

Wall Street Compensation Reform Act of 2010

1. **Scope.** The legislation establishes a new subcategory of taxpayers subject to section 162(m) of the tax code referred to as “Systemically Significant Financial Institutions”. It defines the term as a company or other entity that:
 - a. Engages primarily in activities that are financial in nature (as defined in 12 U.S.C. § 1843(k)), and
 - b. Meets one of the following requirements:
 - i. Owns or controls assets greater than \$10 billion, or
 - ii. Owns or controls assets greater than \$1 billion and maintains a leverage (debt-to-equity) ratio greater than 15:1.
 - c. The definition of a systemically significant financial institution is not limited to publicly held corporations.
 - i. Once a taxpayer qualifies as a systemically significant financial institution, the taxpayer shall remain classified as such in future tax years.
2. **General rules.** In the case of all systemically significant financial institutions:
 - a. Covered employees include the CEO or Managing Partner, the 25 highest paid employees (other than the CEO or Managing Partner), and other employees whose actions have a material impact on the risk exposure of the taxpayer.
 - b. Employees with applicable employee remuneration exceeding \$1 million are presumed to engage in actions that have a material impact on the risk exposure of the taxpayer unless the taxpayer submits an information return to the Secretary that describes the role and responsibilities of the employee and the rationale for why the employee should not be classified as having a material impact on the taxpayer’s risk exposure.
 - c. No deduction shall be allowed in the case of applicable employee remuneration for any taxable year which is attributable to services performed by a covered employee during such year, to the extent the remuneration exceeds \$1 million.
 - i. The exception for remuneration payable on a commission basis in section 162(m)(4)(B) of the tax code does not apply.
 - ii. The exception for performance-based compensation in section 162(m)(4)(C) of the tax code is subject to the limitations below.
 - iii. The timing rules for deferred deductions in section 162(m)(5) of the tax code apply.
 - d. The size and allocation of the taxpayer’s performance-based compensation pool for covered employees must take into account the full range of current and potential risks, including:
 - i. The cost and quantity of capital required to support the risks taken by the taxpayer in the conduct of the taxpayer’s financial activities,
 - ii. The cost and quantity of the liquidity risk assumed by the taxpayer in the conduct of the taxpayer’s financial activities, and
 - iii. The timing and likelihood of potential future revenues from the taxpayer’s financial activities.

- e. Under the material terms of performance-based compensation paid to covered employees:
 - i. At least 50 percent of performance-based compensation must be payable under vesting arrangements of at least five years.
 - ii. The proportion of performance-based compensation payable under vesting arrangements must increase based on an employee's level of seniority or responsibility.
 - iii. Performance-based compensation payable under vesting arrangements must vest no faster than on a pro rata basis over a number of years.
 - iv. In the case of publicly traded corporations, at least 50 percent of performance-based compensation must be awarded in employer stock or other instruments that align employee compensation with long-term value creation and the time horizons of risk.
 - v. Performance-based compensation must be contingent on a formal agreement between the taxpayer and the employee not to use personal hedging strategies, compensation-related insurance, or liability-related insurance that undermines the risk alignment effects of this section.
- f. In the case of the CEO of a publicly held corporation (and the Chief Financial Officer, if the CFO is a covered employee), performance-based compensation must be subject to substantial clawback requirements in the event the taxpayer is required to prepare an accounting restatement due to material noncompliance, as a result of misconduct, with any financial reporting requirement under the securities laws.

3. **Specific rules for privately held institutions.** In the case of a systemically significant financial institution that is not a publicly held corporation, the requirements in section 162(m)(4)(C)(i) through (iii) of the tax code do not apply. In place of these rules, the taxpayer must comply with the following requirements:

- a. The taxpayer must provide for an independent or externally commissioned annual review of compensation policies and practices. The review shall include an examination and analysis of the taxpayer's compliance with the requirements of this legislation.
- b. The taxpayer must certify that performance goals and other material terms are satisfied before any payment of deductible, performance-based compensation is made.
- c. The provisions of this section shall take effect beginning in calendar year 2011.

4. **Specific rules for public corporations.** In the case of a systemically significant financial institution that is a publicly held corporation, the requirements in section 162(m)(4)(C)(i) through (iii) of the tax code continue to apply. In addition, such taxpayers shall provide to the SEC and disclose to the public an annual report on compensation policies and practices, which describes:

- a. The process used to develop and modify the corporation's compensation policies, including the composition and the mandate of the compensation committee,

- b. The actions taken to comply with this legislation,
- c. Additional actions taken to implement the Principles for Sound Compensation Practices adopted by the Financial Stability Board,
- d. The most important design characteristics of the compensation system, including criteria used for performance measurement and risk adjustment, the linkage between pay and performance, vesting policy and criteria, and the parameters used for allocating cash versus other forms of compensation, and
- e. Aggregate quantitative information on compensation, broken down by senior executive officers and by employees whose actions have a material impact on the risk exposure of the firm, indicating: amounts of remuneration for the financial year, split into fixed and variable compensation, and number of beneficiaries.
- f. The amount of compensation that was nondeductible in the prior year as a result section 162(m).
- g. The provisions of this section shall take effect beginning in calendar year 2011.

5. Date of enactment

- a. Except as otherwise provided, for taxpayers that meet the definition of a systemically significant financial institution in calendar year 2010, the provisions are effective for services performed in calendar year 2011 and thereafter.
 - i. Transition period for preexisting compensation agreements. In the case of services covered by compensation agreements entered into prior to the date of introduction, the legislation is effective for services performed in calendar year 2012 and thereafter.
- b. For taxpayers that meet the definition of a systemically significant financial institution for the first time in a calendar year after 2010, the provisions are effective for services performed after December 31 of the year following the calendar year in which the taxpayer meets the definition (*if a taxpayer was an SSFI for the first time in 2013, the provisions would apply to services performed after 12-31-2014*).

6. Regulations

- a. Within 180 days after the date of enactment, the Secretary shall prescribe such guidance, rules, or regulations as are necessary to carry out the purposes of this legislation. The guidance shall: (1) describe the method for valuing assets for purposes of the asset test; (2) describe the method for calculating a taxpayer's leverage ratio; (3) describe criteria for use in determining whether an employee is treated as having a material impact on the risk exposure of the taxpayer; and (4) set forth anti-abuse rules to prevent taxpayers from using independent contractors to avoid the purposes of the legislation.