For several years, leaders at Silicon Valley Bank made a series of bets that contributed, along with poor risk management, to the ultimate failure of that institution. Subsequently, almost up to the very hour federal regulators took over the failing bank, its top leaders were receiving significant bonuses. If bank executives are found to be responsible for the failure of their institution, should those executives be able to keep the profits they earned while leading the bank into ruin? As part of its efforts to prevent future bank failures, Congress has been examining the authorities granted to regulators to discourage bank leaders from taking excessive risks and profiting from bank mismanagement. Leaders within the Senate have arrived at a bipartisan proposal, known as the Recovering Executive Compensation Obtained from Unaccountable Practices (RECOUP) Act, that attempts to address these concerns.

Under current law, the Federal Deposit Insurance Corporation (FDIC) can claw back compensation from banking leaders when it takes over a bank using the Orderly Liquidation Authority (OLA). OLA is a special administrative process, created by the Dodd-Frank Act of 2010, that regulators can invoke when they feel that a failing institution presents a systemic risk to the financial system. If the leaders are found to be “substantially responsible” for the failure, the FDIC can recoup compensation paid out in the two years running up to an institution’s failure. In the case of Silicon Valley Bank, the FDIC did not pursue a resolution using OLA, meaning that those clawback provisions were not available. This process would normally be applicable only to firms with over $250 billion in assets, representing the largest, most complex financial institutions — a small fraction of the total number of insured banks.

As proposed, the RECOUP Act would alter this authority by allowing the FDIC to take back compensation from a wider range of senior executives of institutions that are taken over by the FDIC due to failure or expected failure. This expanded authority is limited to institutions with more than $10 billion in assets, which excludes almost all community banks. The types of compensation under this provision include not only standard compensation such as salary, stock options or equity awards, severance pay, and bonuses, but also proceeds from any stock sale or purchase of company stock in the two years preceding the failure. Additionally, the bill expands the regulators’ authority to ban executives from working in the banking sector if they have been found responsible for the failure of an institution, increases civil penalties for executives found responsible for “reckless” violations of the law, and requires institutions with assets above $10 billion to include new standards and penalties in their charters for managing risks and complying with regulatory instructions.

After much negotiation, the RECOUP Act was brought before the Senate Banking Committee in June. Ranking Member Tim Scott, R-S.C., who negotiated the compromise with committee Democrats, described the proposal as “important and timely.” Chair Sherrod Brown, D-Ohio, stated that the bill will ensure executives face real accountability: “Bank executives who take on too much risk and crash their banks shouldn’t get to land on their feet.” The idea of expanding punishment for negligent executives was not without dissent. Sen. Tom Tillis, R-N.C., has expressed concern that the legislation does not effectively deal with the root causes of the 2023 bank failures and creates the wrong incentive structures for private sector leaders. “We’re not making the distinction between bad management decisions and management malpractice,” Tillis said. “And if we’re not careful here, you’re going to stifle innovation.”

Despite these concerns, the RECOUP Act was voted out of the Senate Banking Committee by a comfortable bipartisan margin of 21 to 2 and is awaiting consideration by the full Senate. Should it eventually pass the Senate, there is no guarantee that it will become law: Leadership in the House of Representatives has said that the Senate’s proposal is under review but has not made a commitment to take up the topic at this time. The process of responding to the 2023 bank failures will likely continue for some time as both regulators and legislators look to ensure that the financial system remains on stable footing.