Bankers Face
Fed Plans to Limit How Lenders Can Structure

Sweeping Curbs on Pay
Compensation for Executives, Traders, Loan Officers; 5,000 Firms Affected

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Policies that set the pay for tens of thousands of bank employees nationwide would require approval from the Federal Reserve as part of a far-reaching proposal to rein in risk-taking at financial institutions.

The Fed's plan would, for the first time, inject government regulators deep into compensation decisions traditionally reserved for the banks' corporate boards and executives.

Under the proposal, the Fed could reject any compensation policies it believes encourage bank employees—from chief executives, to traders, to loan officers—to take too much risk. Bureaucrats wouldn't set the pay of individuals, but would review and, if necessary, amend each bank's salary and bonus policies to make sure they don't create harmful incentives.

A final proposal is still a few weeks from completion and could be revised along the way, according to people familiar with the matter. It requires a vote by the central bank's board, but no congressional approval.

The U.S.'s largest banks, about
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The Fed's planning comes amid an intensifying global debate about the way bank employees are paid ahead of the Group of 20 meeting of world leaders in Pittsburgh next week. U.S. and foreign officials worry that if they don't coordinate their rules, some countries could draw talent away from others.

On Thursday, European Union governments issued a communiqué urging the G-20 to adopt strict rules to restrict bonus payments. Speaking after the meeting of EU leaders in Brussels, French President Nicolas Sarkozy said he would support the idea of linking the size of bonuses at each bank to their level of capital.

The Fed's thinking is the latest in a series of moves by Washington to clamp down on bank compensation. The Treasury earlier this year appointed Kenneth Feinberg to set and review pay for top executives at the largest recipients of federal bailout cash. In July, the House Financial Services Committee approved a bill to give bank regulators the ability to ban "imprudently risky compensation practices" at banks with more than $1 billion of assets, which means it would apply to roughly 700 banks, a piece of legislation in line with the Fed's likely proposal.

President Barack Obama, Treasury Secretary Timothy Geithner and Fed Chief Ben Bernanke have all criticized executive compensation for having pushed employees to take short-term risks with little regard for the long-term effect on their companies and clients. Republicans will likely strongly oppose the move and will be joined by industry leaders.

"Given the changes the industry has already done, if the restrictions on income-producers or salespeople are too draconian, it will actually undermine the strength of the institution," said Scott Talbott of the Financial Services Roundtable, a trade group of financial companies.

The Fed regulates more than 5,000 bank holding companies, which include the nation's largest banks, as well as hundreds of smaller, state-chartered institutions.

Since the financial crisis hit, banks have been tinkering with their compensation systems to make them more palatable to investors and regulators. Citigroup Inc., for example, is shifting pay packages to include more stock and less cash.

At the same time, banks have been boosting the salaries of traders and investment bankers to prevent the recipients' overall compensation from shrinking. Some top banks have been poaching traders, bankers and brokers from rivals by doling out multimillion-dollar signing awards and guaranteeing hefty first-year bonuses, regardless of performance. The Fed effort is being driven by its newest governor, Daniel Tarullo, who was named to the central bank's board by Mr. Obama. Mr. Bernanke has also been involved in crafting the proposals.

The Fed board will consider the proposal in the coming weeks. If approved, it will be proposed for public comment. Officials expect to move forward with the plan quickly, said people familiar with their planning.

The policies would apply to banks regulated by the Fed, not savings-and-loans or state banks that are overseen by the Federal Deposit Insurance Corp. The proposal would let regulators determine whether the type of pay—which includes bonuses based on the volume of business—creates incentives for behavior that risk the safety and soundness of the bank.

—David Enrich and David Gauthier-Villars contributed to this article.