

Statement of
John C. Dugan
Comptroller of the Currency
on the Federal Deposit Insurance Corporation's
Advance Notice of Proposed Rulemaking on Executive Compensation
January 12, 2010

Executive compensation is a topic that has drawn scrutiny from numerous quarters in recent years as Congress, the Executive Branch, financial institution regulators, and scholars have tried to understand the factors contributing to the recent financial crisis, and how to prevent a repeat of those events. There is little doubt that in the mix, some employee compensation schemes encouraged excessive risk-taking by financial institutions both large and small, to the detriment of both individual firms and the financial system as a whole. Legislators and regulators both here and in other countries are currently taking steps to address this problem. In so doing, however, they all confront the real and difficult issues that arise when the government treads closer to prescribing compensation types and levels for private businesses – a process that can also run the risk of substantially and unnecessarily increasing regulatory burden, especially for smaller institutions. While I believe that additional, carefully crafted steps by regulators to address executive compensation risk are appropriate, I do not believe that the draft ANPR is one of those steps – at least not at this time and not with the approach currently presented. I have two major concerns.

First, issuance of the ANPR would be premature. Congress has recently taken up legislation in this area. The Wall Street Reform and Consumer Protection Act passed by the House of Representatives in December included specific rulemaking requirements for all the financial regulators. Those rules would require the disclosure of all incentive-based compensation to the financial regulators, and prohibit incentive compensation that could threaten safety and soundness or have serious adverse effects on economic conditions or the economy. There is every reason to believe that a Senate bill would also address this topic with a similarly coordinated approach, which makes sense.

In addition, the Federal Reserve Board is currently developing significant guidance on sound incentive compensation programs covering all banking organizations, with material input from the other banking regulators. This supervisory approach would not prescribe or limit incentive compensation to a specific approach as would the features suggested in the ANPR. Rather it seeks to ensure that incentive compensation programs discourage excessive risk-taking and incorporate prudent risk management principles and effective quality controls. Unlike the uncertainty of waiting for legislative proposals to become law, coordination and consideration of the work of the Board is quite feasible. It would be very unfortunate to have an end result where insured institutions – and perhaps their holding companies – were subject to inconsistent schemes evaluating the risk of their executive compensation programs. I think we should wait until we have the results of the Board's efforts before heading down a path that could be both unnecessary and inconsistent.

This leads me to my second concern. I do not believe that a sufficient basis has been demonstrated to support the approach in the draft ANPR. While the FDIC's

rulemaking authority to establish a risk-based deposit insurance system is broad, it is not limitless. The risk factors used in the system must relate to the “probability that the Deposit Insurance Fund will incur a loss” with respect to a particular institution.

Citations in the preamble to works of academics and consultants simply do not provide an adequate basis to support the broad approach described in the ANPR. Nor are the Material Loss Reviews helpful to support the ANPR’s broad approach. These reviews deal with a limited, and arguably unrepresentative group of institutions, mostly smaller; when an MLR does mention excessive compensation, it tends to be general and not specific; and, when specific types of excessive compensation are mentioned, the situations are overwhelmingly ones where loans officers were rewarded simply based on volume of loans originated, without consideration of quality. In contrast, the ANPR’s very particular approach would apply to a much broader array of compensation arrangements – for banks large and small – for which there is no empirical connection to losses sustained by the deposit insurance fund.

In short, I have substantial concerns about trying to address the real problem of risky compensation arrangements through finely calibrated increases in deposit insurance assessments. Where there are clearly identified problems, I think we ought to address them first through supervisory guidance and direct examination and supervision, as the Federal Reserve Board process provides and the Congressional process plainly contemplates. Only if that is inadequate should we consider other measures.

For these reasons I cannot support the ANPR.