

AN ALERT FROM THE BDO COMPENSATION & BENEFITS TAX PRACTICE

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## ► SUBJECT

## FDIC VOTES TO FINALIZE RULE ON CLAWBACKS OF EXECUTIVE PAY

## ► SUMMARY

A new rule adopted by the Federal Deposit Insurance Corporation (“FDIC”) allows regulators to take back up to two years of pay from former and current top executives and directors whose financial institutions were liquidated by the government. This rule comes as a result of the FDIC’s extended authority granted by the Dodd-Frank Wall Street Reform and Consumer Protection Act, enacted in July 2010 (the “Act”), to police the nation’s largest financial institutions in the event of their collapse order to prevent a crisis from spreading.

### NEW FDIC RESPONSIBILITIES:

Through the Act, the FDIC’s resolution authority was expanded from winding down failed banks to straightening out the affairs of any financial institution on the brink of collapse. When regulators decide that a bank is very close to failure, the FDIC is assigned to seek out buyers, take on some of the bank’s losses, or sell off bank assets to help cover any shortfall. The FDIC is deciding how the proceeds of those sales should be divided among those who are owed money by the failed bank.

This clawback provision was adopted as part of a broader rule aimed at setting the framework for the FDIC’s orderly liquidation powers. Lawmakers directed regulators to recover executive pay after incentive-based compensation was faulted for inspiring risk-taking at some of the nation’s largest financial institutions.

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According to the language of the new rule, an executive would be deemed liable if he or she failed to act “with the degree of skill and care an ordinarily prudent person in a like position would exercise under similar circumstances.” The FDIC is expected to determine the amount that it will recover from executives based on its assessment on how much of a role each official played in the shareholders’ overall losses after liquidation.

An earlier draft of the rule provided that any executive making strategic decisions for a financial institution could be held responsible for a bank’s failure. Banks objected to this proposal, arguing that this provision might cause key executives to leave at the first sign of trouble rather than risk losing their compensation.

It is anticipated that the recoupment of compensation will be through the court system using a procedure similar to the process the FDIC currently uses when it seeks recovery from individuals whose negligent actions have caused losses to failed institutions.

The former Chairman of the Board of the FDIC, Sheila Bair, whose resignation took effect shortly after this vote was taken, says “We need shareholders and creditors out there conducting their own due diligence and asking the tough questions of executives and management.”

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