

Regulatory Bulletin
RB 27b

Handbook: **Thrift Activities**
Subject: **Oversight by the Board of Directors**

Section: 310

Compensation

Summary. This Bulletin provides guidance to examiners for review of compensation provisions. This Bulletin clarifies that this guidance applies to both mutual and stock institutions and re-emphasizes OTS policy to defer to healthy thrifts' boards of directors in compensation matters. OTS updated and incorporated into Section 310, Oversight by the Board of Directors, of the Thrift Activities Handbook, the required contract provisions, unsafe and unsound practices, and guidelines on reviewing contracts of troubled associations that were in RB 27a. Because these provisions are now in Section 310, OTS rescinded RB 27a. See RB 1-1c dated April 18, 2001.

For Further Information Contact: Your Regional Office or the Supervision Policy Division of the Office of Thrift Supervision.

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Thrift institutions need to offer competitive compensation packages to hire and retain experienced staff or individuals with specialized skills to successfully compete and when entering into new activities.

OTS recognizes that both mutual and stock associations have the same need to hire and retain competent employees. OTS also recognizes that many mutual institutions feel they are at a disadvantage in competing for talent with stock institutions who have more flexibility with compensation arrangements (e.g., granting stock options). OTS recognizes that mutual associations may use a combination of higher salaries, bonuses, and benefits to overcome this disadvantage.

OTS will ordinarily give healthy mutual and stock associations deference concerning compensation levels and compensation arrangements for their directors and senior executive officers, provided the arrangements are reasonable and do not present significant safety or soundness concerns that could lead to material financial loss or damage to the association. Examiners will consider all CAMELS factors, not just capital, in their review of employment contracts and other compensation arrangements.

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Board of Directors Responsibilities

OTS requires the board of directors of each association to adopt compensation plans that compensate their staffs adequately and allows the association to hire and retain qualified staff.

The board of directors must annually review all employment contracts and compensation arrangements for regulatory and competitiveness concerns. The board must document their justification and approval in the board minutes.

Directors of institutions who have a personal interest in the compensation arrangements should not participate in the deliberations or vote on the arrangements.

Definitions

Compensation includes any payment of money or provision of any other thing of value in consideration of employment, including, without limitation, base salary, commissions, bonuses, pension and profit-sharing plans, severance payments, retirement, director or committee fees, fringe benefits, payment of expense items without accountability or business purpose or that do not meet the IRS requirements for deductibility by the association. As a rule, OTS will not consider the grant or exercise of stock options compensation unless they are so material in amount or conditioned upon factors that result in incentives that cause supervisory concerns.

A senior executive officer, defined in 12 CFR § 563.555, is any individual who performs the functions of one or more of the following positions (without regard to title, salary, or compensation): president, chief executive officer, chief operating officer, chief financial officer, chief lending officer, chief investment officer. Senior executive officer also includes any other person identified by OTS in writing as an individual who exercises significant influence over, or participates in, major policymaking decisions, whether or not hired as an employee.

A director is any individual who is a member of the board of directors of the association or of any subsidiary of the association.

An employment contract is any agreement, intended to be legally enforceable, that materially affects the terms and conditions of a person's employment.

Requirements for Compensation Plans

12 CFR Part 570 prohibits excessive compensation and compensation that could lead to a material financial loss to an institution and both are unsafe and unsound practices.

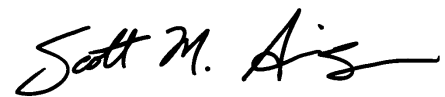
Compensation arrangements are reasonable if they are comparable to compensation practices at institutions of comparable asset size, geographic location and the complexity of the loan portfolio or other assets.

Peer groups may be composed of all stock, all mutual, or a mixed group of similar sized institutions.

Incentive-based Compensation

An increasing number of businesses today rely on incentive pay to motivate managers and employees to excel. OTS encourages incentive-based compensation but prohibits arrangements that provide incentives contrary to the safe and sound operation of the association. For example, compensation based primarily on short-term operating results may encourage unreasonable risk-taking to achieve short-term profits. The board of directors should closely monitor compensation tied to current operating results.

In many cases, stock-based compensation provides incentives. Because stock-based compensation plans are unavailable to mutuals, they use bonuses and profit-sharing plans to provide incentive compensation. Both mutual and stock charters sometimes use phantom stock options to provide incentive compensation.



—*Scott M. Albinson*

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