



ALVAREZ & MARSAL INSIGHTS

ON DEVELOPMENTS IN INCENTIVE COMPENSATION

Executive Summary

- There have been several recent occurrences of “conduct related” risk management mishaps resulting in sizeable Reputational, Regulatory and Financial risk.
- In the occurrence of these mishaps, multiple levels of control have failed driven by a misalignment of governance, risk expectations, monitoring, supervision, sales practices, recognition and reward mechanisms.
- What risk management failures contributed to these events? What processes and tools for constructing, assessing, validating and remediating risk management are necessary to manage and mitigate these risks?

The Sales Practice Environment

The current sales practice environment is faced with heightened scrutiny given recent public exposure and regulatory developments. This is an outgrowth of the rapid evolution of the new Fiduciary Era, increased transparency and the advancement of social media. This is not fleeting.

- **Headline risk:** Wells Fargo, Citizens Bank, TCF Bank, Volkswagen, Deutsche Bank, Yahoo and Mylan, along with new instances every week
- **Heightened regulatory requirements:** Federal Deposit Insurance Corporation (FDIC), Federal Housing Finance Agency (FHFA), Federal Reserve Bank (FRB), National Credit Union Administration (NCUA), Office of the Comptroller of the Currency (OCC) and U.S. Securities and Exchange Commission (SEC) are all reviewing incentive compensation in regulatory exams, horizontal reviews (i.e., OCC); new regulations are forthcoming in response to Dodd-Frank section 956
- **Broad ranging risk dimensions:** headline risk, reputational risk, strategic risk, financial risk, vendor risks and going concern risk
- **Impact on all stakeholders or constituencies:** shareholders, consumers, employees, investors, proxy agencies and the public at large

Horizontal Survey

The OCC sent an informational survey in October 2016 to the top covered systemically important financial institutions (SIFIs), and several midsize institutions, inquiring as to the sales and compensation practices of each firm. As of this date, the OCC has not provided feedback or findings. While specific direction should be expected in either handbook form or as additional “focus” items in upcoming annual examinations, the industry should expect that the guidelines will closely align with certain themes already identified in the regulatory environment as “best practice.”

Guiding Principles

These principles are informed by our experience and our research of the industry and regulatory trends and developments, including upcoming regulations:

- **Three General Risk Principles:**

- Is incentive pay as a percentage of total pay too risky? Does the mix of base and incentive pay overly incent risky behavior?
- Is the range of incentive pay broad enough to not incentivize overly risky behavior but not too broad to negatively impact profitability by over incentivizing employees?
- Does the performance measure include a proper mix of counter balancing metrics (rate of return, net new money, etc.)?

- **Sales Practice / Compensation and Reward Principles:**

- Identify “significant risk taker” positions in your company (i.e., covered person)
- Ensure incentives do not encourage inappropriate risk and appropriately balance risk and reward
- Ensure incentive compensation paid is not unreasonable or disproportionate to the value of the services performed
- Ensure the incentive compensation program has appropriate deferrals, downward adjustments, forfeitures and clawback provisions to reduce incentive compensation at all stages of compensation including a period only determinable after a long period of time; this is to balance short term and long term results and related incentive compensation
- Ensure there are robust and effective corporate governance, risk management, policies and procedures, internal controls and supervisory standards to construct, implement, manage, monitor and report on the incentive compensation program

What can you do today?

- Self-disclose and begin remediation, if during your horizontal submission, or on subsequent reflection and review, you identified any shortcomings in the makeup and administration of your employee compensation and incentive approach
- Anticipate and proactively prepare for related questions and review around incentive compensation during the 2017 OCC Examination cycle
- Revisit and update your Business Risk Assessment requirements to ensure appropriate consideration and coverage
- Review first, second and third layers of defense governance, supervision, monitoring and independent control
- Seek best practice guidance

How can Alvarez & Marsal (A&M) help?

- Support to existing “known” issues; confirmation, sizing, action plan development, execution support and sustainability testing
- Development of Rapid Risk Assessment targeted against specific business development environments including current state assessment, testing, gap identification and risk weighting and prioritization
- Development and implementation of Remediation Plan resulting from Rapid Risk Assessment

A&M Senior Leadership



Craig Walling
Managing Director
A&M Financial Industry Advisory Services
+1 212 763 9570
cwalling@alvarezandmarsal.com

Craig Walling provides transformation services within the wealth management sector of the financial services industry. He has over 30 years of executive leadership experience, including operating expertise across asset management, banking, financial planning, trust and estate, and family office verticals, as well as a strong record of accomplishment in enterprise restructuring, regulatory compliance and value creation activities.



Samuel P. Golden
Managing Director and Senior Advisor
A&M Financial Industry Advisory Services
+1 713 221 3922
sgolden@alvarezandmarsal.com

With nearly 34 years of executive leadership experience in the financial services industry, Sam Golden focuses on guiding financial institutions through complex and challenging economic periods. Mr. Golden is the founding Managing Director of A&M's Financial Industry practice and for eight years, he served as the CEO or co-CEO of that business. Prior to joining A&M, Mr. Golden served with the Office of the Comptroller of the Currency (OCC), the regulator and administrator of the National Banking Industry, in a variety of leadership roles, including the Ombudsman and Senior Deputy Comptroller, Member of the Executive Committee and Chairman of the Audit Subcommittee.



Anthony Gibbs
Managing Director
A&M Financial Industry Advisory Services
+1 312 833 0780
agibbs@alvarezandmarsal.com

Anthony Gibbs specializes in all aspects of governance, enterprise risk management, regulatory compliance, and process and system optimization. His primary areas of focus are Consumer Financial Protection laws and regulations and designing and building effective, efficient and sustainable enterprise compliance risk management processes. Mr. Gibbs also helps clients proactively prepare for regulatory expectations and helps navigate them through regulatory supervisory examinations and their aftermath for all regulatory agencies.