

Regulatory Bulletin

Handbook: Thrift Activities

Section: 140

Subject: Oversight

RB 27

RB 27 was rescinded 01/13/95 by RB 27a. Click [HERE](#) to link to RB 27a.

November 8, 1991

RESCINDED

Summary: This bulletin provides guidance to regulatory personnel for review of employment contracts and clarifies OTS policy regarding unsafe and unsound practices relating to executive compensation and employment contracts contained in 12 C.F.R. §§ 563.39 and 563.161.

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

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The Director of the Office of Thrift Supervision (OTS) has authority under Section 4(a)(1) of the Home Owners' Loan Act to provide for the safe and sound operation of savings associations. Section 8(b)(6) of the Federal Deposit Insurance Act authorizes each regulatory agency to take actions to limit the terms of, or to prohibit an insured depository institution from entering into or making payments under any contracts between an insured depository institution and an institution-affiliated party that constitute an unsafe or unsound banking practice.

General Policy

As a general rule, the OTS will defer to the savings association's board of directors concerning executive compensation arrangements, provided the following conditions are met:

- The savings association is not a problem association, i.e., the association is in compliance with its current minimum capital requirements and has not otherwise been designated a problem association.

- The compensation arrangements do not present any safety or soundness concerns as specified in this bulletin.

The OTS requires the board of directors of the association to annually review all employment contracts and compensation arrangements for senior executive officers and document their justification and approval in the board minutes. Only those directors that have no personal interest in the contract should discuss or vote on the contract.

Prior Approval Requirement

Supervisory personnel should ensure that all problem associations are subject to written agreements that require them to submit employment contracts for senior executive officers and directors to the Regional Director for prior review. The Regional Director may extend this requirement to other employees of the savings association as well.

Definitions

"Compensation" includes salary, 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, and any other employee compensation.

A "senior executive officer" includes any individual who exercises significant influence over, or participates in major policymaking decisions of a savings association without regard to title, salary, or compensation. The term includes but is not limited to the president, chief executive officer, chief operating officer, chief financial officer, chief lending officer, chief investment officer, general counsel, or their functional equivalents.

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 that materially affects the terms and conditions of a person's employment.

"Problem" associations are defined as those with a composite MACRO rating of 4 or 5 or associations failing any one of their minimum regulatory capital requirements, or any other association that has been notified by regulators of problem status.

Unsafe or Unsound Practices

The following guidelines are illustrative, not exhaustive, examples of compensation provisions considered unsafe or unsound. Other compensation provisions may also be objectionable depending on individ-

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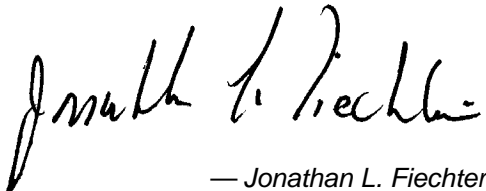
ual circumstances. These guidelines should be followed when compensation is reviewed: 1) during examinations; 2) in conjunction with applications that contain compensation arrangements; and 3) when employment contracts and compensation payments are submitted by problem associations and associations under a written agreement.

- Compensation arrangements that provide incentives contrary to the safe and sound operation of the association. For example, compensation based primarily on current operating results may encourage unreasonable risk-taking to achieve short-term profits. Compensation tied to operating results should be closely monitored by the board of directors.
- Compensation arrangements that provide for excessive compensation when compared with compensation paid to persons with similar responsibilities and duties in other insured institutions of similar size, in similar locations, and under similar circumstances, including health and profitability.
- Contracts that contain automatic renewals or extensions of the contract without providing for

explicit review and approval by the board of directors.

- Contracts that provide for an excessive term. As a general matter, a one-year term is not objectionable; a term exceeding three years is generally objectionable.
- Contracts that have severance pay arrangements greater than the individual's annual salary for the immediately preceding year.
- Combined compensation from any severance provision and remaining employment contract terms should not exceed three times the employee's annualized salary or trigger a penalty tax under the "golden parachute" provisions of the Internal Revenue Code.
 - NOTE: The savings association may, depending upon its condition, be subject to the prohibitions on "golden parachute" payments contained in Section 2523 of the Omnibus Crime Bill (to be codified at 12 U.S.C. 1828 (k)). If so, no severance payments will be permitted, except in accordance with any requirements imposed by the FDIC.

- Contracts that do not adequately reflect or define the duties and responsibilities of the employee.
- Compensation programs (including deferred compensation/retirement/insurance) for independent directors that are not commensurate with their duties, or that jeopardize their independence, such as vesting requirements that would require an independent director to forfeit previously accrued amounts if they did not serve for a minimum number of years.
- Contracts that are collateralized or otherwise guaranteed by the savings association, unless the contract terms provide that the contract is unenforceable if the association becomes troubled, or the contract is approved by the Regional Director. Guarantees provided solely by the holding company are permissible.
- Contracts that provide for employer reimbursement of costs incurred by employees seeking to enforce employment contract terms in the absence of legal judgment or settlement.



— Jonathan L. Fiechter
Deputy Director for Washington Operations