations).

Pillar 3 requires 18 qualitative and 11 quantitative disclosures, with the quantitative disclosures covering, and broken down between, senior management and other material risk takers. Here are a few examples:

## **Qualitative:**

- The types of employees considered senior managers and material risk takers, including the number of employees in each group.
- How the bank ensures that risk and compliance employees are compensated independently of the businesses they oversee.
- The measures the bank will implement to adjust remuneration if performance metrics are weak, including the bank's criteria for determining "weak" performance metrics.
- The bank's policy on deferral and vesting of variable compensation and, if the fraction of variable compensation that is deferred differs across employees or groups of employees, the factors that determine the fraction and their relative importance.

## **Quantitative:**

- The numbers and total amounts of guaranteed bonuses, sign-on awards and severance payments granted in the fiscal year.
- For deferred compensation, the total amount outstanding (with a breakdown by cash, equity, equity-based and other forms) and the total amount paid out in the fiscal year.

- For compensation generally, a breakdown by fixed/variable, deferred/non-deferred and form (cash, equity, equity-based and other forms).
- Information about employees' exposure to compensation adjustments, both implicit (e.g., fluctuations in the value of shares or performance units) and explicit (e.g., malus, clawbacks or similar reversals or downward revaluations of awards). Such information must include the total amount of outstanding compensation exposed to such adjustments and the total amount of reductions during the fiscal year, with the reductions broken out by those due to implicit versus explicit adjustments.

Banks are expected to provide the disclosures on one site or in one document. But Pillar 3 provides the Fed with discretion to permit banks to cross-reference to a different site or document if equivalent disclosure has already been made under an accounting or listing requirement relating to the same time period (e.g., proxy statement disclosure under Item 402 of Regulation S-K). The Fed also would have discretion to exempt banks fully or partly from the requirements, depending on the banks' risk profile, and to exempt certain types of compensation as immaterial, proprietary or confidential.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

**Barbara Nims**

+1 212 450 4591

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