



July 22, 2016

*Via Electronic Mail*

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Docket No. 1536  
RIN No. 7100 AE-50

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File Number S7-07-16

Re: Notice of Proposed Rulemaking on Incentive-Based Compensation Arrangements (Docket Nos. OCC-2011-0001, 1536, RIN No. 7100 AE-50, RIN 3064-AD86, RIN 2590-AA42, File Number S7-07-16)

Ladies and Gentlemen:

The Clearing House Association L.L.C.<sup>1</sup> appreciates the opportunity to comment on the Notice of Proposed Rulemaking and Request for Comment on Incentive-Based Compensation

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<sup>1</sup> The Clearing House is a banking association and payments company that is owned by the largest commercial banks and dates back to 1853. The Clearing House Association L.L.C. is a nonpartisan organization that engages in research, analysis, advocacy and litigation focused on financial regulation that supports a safe, sound and competitive banking system. Its affiliate, The Clearing House Payments Company L.L.C., owns and

Arrangements by the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Housing Finance Agency, the National Credit Union Administration and the U.S. Securities and Exchange Commission (the “Agencies”).<sup>2</sup>

We focus the majority of this letter, in considerable detail, on a range of constructive suggestions and recommendations that we believe would better promote the underlying objectives of the proposal while also reducing various sources of complexity and perverse incentives. These comments are intended to ensure that the proposal appropriately reflects and encourages a diversity of incentive compensation practices and structures that appropriately balance risk and reward, and avoids overly prescriptive or “one size fits all” approaches that would be counterproductive in practice.

Our suggestions and recommendations draw upon the substantial expertise and experience of our owner banks in designing, implementing, monitoring and refining their incentive compensation frameworks over time. We remain committed to working constructively with the Agencies, both in the context of Section 956’s implementation and elsewhere, to improve compensation practices.

Nonetheless, it is crucial to underscore at the outset our fundamental legal and procedural concerns with the proposal. Section 956 is both straightforward and specific in its grant of rulemaking authority to the Agencies. In addition to certain disclosure-related provisions, Section 956 authorizes the Agencies to jointly prescribe rules or guidance that *prohibit* incentive-based payment arrangements that the Agencies determine either (i) encourage inappropriate risks by certain financial institutions by providing excessive compensation or (ii) encourage inappropriate risks by certain financial institutions that could lead to material financial loss.

Unfortunately, as a matter of implementation, the interagency proposal ignores the clear statutory directive of Section 956. Instead of *proscribing* compensation arrangements that the Agencies have determined would meet this statutory standard, the proposal would instead *prescribe* requirements that effectively amount to mandatory incentive compensation structures across covered firms. This is neither consistent with Section 956 nor prudent: effective incentive compensation regimes must consider numerous key factors, including the need to drive performance, maintain employee focus on both profitability and risk, and attract and retain talent. Regimes also must be tailored to an institution’s particular business and designed to optimize its talent relative to competitors (both regulated and unregulated). Had Congress intended the

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operates core payments system infrastructure in the United States and is currently working to modernize that infrastructure by building a new, ubiquitous, real-time payment system. The Payments Company is the only private-sector ACH and wire operator in the United States, clearing and settling nearly \$2 trillion in U.S. dollar payments each day, representing half of all commercial ACH and wire volume.

<sup>2</sup> Incentive-Based Compensation Arrangements, 81 Fed. Reg. 37,670 (proposed June 10, 2016) (to be codified at 12 C.F.R. pt. 42, 12 C.F.R. pt. 236, 12 C.F.R. pt. 372, 12 C.F.R. pts. 741, 751, 12 C.F.R. pt. 1232, 12 C.F.R. pts. 240, 275, 303). Unless otherwise specified, the citations herein are to the proposed rules as set forth by the Board of Governors of the Federal Reserve System.

Agencies to design and prescribe mandatory compensation structures, it certainly would have required the Agencies to consider numerous other necessary factors that are relevant to a sound compensation system. But it did not; rather, it granted the Agencies only the power to prohibit certain arrangements and focused that determination on two factors—excessive compensation and the risk of loss as a result of inappropriate risk-taking—and set the bar for the latter factor very high at “material financial loss.”

Over the past several years, financial firms, consistent with formal, principles-based guidance from the OCC, Federal Reserve and FDIC (the “Banking Agencies”), have continually adapted their compensation arrangements to be more risk-sensitive, provide balanced incentives, reflect the diversity of financial organizations and maintain competitive balance with a growing number of unregulated competitors. The fact that financial institutions have established particular deferral and clawback policies does not provide evidence that such requirements are necessary, much less that any other form of compensation structure is *per se* likely to lead to material financial loss. Rather, it represents the kind of continued experimentation and trial-and-error in compensation that Congress in Section 956 clearly intended to encourage—so long as there is no evidence that a chosen structure encourages inappropriate risk-taking that could lead to material financial loss, or does so by providing excessive compensation. In contrast, with respect to important parts of any compensation regime, the proposal would halt innovation and adaptation, which we believe is not only inconsistent with the statute but also poor policy. To highlight these points, the actual operative language of Section 956 is worth setting forth in full:

*[T]he appropriate Federal regulators shall jointly prescribe regulations or guidelines that prohibit any types of incentive-based payment arrangement, or any feature of any such arrangement, that the regulators determine encourages inappropriate risks by covered financial institutions—*

*(1) by providing an executive officer, employee, director, or principal shareholder of the covered financial institution with excessive compensation, fees, or benefits; or*

*(2) that could lead to material financial loss to the covered financial institution.<sup>3</sup>*

As noted, we do not believe that this statutory grant can be read to authorize the Agencies to design a single compensation structure for the regulated financial services industry; rather, we believe it is clearly intended as an authorization to prohibit practices that have a demonstrated history of encouraging inappropriate risk-taking that could lead to material financial loss or by providing excessive compensation.

Just as concerning, the proposal’s uniform compensation standards are implicitly premised upon a series of simplifying and irrebuttable presumptions that are neither reasonable nor supported by evidence. For example:

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<sup>3</sup> 12 U.S.C. § 5641(b).

- The proposal presumes that any compensation arrangement that does not meet its detailed requirements as to the amount and length of deferral, forfeiture, downward adjustment, clawback and other specified characteristics by definition encourages inappropriate risks that could lead to material financial loss.
- The proposal presumes that there are precise and particular amounts and periods of deferral (and other specified characteristics) at which incentive compensation arrangements would cease to encourage inappropriate risks that could lead to material financial loss, and further assumes that such precise and particular amounts and periods will always vary depending on the size of the institution and role or relative compensation of the individual being compensated.
- The proposal presumes that any individual, notwithstanding his or her function and level of responsibility, whose compensation is relatively higher than that of certain other individuals employed by the same institution to a particular extent (*e.g.*, at the 95<sup>th</sup> or 98<sup>th</sup> percentile thereof) is necessarily in a position to expose the institution to inappropriate risks that could lead to material financial loss.
- By varying the prescribed regime by asset size, the proposal presumes that the same compensation arrangement for the same employee would meet the statutory standard if the employee were being compensated by one financial institution, but would not meet that standard if the employee were being compensated by a different financial institution with fewer total assets.
- The proposal does not define, nor does it provide the Agencies' joint view with respect to, fundamentally key statutory terms, including "inappropriate risk" and "material financial loss."

Taken together, these presumptions result in a proposal that would subject to its mandatory framework a wide range of employees, including control persons, investment and financial advisers and technology experts, in the absence of any evidence that any of these types of employees could engage in risk-taking that has led to a material financial loss, much less conduct that would have been altered by a different compensation structure. It also varies the details to impose more onerous requirements on employees of larger institutions, expressly contrary to the materiality standard in Section 956, which bespeaks an equal level of concern about each institution.

The proposal's single, formulaic approach is not only in tension with the statute, but also departs from the Banking Agencies' existing policy view on incentive compensation

practices. Indeed, to date the Banking Agencies have taken a very different view, as discussed in their 2010 Guidance:<sup>4</sup>

The Agencies believe [a principles-based] approach is the most effective way to address incentive compensation practices, given the differences in the size and complexity of banking organizations covered by the guidance and the complexity, diversity, and range of use of incentive compensation arrangements by those organizations. For example, activities and risks may vary significantly across banking organizations and across employees within a particular banking organization. For this reason, the methods used to achieve appropriately risk sensitive compensation arrangements likely will differ across and within organizations, and use of a single, formulaic approach likely will provide at least some employees with incentives to take imprudent risks.<sup>5</sup>

We believe that Congress clearly concurred with this analysis in drafting Section 956 as a narrow mandate to proscribe, and not prescribe, specific incentive compensation practices.

Leaving aside the scope of the proposal, it is also notable that the preamble provides almost no evidentiary basis for its assertions and conclusions, and that the little evidence that is marshaled is unresponsive of the proposed rule. The recent financial crisis provides an extraordinary amount of data from which one could assess compensation schemes: which ones encouraged inappropriate risk-taking leading to material financial losses, and which ones did not. Section 956 is a clear mandate to the Agencies to explore this history. Yet the proposal reflects no analysis of this evidence, either to determine the breadth (how many employees should be covered) or depth (how restricted their compensation must be) of the proposed rule. The proposed rule also fails to consider the impact on current or prospective employees. For example, the proposal would subject a wide range of employees, including control persons, investment and financial advisers and technology experts, to its mandatory framework, but has provided no evidence that any of these types of employees have engaged in conduct that has led to a material financial loss, much less conduct that would have been altered by a different compensation structure. Similarly, the proposal imposes various prescriptive requirements regarding the amount and period of incentive compensation deferral, but has provided no evidence from the crisis or any other experience to suggest that, say, a two-year deferral may encourage risk-taking that could lead to a material financial loss, but a four-year deferral would not. As discussed later in the letter, the six examples of material financial loss that the preamble does cite are only that—examples of material financial losses at financial institutions—but provide no evidence to suggest that the restrictions of the proposed rule should be applied to tens of thousands of people, or include the restrictions that have been proposed.

Section I of this letter provides an executive summary of our comments. Sections II through VIII provide structural and procedural comments on the proposal, and Sections IX

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<sup>4</sup> Guidance on Sound Incentive Compensation Policies, 75 Fed. Reg. 36,396 (Office of the Comptroller of the Currency, Treasury, Bd. of Governors of the Fed. Reserve Sys., Fed. Deposit Ins. Corp. and Office of Thrift Supervision, Treasury June 25, 2010) (the “2010 Guidance”).

<sup>5</sup> 75 Fed. Reg. at 36399 (emphasis added).

through XVII provide section-specific comments on detailed aspects of the proposal, in each case in the event that the Agencies proceed with the application of a uniform “one size fits all” framework. Annex 1 provides an illustrative example of the impact of the Agencies’ proposed deferral and clawback requirements on individual incentive compensation over time and is further highlighted throughout this letter. Annex 2 provides responses to the specific requests for comment made by the Agencies. Given the volume of changes necessary for the proposed rule to be effectively implemented in a manner that is consistent with Section 956, and given that the Agencies did not provide the public with a sufficient and meaningful opportunity to comment on the proposal in the first instance, we ask that the Agencies provide notice and an opportunity for public comment on a revised proposal before any final rule becomes effective.

## **I. Executive Summary**

This executive summary provides an overview of certain of our key recommendations, which are focused on the continued use of an appropriately flexible approach to avoiding the encouragement of risk-taking that could lead to a material financial loss and better reflecting the Congressional mandate under Section 956 of the Dodd-Frank Act.

We urge the Agencies not to abandon the significant work and strides that institutions and the Agencies together have made over the past six years toward preventing inappropriate risks in favor of a single, static, highly prescriptive and government-designed incentive compensation framework. Many of the proposed rule’s provisions have little to no relationship to the prevention of material financial loss that results from inappropriate risk-taking and could harm covered institutions by putting them at a significant disadvantage in the market for talent. The substantial implementation, operational and monitoring costs that would stem from the proposal’s requirements would further encumber covered institutions relative to unregulated competitors.

With these concerns and objectives in mind, we urge the Agencies to modify the proposal as follows:

### *Structural Comments*

- The proposed rule would place all institutions into standardized, industry-wide compensation structures, contrary to the plain meaning of Section 956. As discussed in the Introduction, Section 956 requires the Agencies to prohibit incentive-based payment arrangements that encourage “inappropriate” risks in one of two ways. There is no authority or policy basis for the Agencies to instead require standardized, industry-wide compensation structures or to require the use of specific forms of incentive compensation.
- The proposed rule deviates from clear precedent on the meaning of material financial loss. Material financial loss is a standard that is well developed in a variety of financial contexts. We propose that the Agencies reconsider the proposal and target the prevention of losses that reach the level Congress contemplated and provide an evidentiary basis for their assertions and conclusions.

- The proposed rule would deviate from the findings underlying the *Guidance on Sound Incentive Compensation Policies* adopted by the Banking Agencies in 2010 and the work done by covered institutions, together with their supervisors, to establish incentive compensation arrangements that support safe and sound banking practices. The final rule should instead mirror the flexibility and diversity of appropriate practices imbedded in the principles-based framework in the 2010 Guidance, which is consistent with Section 956. We propose replacing the specific deferral, forfeiture, downward adjustment and clawback requirements and permitting “customized arrangements for each [financial] organization”<sup>6</sup> that are “tailored to the business, risk profile, and other attributes of the [financial] organization.”<sup>7</sup> The costs of reversing course, as the proposed rule would do, are substantial and unjustified.
- The final rule should apply on a consolidated basis. The proposal recognizes that large financial institutions increasingly operate and manage their businesses on a consolidated basis, and yet it would apply several of its requirements on an entity-by-entity basis. Application on an entity-by-entity basis would result in an unnecessary and duplicative standard under which hundreds of covered subsidiaries within one affiliated group would find themselves individually subject to the provisions of the rule (including some subsidiaries that have different regulators).
- The Banking Agencies should consider the costs and benefits of the proposal, which they have failed to do. This is essential given the importance of compensation arrangements to the safety and soundness of banks.
- We support having two annual compensation cycles before any final rule becomes effective, and no requirement should become effective in the middle of an institution’s fiscal year.

### *Section-Specific Comments*

We strongly disagree with the “one size fits all employees” approach to incentive compensation taken by the proposal and encourage the continued use of the greater flexibility afforded under the principles-based framework of the 2010 Guidance. If the Agencies decide to proceed with the application of a uniform framework, we have identified specific revisions that would enhance the operation of the framework, reduce its costs or provide additional flexibility that would not encourage inappropriate risk-taking. Some of these are highlighted as follows:

- The final rule should not include a three-level structure, as the types or features of compensation that encourage inappropriate risks do not differ based on institutional size and Section 956 does not contemplate varying treatment by size of institutions above \$1 billion. To the extent the Agencies both continue to apply the final rule on

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<sup>6</sup> 75 Fed. Reg. at 36,400.

<sup>7</sup> *Id.* at 36,399.

- an entity-by-entity basis and maintain a three-level structure, all subsidiaries of covered institutions should be treated at the level corresponding to their own assets, and only subsidiaries that would be “covered institutions” on their own should be subject to the final rule.
- The final rule should expressly permit covered institutions that are also subject to the requirements of supervisors of non-U.S. jurisdictions to coordinate requirements. A number of non-U.S. jurisdictions have introduced compensation regulations that apply to financial institutions that are organized or do business in those jurisdictions. As a result, financial institutions with international operations could be subject to multiple, overlapping regulatory requirements.
  - The definitions of senior executive officers, significant risk-takers and covered persons should be amended to focus on material risks and policy influence and determined on a consolidated basis. Rather than encompassing all employees, “covered persons” should be defined based on a material risk taker framework (categories 1, 2 and 3 under the 2010 Guidance), appropriately limiting the final rule to only those individuals who could, either individually or collectively as part of a group, take the type of inappropriate risks that might lead to material financial loss. Significant risk-takers should be limited to category 2 material risk takers rather than encompassing employees who have no or limited connection to risk-taking, and senior executive officers should be limited to category 1 material risk takers at the parent institution (rather than encompassing heads of subsidiaries who do not have a policy function or senior executive authority), in each case, as agreed between covered institutions and their supervisors.
  - The minimum deferral and clawback requirements should be significantly revised. Covered institutions already face level playing field issues, particularly in technology-focused areas. We are concerned that the extreme deferral requirements proposed, together with the lengthy post-vesting clawback requirements proposed, will do serious competitive harm, particularly if the scope of employees to which the restrictions apply is not otherwise narrowed. *Annex 1 illustrates that, as proposed, a senior executive officer would have over three times her annual incentive compensation at risk (both short-term and long-term) and over ten times her total annual incentive compensation at risk at any one time. A current 48-year-old employee is faced with the possibility that compensation will not be finalized and complete until age 60.*
  - The Agencies should not prescribe maximum incentive opportunities. The proposed rule would impose limits that are arbitrary and unnecessary, particularly in light of the proposal’s extensive deferral and clawback periods. Although the preamble argues (without support) that these limits are in line with current industry practice, that assertion is incorrect. Also, industry practice can change to reflect experience, but the rule will not.



- The term “incentive-based compensation” should be clarified to avoid unintended consequences. Programs that cannot influence risk-taking, such as recognition and service awards, should be excluded, as should compensation below a quantitative minimum. These arrangements could not lead to material financial loss as a result of inappropriate risk-taking. Similarly, commissions should be treated as salary, as they have been under other regulatory and tax regimes, and carried interest arrangements should be explicitly excluded from the definition of “incentive-based compensation.”
- The proposed rule’s governance requirements are too granular and may distract a board from proper oversight. Although board oversight of compensation arrangements is an important objective, the proposed rule’s requirements are excessively granular and would detract from the rest of a board’s duties. Similarly, requiring two risk reports appears arbitrary, particularly when the Agencies have required a single risk report in other, more material, circumstances.

## **II. The proposed rule would place all institutions into standardized, industry-wide compensation structures, which is inconsistent with the plain meaning of Section 956.**

The proposed rule’s requirements extend far beyond what Congress has authorized for agency rulemaking in Section 956. This is not just a question of degree but of the fundamental framework.

Section 956 is limited and specific. It requires the Agencies to prohibit incentive-based payment arrangements that encourage “inappropriate” risks in one of two ways. There is no authority for the Agencies to instead require standardized, industry-wide compensation structures or to require the use of specific forms of incentive compensation.

Yet the proposal would require a broad swath of financial institutions to adopt an incentive compensation program that incorporates multiple specific requirements covering a wide scope of incentive compensation arrangements. The examples are legion:

- The proposal not only would require that all incentive compensation arrangements include both financial and non-financial measures, but also that non-financial measures must be allowed to override financial measures.
- The proposal not only would require deferral, but also would prescribe the amount deferred, the length of deferral, the minimum forfeiture conditions and the form in which deferred compensation may be paid.
- The proposal not only would require a “clawback” arrangement, but also would prescribe the duration and commencement point of the clawback, as well as specify the circumstances under which the clawback would become operative.
- The proposal not only would require specific internal control mechanisms, but also require specific board approvals.

The Agencies have made no attempt to demonstrate (and, indeed, could not demonstrate) that all other possible incentive compensation arrangements and practices would encourage risk-taking that could lead to a material financial loss. And as a structural matter, such an argument would turn Congress's intention on its head. When Congress intends for an Agency to require certain practices, it knows how to do so. For example, under Section 954 of Dodd-Frank, just two sections earlier, Congress specifically prescribes that the "rules of the Commission . . . shall require each issuer to develop and implement a [clawback] policy."<sup>8</sup> Even Section 955, the immediately preceding section, prescribes that the Commission "shall, by rule, require each issuer to disclose [its hedging policy] . . . ."<sup>9</sup> On the other hand, when Congress instead intends to prohibit certain practices, it again knows how to do so, not only here, but in countless other cases (such as Section 957, where rules must "prohibit" discretionary voting by brokers on certain matters<sup>10</sup>). Within Section 956 itself, the distinction is clear between subpart (a), where the Agencies are to "prescribe regulations or guidelines to require," and subpart (b), where they are to "prescribe regulations or guidelines that prohibit."<sup>11</sup> A similar distinction can be found in the Bureau of Consumer Financial Protection ("CFPB") rule implementing Sections 1411, 1412 and 1414 of Dodd-Frank. In its final rule, the CFPB did not require specific underwriting models for creditors, given that there were "no indicators in the statutory text or legislative history . . . that Congress intended to replace proprietary [] standards with [] standards dictated by governmental or government-sponsored entities . . ." Instead, the CFPB's final rule generally prohibits only certain delineated practices, such as certain loans, types of payments or term lengths.<sup>12</sup>

To argue that prohibitory and prescriptive regulatory authorization statutes should be read identically would defy logic and common sense. In addition, the very language of the proposal belies any attempt to interpret it as imposing prohibitions rather than requirements. The title of one section of the proposed rule is clear that the section encompasses only "prohibitions" (Section \_\_.8), the title of another is clear that it contains both "requirements and prohibitions" (Section \_\_.4) and the titles of most other sections, which prescribe the more specific features, identify the content as "requirements" (Sections \_\_.5, \_\_.7, \_\_.9, \_\_.10 and \_\_.11).

### **III. The proposed rule deviates from clear precedent on the meaning of material financial loss.**

Section 956 authorizes the Agencies to prohibit only types or features of incentive-based compensation arrangements that encourage inappropriate risks by providing excessive compensation or that encourage inappropriate risks that might lead to material financial loss. In

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<sup>8</sup> 15 U.S.C. § 78j-4 (emphasis added).

<sup>9</sup> 15 U.S.C. § 78n (emphasis added).

<sup>10</sup> 15 U.S.C. § 78f(b).

<sup>11</sup> 12 U.S.C. § 5641 (emphasis added).

<sup>12</sup> Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act (Regulation Z), 78 Fed. Reg. 6408, 6409 (Jan. 30, 2013).

using the word “material,” Congress invoked a standard that is well developed in a variety of *financial* contexts.

For example, the SEC has provided guidance on the application of materiality thresholds in preparing financial statements and audits.<sup>13</sup> The guidance states that “[t]he use of a percentage as a numerical threshold, such as 5% [of net income], may provide the basis for a preliminary assumption that . . . a deviation of less than the specified percentage with respect to a particular item on the registrant’s financial statements is unlikely to be material.” Although this quantitative rule of thumb is “only the beginning of an analysis of materiality . . . [and] cannot appropriately be used as a substitute for a full analysis of all relevant considerations,”<sup>14</sup> it does provide a consistent starting point.

Similarly, case law also supports the use of a quantitative rule of thumb as a baseline: “the five percent numerical threshold is a good starting place for assessing the materiality of the alleged misstatement.”<sup>15</sup> Courts have applied a 5% rule of thumb for alleged misstatements of various quantitative measurements on financial statements, including revenue, assets and income.<sup>16</sup>

The proposed rule, however, is in no way tied to the historical definition of material financial loss; nor does it explain its departure from that definition. Instead, the proposal would impose requirements on incentive compensation arrangements and employees receiving them, without regard to whether either the arrangement or the employee in any way could lead to a loss of 5% of net income, assets or capital. Similarly, even the concept of significant risk-takers, which is intended to represent the group of employees whose actions could lead to material financial loss, is not in any way connected to the traditional concepts of materiality.

The traditional definition of materiality would lead to a vastly different set of prohibitions. For example, as of December 31, 2015, our median owner bank had total consolidated assets of \$376 billion and common equity tier 1 capital (on a fully phased-in basis) of \$28 billion. Under a historically accepted definition of materiality, 5% of total consolidated assets would equal nearly \$19 billion and 5% of common equity tier 1 capital would equal nearly \$1.5 billion. The proposed rule, however, would implement standards and apply to employees that are in no way connected to these significant loss levels.

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<sup>13</sup> See Staff Accounting Bulletin No. 99, Release No. 99 (Aug. 12, 1999) [hereinafter *SEC Bulletin*].

<sup>14</sup> *Id.*

<sup>15</sup> *ECA, Local 134 IBEW Joint Pension Trust of Chicago v. JP Morgan Chase Co.*, 553 F.3d 187, 204 (2d Cir. 2009) (holding that misstated accounting categorization of approximately 0.3% of defendant’s total assets was not material).

<sup>16</sup> See, e.g., *Masters v. GlaxoSmithKline*, 271 Fed. Appx. 46, 2008 WL 833085 (2d Cir. 2008) (finding that failure to disclose research trial results was immaterial where results were financially immaterial because less than 3% of the company’s revenue would be affected); *In re Lions Gate Entm’t Corp. Sec. Litig.*, No. 14-CV-5197 (JGK), 2016 WL 297722 (S.D.N.Y. Jan. 22, 2016) (holding a civil penalty amount that amounted to less than 1% of the company’s consolidated quarterly revenues immaterial); *Garber v. Legg Mason, Inc.*, 537 F. Supp. 2d 597, 613-14 (S.D.N.Y. 2008) (finding omission of 0.4% of annual revenue immaterial).

Furthermore, Congress set a single material loss standard for all covered institutions, one that should be applied uniformly, with equal concern about the possible failure of each covered institution. A sliding scale, where smaller losses may be material for a small firm but not for a large firm, is consistent with Section 956. However, the Agencies have done *precisely the opposite* in turning Section 956 into a set of requirements that become *more* constraining as the size of the covered institution grows. Thus, as discussed in Section IX.A below, the final rule should not include a three-level structure because the types or features of compensation that encourage inappropriate risks do not differ based on institution size and Section 956 does not contemplate varying treatment by size of institutions above \$1 billion.

It is incontrovertible that Congress did not authorize the Agencies to prohibit certain compensation structures for the purpose of preventing any loss. Instead, Congress limited the authority only to large institutions (having more than \$1 billion in assets) and then only to prevent material financial loss resulting from inappropriate risk-taking to such institutions. The proposal, however, renders “material financial” meaningless. We believe the Agencies are obligated to reconsider the proposal and target only the prevention of losses that reach the level that Congress specifically prescribed.

In addition, leaving aside the scope of the proposal, the preamble provides almost no evidentiary basis for its assertions and conclusions. The Agencies have failed to utilize the extraordinary amount of data from the financial crisis in assessing compensation programs as well as other risk systems, models and control mechanisms for excessive risk-taking: which ones encouraged inappropriate risk-taking leading to material losses, and which ones did not. The proposal would subject a wide range of employees, including control persons, investment and financial advisers and technology experts to its mandatory framework, but has provided no evidence that any of these types of employees (or any others) could engage in conduct that has led to a material financial loss, much less conduct that would have been altered by a different compensation structure.

Indeed, even the six specific examples the preamble does reference provide no support or rationale for the requirements of the proposed rule. Three of the examples involve individual employee misconduct that was already prohibited and subject to—but not deterred by—the disincentivizing effects of criminal law.<sup>17</sup> Another references an incident that underwent thorough internal, supervisory and Congressional review with no indication that incentive compensation was a factor. The last two involve activities prohibited by statute (*i.e.*, Section 619 of the Dodd-Frank Act)<sup>18</sup> or particular compensation practices now subject to significant and specific restrictions under the Truth in Lending Act made in title 14 of the Dodd-Frank Act and implementing rules thereunder.<sup>19</sup>

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<sup>17</sup> See 81 Fed. Reg. at 37674 n.14.

<sup>18</sup> 12 U.S.C. § 1851.

<sup>19</sup> 15 U.S.C. § 1639b.

In sum, the preamble's examples only stand for the propositions that banks sometimes lose money and that sometimes rogue employees may cause those losses, despite the existing deterrence of civil and even criminal penalties. These examples do not provide any support for the proposition that the proposal's incentive compensation requirements—and only the proposal's incentive compensation requirements—would have prevented the same losses as a result of inappropriate risk-taking.

Furthermore, with only the exception of mortgage originators, all of the examples deal with securities traders, who are a small percentage of the employees covered by the proposal. For the great majority of employees proposed to be covered—including compliance professionals, investment and financial advisers, lawyers, finance professionals, human resource professionals and insurance executives—the proposal provides not a single historical example of such persons imposing a material financial loss on a regulated financial institution, much less an example of a compensation structure incentivizing such a loss. Any regulation under the statute should focus on the population of individuals at a financial institution that could have the potential to effect material risk.

**IV. The proposed rule would deviate, without substantiation, from the findings underlying the 2010 Guidance and the work done by covered institutions, together with their supervisors, to establish incentive compensation arrangements that support safe and sound banking practices. The costs of reversing course, as the proposed rule would do, are substantial and unjustified.**

The final rule should, instead of deviating from the 2010 Guidance, incorporate the flexibility and recognition of the diversity of appropriate practices imbedded in the principles-based framework of the 2010 Guidance, as well as take into account the relationship between incentive compensation and risk management practices. Accordingly, we believe the final rule should eliminate the specific deferral, forfeiture, downward adjustment and clawback requirements and instead permit “customized arrangements for each [financial] organization”<sup>20</sup> that are “tailored to the business, risk profile, and other attributes of the [financial] organization.”<sup>21</sup>

The structure of Section 956 is not accidental. Dodd-Frank was adopted within a month after the Banking Agencies published the *Guidance on Sound Incentive Compensation Policies*, which was “designed to help ensure that incentive compensation policies at banking organizations do not encourage imprudent risk-taking” and is still in effect.<sup>22</sup> The 2010 Guidance retained the same “principles-based framework” that had been originally proposed by the Federal Reserve System in 2009:

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<sup>20</sup> 75 Fed. Reg. 36,396, 36,400.

<sup>21</sup> *Id.* at 36,399.

<sup>22</sup> 75 Fed. Reg. at 36,396.

After reviewing the comments, the Agencies have retained the principles-based framework of the proposed guidance. The Agencies believe this approach is the most effective way to address incentive compensation practices, given the differences in the size and complexity of banking organizations covered by the guidance and the complexity, diversity, and range of use of incentive compensation arrangements by those organizations. For example, activities and risks may vary significantly across banking organizations and across employees within a particular banking organization. For this reason, the methods used to achieve appropriately risk-sensitive compensation arrangements likely will differ across and within organizations, and use of a single, formulaic approach likely will provide at least some employees with incentives to take imprudent risks.<sup>23</sup>

The 2010 Guidance goes on to note that the Agencies considered whether to require certain forms of compensation or whether to ban other forms. Ultimately, the Agencies concluded not to adopt such rigid requirements and that “incentive compensation arrangements of various forms and levels may be properly structured so as not to encourage imprudent risk-taking.”<sup>24</sup> It is in that context that Congress required the Agencies to prohibit only certain “types” or “features” of incentive compensation arrangements, and only then after they affirmatively “determine” that the type or feature encourages inappropriate risks.

The proposal would ignore the findings underlying the 2010 Guidance and Section 956, as well as the considerable investments covered institutions have made to implement it. Instead, the proposal would adopt the type of “one size fits all” approach that commentators warned against and the Agencies specifically rejected. In 2010, the Agencies specifically cautioned that, even within a single banking organization, “the use of a single, formulaic approach to making employee incentive compensation arrangements appropriately risk-sensitive is likely to result in arrangements that are unbalanced at least with respect to some employees.”<sup>25</sup> And now, in 2016, the SEC reaches exactly the same conclusion, noting in the preamble that “[t]here could be situations, however, where bonus deferral could actually lead to an *increase* in risk-taking incentives.”<sup>26</sup>

The final rule should limit covered employees to those identified as having “the ability to expose [a banking organization] to material amounts of risk.”<sup>27</sup> These narrowly tailored requirements would adhere to the narrow guidance of the statute while building on the significant progress that the Agencies have noted and allow compensation practices to continually evolve.

The final rule also should take into account that incentive compensation arrangements operate in conjunction with each institution’s risk management framework. Differing emphasis

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<sup>23</sup> *Id.* at 36,399.

<sup>24</sup> *Id.* (emphasis added).

<sup>25</sup> *Id.* at 36,410.

<sup>26</sup> 81 Fed. Reg. at 37,785 (emphasis added).

<sup>27</sup> *Id.* at 36,400.

on, and types of, incentive compensation controls, on the one hand, and risk management controls, on the other hand, can provide equal protection against inappropriate risk-taking and an optimal approach is likely to change the blend over time and with respect to certain businesses. Prescribing specific requirements for incentive compensation arrangements will not be as effective or efficient as allowing institutions to create an appropriate web of protections that is founded on their own risk profile and risk management programs.

In particular, the 2010 Guidance notes that “effective and balanced incentive compensation practices are likely to evolve significantly in the coming years.”<sup>28</sup> The proposal, however, would bring an end to that evolution, instead freezing compensation practices in time for a large subset of the financial sector. We strongly urge the Agencies not to abandon their tested structure, and force covered institutions to abandon the developments and improvements that have been made and would continue to be made if there was the flexibility to do so. If, on the other hand, the Agencies continue with the proposed structure, we believe they must expressly revoke the 2010 Guidance, the findings and conclusions of which are fundamentally inconsistent with the proposal.

#### **V. The final rule should apply on a consolidated basis.**

As an initial matter, we note that the proposal recognizes that large financial institutions increasingly operate and manage their businesses on a consolidated basis. Allowing the final rule to apply to all covered institutions on a consolidated basis would appropriately reflect the Agencies’ finding that “the expectations and incentives established by the highest levels of corporate leadership set the tone for the entire organization and are important factors of whether an organization is capable of maintaining fully effective risk management and internal control processes.”<sup>29</sup> It would also avoid the potentially costly and uneven application of various components of the proposal applying differently within one covered institution.<sup>30</sup>

Incentive-based compensation programs are generally governed and designed at the holding company level and applied on a consolidated basis across the organization in order to maintain effective risk management and controls. The proposal recognizes this fact by applying the relative compensation test for significant risk-takers on a consolidated basis.<sup>31</sup> However, it does not take a consolidated approach in a consistent manner, nor does it appear to take into account the enterprise-wide viewpoint and structure of compensation plans at many covered institutions. Instead, the proposal requires each subsidiary of a holding company (meeting the minimum asset threshold) to comply with requirements on an individual basis, including, for Level 1 and Level 2 covered institutions, requirements to identify and regulate the compensation

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<sup>28</sup> 75 Fed. Reg. at 36,407.

<sup>29</sup> 81 Fed. Reg. at 37,685.

<sup>30</sup> Only subsidiaries that are consolidated on a firm’s balance sheet should be included in such consolidation and not all entities that are under the “control” of the institution, as such term is defined in various regulations.

<sup>31</sup> Although we believe the definition of “significant risk-taker” should be revised, we believe regardless of the approach taken by the Agencies, it should remain on a consolidated basis. *See* Section X.C.2 below.

of a separate set of senior executive officers, to establish a compensation committee and to undertake specific governance practices. Applying the final rule on an entity-by-entity basis would result in an unnecessary and duplicative standard under which at many organizations, hundreds of covered subsidiaries would find themselves subject to the aforementioned provisions.

This entity-by-entity approach should be revised to consistently allow for the regulation of covered institutions on a consolidated basis. As discussed throughout this letter, the entity-by-entity approach is inappropriate in a number of circumstances, including the requirements imposed on senior executive officers of subsidiaries (see Section X.B below) and the governance and risk management framework requirements for subsidiaries (see Section XVI.A below). In addition, materiality determinations on an entity-by-entity basis are particularly inappropriate, considering that what may be material in nature for a subsidiary may be immaterial for the parent company and may, in fact, substantially contribute to a balanced risk appetite. As discussed in Section IX.B below, at a minimum, the final rule should apply consolidation principles consistently to all covered institutions and avoid subjecting Level 3 covered institutions to the heightened requirements for Level 1 and Level 2 covered institutions.

**VI. The importance of compensation arrangements to safety and soundness requires due consideration of the costs and benefits, which is missing from the proposal.**

The costs of implementing the standardized approach to incentive compensation arrangements contemplated by the proposal are substantial. Not only could the costs manifest themselves in the requirements to unnecessarily restructure an institution's established compensation program, but they could also result in increases to fixed compensation and the loss of employees due to a competitive disadvantage relative to unregulated competitors.<sup>32</sup> Covered persons will likely either demand increased fixed compensation to offset losses imposed on them by various aspects of the proposal or pursue opportunities at competitors that are not subject to the proposed rule. As the SEC noted in its economic impact analysis, the proposed "mandatory deferral requirements" alone could result in "significant costs" on affected institutions.<sup>33</sup> Taken as a whole, the unintended consequences of the proposed industry-wide structure "may contribute to reduce the competitiveness of certain U.S. financial institutions in their role of intermediation, potentially affecting other industries."<sup>34</sup>

The Agencies are proposing to impose these costs and related risks without, as required by a plain reading of Section 956, reaching the determination that any compensation that does not comply with specific requirements of the proposal would encourage inappropriate risk-

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<sup>32</sup> As discussed in Section X.B.3 below, the loss of employees in technology could present serious safety and soundness concerns for covered institutions as cybersecurity is an increasingly important focus for covered institutions.

<sup>33</sup> 81 Fed. Reg. at 37,785.

<sup>34</sup> *Id.* at 37,763.



taking. To the contrary, the SEC's review of academic literature reaches the opposite conclusion:

[T]he existing academic literature does not provide conclusive evidence about a specific type of incentive-based compensation arrangement that leads to inappropriate risk-taking without taking into account other considerations, such as firm characteristics or other governance mechanisms. In particular, there may be mitigating factors—some more effective than others—that allow efficient contracting to develop compensation arrangements for managers to align managerial interests with shareholders' interests and provide incentives for maximization of shareholder value.<sup>35</sup>

Based on the significant, identified potential costs of the rigid structure proposed, the recognition that there are alternative methods to address risk-taking and the 2010 Guidance's finding that a principles-based approach is the "most effective" way to address inappropriate risk-taking,<sup>36</sup> we strongly encourage the Agencies to undertake a full cost-benefit analysis and consider more efficient alternatives.

## **VII. The Agencies have not provided the public with a sufficient and meaningful opportunity to comment on the proposal.**

In our letter of June 1, 2016, we requested a reasonable comment period in light of the significance of the proposal and its complexity.<sup>37</sup> When the proposal was ultimately published in the Federal Register on June 10, 2016, the Agencies established an unusually short 42-day comment period, ending July 22, 2016.

The proposal is long, dense and complex. It includes hundreds of footnotes and poses over 100 questions. The proposal itself recognizes that it is likely to have a significant impact on covered institutions, and the proposed framework represents a reversal of prior multi-agency perspectives on compensation structure and risk-taking. The proposal is also a matter of meaningful public interest, with over 10,000 comments received on the 2011 Joint Notice of Proposed Rulemaking on Incentive-Based Compensation (the "2011 Proposal").<sup>38</sup> The 2011 Proposal also had a longer comment period, notwithstanding that it was much less prescriptive and less than one-third as long. Under these circumstances, we believe the July 22 deadline was not reasonably sufficient for interested parties to perform the level of analysis necessary to understand the likely implications and potential consequences of the proposal and to comment appropriately.

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<sup>35</sup> *Id.*

<sup>36</sup> 75 Fed. Reg. 36,396, 36,399.

<sup>37</sup> The Clearing House Association, *Request for Extension of Comment Period Deadline with Respect to Proposed Incentive-Based Compensation Arrangements* (June 1, 2016).

<sup>38</sup> Incentive-Based Compensation Arrangements, 76 Fed. Reg. 72 (proposed April 14, 2011) (to be codified at 12 C.F.R. pt. 42).

We recognize that the NCUA first announced the potential July 22 deadline on April 21, with its announcement of its version of the proposed rule. However, each Agency's proposal is different (with some raising issues or containing analysis not in others) and was in draft format until all Agencies agreed to publication. It was only upon publication on June 10 that the complete proposal was available.

**VIII. We support having two annual compensation cycles before the final rule becomes effective, although no requirements should become effective during a fiscal year.**

We support the consideration underlying the proposal's implementation timeline, which would allow most covered institutions two annual compensation cycles from publication of the final rule to be in full compliance. Designing, socializing and implementing necessary compensation changes will take time, and institutions will benefit from being able to do so thoughtfully. As seen in the U.K., prescriptive incentive-based compensation requirements of the type proposed by the Agencies can be difficult to implement and may require trial and error before a workable framework is established. In the U.K., remuneration rules were issued in 2009 and took effect in 2010, yet details are still being considered and revised today.<sup>39</sup> For example, the U.K. Prudential Regulation Authority and the Financial Conduct Authority initially sought and received comments on the treatment of buy-out compensation in 2014, but the approach to such regulation is under active consideration and has yet to be proposed.<sup>40</sup>

We note, however, that as currently structured, the final rule would become effective in the middle of a compensation year. Although incentive-based compensation plans with open performance periods would not be required to comply, some requirements would become effective during a compensation cycle (including for new employees, who would be subject to revised compensation structures before the continuing covered employees). As a result, many institutions would effectively have only one compensation cycle to come into compliance, and such staggered implementation throughout an institution serves no obvious risk-balancing purpose. We request that the Agencies adjust the implementation timeline so that it begins at the beginning of the first fiscal year that occurs 18 months after the final rule is published.

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<sup>39</sup> See United Kingdom Prudential Regulation Authority and Financial Conduct Authority, "PRA PS12/15/FCA PS15/16: Strengthening the Alignment of Risk and Reward: New Remuneration Rules" (June 25, 2015), available at <http://www.bankofengland.co.uk/pradocuments/publications/ps/2015/ps1215.pdf>; see generally *Supervisory activities - Remuneration Rules*, Bank of England Prudential Regulation Authority, <http://www.bankofengland.co.uk/pradocuments/supervision/activities/remuneration.aspx>.

<sup>40</sup> Bank of England news release, Prudential Regulation Authority and Financial Conduct Authority announce new rules on remuneration (June 23, 2015), available at <http://www.bankofengland.co.uk/publications/Documents/news/2015/ps1215.pdf>.

**IX. Covered Institutions (including Levels of Covered Institutions, Subsidiaries and Non-U.S. Institutions)**

**A. The final rule should not include a three-level structure because the types or features of compensation that encourage inappropriate risks do not differ based on institutional size and Section 956 does not contemplate varying treatment by size of institutions above \$1 billion.**

The proposed rule would vary the requirements that apply to institutions by grouping institutions according to asset size, with the most stringent requirements applying to so-called Level 1 covered institutions, *i.e.*, those covered institutions having average total consolidated assets greater than or equal to \$250 billion.<sup>41</sup> These requirements include specific deferral, forfeiture, adjustment and clawback requirements, which become more onerous as asset size increases, and limits on incentive opportunity and performance measures that do not apply to Level 3 covered institutions, *i.e.*, those covered institutions having average total consolidated assets less than \$50 billion. This contemplated three-level structure to categorizing covered institutions by asset size is an unauthorized and imprudent implementation of Section 956.

- The types or features of compensation that could lead to inappropriate risk-taking do not vary by the size of institution. The Agencies do not provide support for their apparent conclusion that the types or features of compensation that could lead to inappropriate risk-taking vary by the size of institution, and we do not believe such a position is supportable. We believe, instead, that the conclusions of the 2010 Guidance were correct: that “activities and risks may vary significantly across banking organizations and across employees within a particular banking organization” and a principles-based approach is more effective. To the extent, however, that the Agencies determine that only certain types of incentive-based compensation may discourage inappropriate risks, we do not believe that determination could reasonably vary based on asset size. For example, should the Agencies determine that a compensation opportunity in excess of 200% of target would encourage individuals to take inappropriate risks, such leverage would equally encourage inappropriate risk-taking at all institutions, not just those with assets at or above a given threshold. There is no basis to distinguish between institutions of different sizes in order to prohibit incentive-based compensation arrangements that encourage inappropriate risks.
- Section 956 does not contemplate varying treatment by size of institutions above \$1 billion. In pertinent part, Section 956 authorizes the Agencies to prohibit types or features of incentive-based compensation arrangements. Unlike other sections of Dodd-Frank (of which there are many), it does not contemplate treating institutions differently based on asset size beyond the initial \$1 billion threshold.<sup>42</sup> When

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<sup>41</sup> Section 236.2(v)–(x), 81 Fed. Reg. at 37,807.

<sup>42</sup> A number of Dodd-Frank’s requirements apply only to institutions with over \$50 billion in total consolidated assets (including requirements regarding enhanced prudential standards, resolution planning and early

Congress intends to distinguish institutions based on their size, it knows how to do so explicitly.<sup>43</sup> Also, Section 956 does not contemplate the prohibition of compensation types or features by reference to the impact to the broader financial system. Instead, Section 956 contemplates doing so by reference only to financial losses meaningful to the covered institution itself—thereby expressing equal concern about every institution. By introducing increasing levels of restriction based on asset size, and without reference to any other risk-related factors, the proposal places larger institutions at a competitive disadvantage that was not contemplated or authorized by Section 956.

We strongly urge the Agencies to reconsider this three-level structure.

**B. To the extent the Agencies both continue to apply the final rule on an entity-by-entity basis and maintain a three-level structure, all subsidiaries of covered institutions should be treated at the level corresponding to their own assets.**

The proposed rule (except as proposed by the SEC) defines covered institutions that are subsidiaries of other covered institutions to be the same “level”—and, accordingly, subject to the same, more restrictive requirements—as their top-tier parent institution.<sup>44</sup> If this three-level structure is maintained, we strongly urge the Agencies to treat all covered institutions based on their own characteristics and not based on those of their affiliates. To do otherwise would place identical covered institutions on different playing fields based solely on the nature of their affiliation with a larger institution (unless regulated by the SEC).

- Placing subsidiaries at the level of their parent is inconsistent with the otherwise unconsolidated approach of the proposal. Although we believe the proposal should be applied on a consolidated basis (as discussed in Section V above), it currently takes an entity-by-entity approach. Under this approach, the proposal would require each covered institution to identify its own senior executive officers, have its own governance process and determine downward adjustment and forfeiture by reference to its own subsidiary business. It is inconsistent with the entity-by-entity framework to, at the same time, subject these same institutions to requirements inappropriate to their size and complexity solely on the basis of their affiliation with larger institutions. We believe that either (i) compensation at institutions should be regulated on a consolidated basis, consistent with the Agencies’ finding that large

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remediation, *see* 12 U.S.C. §§ 5365(b), and (d), and § 5366 ), but Congress specifically chose to apply Section 956 to a broader population of institutions by setting a lower asset threshold. The proposed rule’s three-level structure directly contradicts Congress’s established asset threshold.

<sup>43</sup> For example, when imposing capital requirements, Congress exempted depository institution holding companies “with total consolidated assets of less than \$15,000,000,000” from the capital deductions that Dodd-Frank required of other institutions. 12 U.S.C § 5371(b)(4)(C). Congress also distinguished between very large banks with “total assets of more than \$10,000,000,000” and other banks with “total assets of \$10,000,000 or less” in granting the CFPB authority to supervise banks. *Compare* 12 U.S.C. § 5515 *with* 12 U.S.C. § 5516.

<sup>44</sup> *See* Section 236.2(v)–(x), 81. Fed. Reg. at 37,807.

institutions “increasingly” manage their risks on this basis, or (ii) the Agencies should be consistent in their view of entity-by-entity treatment. To effectively subject smaller covered institutions to the worst of both worlds is unnecessary and unsupportable.

- Placing subsidiaries in the level of their parent places them at a competitive disadvantage relative to institutions that are standalone or subsidiaries of uncovered institutions. A subsidiary of a Level 1 or Level 2 covered institution would be subject to the more restrictive requirements of the proposed rule. This, in turn, would lead to a tangible impact on the subsidiary’s ability to compete in the marketplace for employees and have severe, far-reaching and long-term negative effects on the institution. For example, a bank holding company with over \$250 billion in assets may have a subsidiary that operates as a small boutique asset manager with just over \$1 billion in assets. Under the proposed rule, the subsidiary would be a Level 1 covered institution and subject to the additional requirements and prohibitions stemming from that categorization.<sup>45</sup> Those requirements include subjecting incentive pay to deferral and clawback requirements for a number of years. In contrast, a similar asset manager that is the subsidiary of a Level 1 covered institution and regulated by the SEC—which does not include covered institution subsidiaries in the “level” of their parent—would not be subject to those same requirements.<sup>46</sup> An employee, including one in a control function, faced with otherwise identical job offers from these two asset managers, would have an easy choice between the two employers.

The competitive disadvantage faced by subsidiaries treated like their Level 1 or Level 2 covered institution parents extends beyond the market for talent. The proposal’s requirements would require ongoing implementation, operational and monitoring costs, as well as significant time and attention from employees. These costs are not trivial and would be burdensome for subsidiaries to implement and maintain. While we appreciate the Agencies’ recognition that this proposed treatment of subsidiaries has disadvantages for smaller subsidiaries within a larger holding company structure, we urge them to further consider the burden this requirement would impose and the possible negative implications it could have on such institutions.

- There is no basis for more restrictive treatment of subsidiaries of larger covered institutions versus standalone entities or subsidiaries of uncovered institutions. By subjecting the compensation of executives and business leaders at the parent entity to the appropriate level, the proposal would provide such incentives as the Agencies determine appropriate to deter inappropriate risk-taking within all parts of the organization. As noted in the preamble, “the expectations and incentives established by the highest levels of corporate leadership set the tone for the entire organization

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<sup>45</sup> See Section 236.2(v), 81 Fed. Reg. at 37,807.

<sup>46</sup> See Section 303.2(v), 81 Fed. Reg. at 37,833.

and are important factors of whether an organization is capable of maintaining fully effective risk management and internal control processes.”<sup>47</sup> Imposing additional requirements that were deemed unnecessary, but for a relationship with a larger covered institution, does not add meaningful protection against inappropriate risk-taking.

- At a minimum, the final rule should both apply consolidation principles consistently to all covered institutions and not subject Level 3 covered institutions to the heightened requirements for Level 1 and Level 2 covered institutions. If the final rule does not apply on a consolidated basis (as we have suggested it should in Section V above) and places subsidiaries in the “level” of their parent (notwithstanding our comments in this section), the final rule should, at a minimum, both take a consistent approach to consolidation across all institutions and ensure that Level 3 covered institutions are not subjected to the additional requirements and prohibitions because of their affiliation with a Level 1 or Level 2 covered institution. It is important that all the Agencies, including the SEC and the Federal Banking Agencies, agree on an approach to consolidation to avoid differing treatment for covered institutions solely based on the identity of their regulator. It is also important that consolidation rules do not impose an entirely different set of requirements on Level 3 covered institutions, which are subject to a limited subset of the proposed rule’s requirements, based solely on the identity of their parent.
- Affiliates should not be consolidated unless consolidated for accounting purposes. The proposal, as written, could be read to imply that companies that are not covered institutions, due to having consolidated assets of less than \$1 billion, may be treated as consolidated with affiliates depending on “facts and circumstances” (for example, if those affiliates are “operationally integrated”), and thereby be treated collectively as a single covered institution if together they exceed \$1 billion in assets.<sup>48</sup> Section 956 does not contemplate such a concept of consolidation and explicitly states that “this section shall not apply to covered financial institutions with assets of less than \$1,000,000,000.”<sup>49</sup> Moreover, the possibility that uncovered institutions might be treated as a consolidated covered institution creates uncertainty and is unreasonable in light of the specific Congressional mandate. The Agencies should clarify that affiliates will not be treated as consolidated unless those affiliates are consolidated for purposes of applicable accounting requirements. Concerns regarding evasion are better addressed directly, for example, by further clarifying that affiliates will not be treated as consolidated with covered institutions *unless* a principal purpose

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<sup>47</sup> 81 Fed. Reg. at 37,685.

<sup>48</sup> See 81 Fed. Reg. at 37,686, n.64 (“[T]he SEC has stated that it will, based on facts and circumstances, treat as a single investment adviser two or more affiliated investment advisers that are separate legal entities but are operationally integrated.”).

<sup>49</sup> 12 U.S.C. § 5641.

of conducting the businesses of the affiliates through separate entities is avoidance of the final rule.

**C. “Covered institution” should not automatically cover all subsidiaries of depository institution holding companies; only subsidiaries that would be covered institutions on their own should be subject to the final rule.**

The proposal would cover subsidiaries that would not, but for their affiliation with a covered institution holding company, be included within the ambit of Section 956. For example, all subsidiaries of bank holding companies would be covered financial institutions without regard to risk profile, business or the integration of the businesses of the subsidiary with that of its covered institution parent, unless the subsidiary has less than \$1 billion in assets.

Including all of these subsidiaries increases the compliance burden and cost to depository institution holding companies. It also places these subsidiaries at a competitive disadvantage relative to their standalone competitors and relative to competitors that are affiliated, but not part of, a depository institution holding company. Moreover, Section 956 does not require or contemplate treating all subsidiaries of certain covered financial institutions as “covered financial institutions.” We ask the Agencies to revise the proposal either (i) to treat institutions on a consolidated basis or (ii) if the Agencies continue the entity-by-entity approach, to encompass only institutions that, by nature of their own regulatory profile and asset size, qualify as covered institutions, consistent with the text and purpose of Section 956.

**D. In the Federal Reserve’s final rule, “regulated institution” should explicitly exclude subsidiaries of depository institutions.**

The Federal Reserve’s proposal defines “covered institution” by reference to “regulated institution” which includes “[a] bank holding company . . . and a subsidiary of such a bank holding company that is not a depository institution, broker-dealer or investment adviser.”<sup>50</sup> This definition could be interpreted to include a subsidiary of a bank holding company that is also a subsidiary of a depository institution. Such an interpretation would create an overlap between the coverage of the Federal Reserve’s proposal and the coverage of the OCC’s and the FDIC’s. The OCC’s proposal applies to “subsidiar[ies] of a national bank”<sup>51</sup> and the FDIC’s applies to “subsidiar[ies] of a state nonmember bank[.]”<sup>52</sup> The Federal Reserve should clarify that a “regulated institution” does not include a subsidiary of a depository institution.

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<sup>50</sup> Section 236.2(dd)(2), 81 Fed. Reg. at 37,808 (emphasis added).

<sup>51</sup> Section 42.2(i)(2), 81 Fed. Reg. at 37,800.

<sup>52</sup> Section 372.2(i)(2), 81 Fed. Reg. at 37,814.

**E. The definition of “subsidiary” should be amended to include only entities that are majority owned.**

The proposed rule defines “subsidiary” broadly, as “any company that is owned or controlled directly or indirectly by another company”<sup>53</sup> and “control” in a manner “similar to the definition of the same term in the Bank Holding Company Act.”<sup>54</sup> This combination would cover entities that are not covered institutions themselves and which are less than majority-owned by a covered institution. For example, a covered institution may participate in and indirectly own a significant (but below majority) stake in a joint venture, which would be a subsidiary, as defined, by virtue of the ownership structure and subject to compensation restrictions at the same “level” as the parent. The parent, however, could be unable to exercise control over that joint venture’s employee or risk management procedures. This example becomes even more problematic for a joint venture outside the United States, where a parent may have limited ability to control its subsidiary and where such subsidiary may be subject to regulation in its home country. The proposed rule’s overly broad definition of “subsidiary” also does not advance any of the stated purposes of Section 956, and the Agencies are under no obligation to follow the definition of “control” contemplated by the Bank Holding Company Act (which was developed for other purposes). The minority-owned institutions that would be included as “subsidiaries” are not those that would be likely to present risk of material financial loss as a result of inappropriate risk-taking to the larger organization. In any case, the proposal includes an anti-evasion provision that is designed to ensure that a covered institution cannot indirectly do anything that would be unlawful under the rule,<sup>55</sup> which alleviates the need for such a broad scope of “subsidiaries.”

We would have no concerns if the covered institution determination was made without reference to affiliation and only based on the institution’s own characteristics. In that case, each covered institution would have an independent obligation to comply with the Agencies’ compensation prohibitions. However, if a covered institution’s status can result solely from its affiliation with a parent covered institution, the final rule should clarify that only majority-owned subsidiaries should be included so that the parent is able to enforce compliance. The proposed rule’s definition of “subsidiary” is impractical and would create significant operational and cost issues.<sup>56</sup> If the definition of “subsidiary” is maintained, the Agencies should explain how covered institutions are expected to implement the proposal’s requirements at subsidiaries where they hold a non-majority stake and do not have actual control over compensation practices.

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<sup>53</sup> See Section 236.2(ii), 81 Fed. Reg. at 37,809.

<sup>54</sup> 81 Fed. Reg. at 37,689.

<sup>55</sup> Section 236.12, 81 Fed. Reg. at 37,813.

<sup>56</sup> We support the exclusion of merchant banking investments that are owned or controlled pursuant to Section 4(k)(4)(H) of the Bank Holding Company Act, as provided for in the Federal Reserve’s version of the proposed rule. See 81 Fed. Reg. at 37,689. Merchant banking investments are in commercial companies that are not financial in nature, and we support applying this exclusion more broadly to include financial portfolio companies that would qualify as merchant banking investments but for the fact that they are financial companies.



**F. The final rule should expressly permit covered institutions that are also subject to the requirements of supervisors of non-U.S. jurisdictions to coordinate requirements.**

The preamble notes that non-U.S. jurisdictions have introduced compensation regulations that apply to financial institutions that are organized or do business in that jurisdiction. As a result, domestic covered financial institutions with international operations and foreign banks with U.S. operations would be subject to multiple, overlapping regulatory requirements.

The 2010 Guidance recognized this potential for jurisdictional overlap and related inefficiency, and specifically noted that incentive compensation policies “should be coordinated.”<sup>57</sup> The proposal’s standardized approach, however, does not accommodate such coordination. Instead, institutions based outside of the United States or with non-U.S. operations would become subject to two sets of recordkeeping, reporting and compliance requirements—which may or may not overlap—and two sets of specific, and in some cases prescriptive, requirements as to the type, form and amount of incentive-based compensation. Institutions would effectively be required to comply with the most onerous requirements applicable in every instance. The proposed approach is burdensome and places international institutions at an unnecessary competitive disadvantage.

To the extent the Agencies adopt the principles-based approach we suggest, which is preferable and consistent with the 2010 Guidance, the revised approach would be flexible enough to allow institutions covered by foreign regimes to meet both their home country and U.S. requirements. However, if the Agencies keep the proposed rule’s standardized approach to incentive-based compensation arrangements, institutions that are subject to supervision by a home country regulator in jurisdictions determined to be substantially comparable with the Financial Stability Board’s Principles for Sound Compensation Practices and their Implementation Standards (“Selected Jurisdictions”) should be exempt so long as they comply with their home country regulation and/or supervision.<sup>58</sup> The exception should apply to both the international operations of domestic covered financial institutions and the U.S. operations of covered foreign institutions.<sup>59</sup>

Providing this exception would allow home country supervisors to serve as the primary regulator with respect to incentive compensation arrangements and would be consistent with a consolidated approach to compensation decisions. Permitting home country supervisors to review compensation arrangements under one comprehensive and consistent regime would

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<sup>57</sup> 75 Fed. Reg. 36,396, 36,400, 36,407.

<sup>58</sup> For foreign banking organizations (“FBOs”), we would recommend that a checkbox be added to Federal Reserve’s form FR Y-7 allowing an FBO to confirm that their incentive compensation plans are in compliance with home country regulations and/or supervision in a Selected Jurisdiction.

<sup>59</sup> At a minimum, the Agencies should exempt U.S. branches of foreign banks in Selected Jurisdictions from the proposal’s requirements. As a legal part of the foreign bank itself, subjecting branches to both the U.S. requirements and the requirements of their home country regulator intensifies the likelihood of conflicting and overlapping rules.

ensure enterprise-wide coordination and alignment of incentive compensation practices. Further, some institutions may otherwise be forced to change their current executive management practices. Many foreign banks regularly have home country-based senior executives serve in leadership and management positions in U.S. branches and subsidiaries. This practice supports home country management's ability to execute enterprise-wide risk management and supervision of its branches and subsidiaries located abroad. These executives' compensation arrangements (especially long-term incentives) would be significantly disrupted, especially as the lengthy deferral and clawback requirements may lead a single employee to have compensation subject to adjustment or forfeiture in multiple jurisdictions at one given time. The complexity of these differences in compensation arrangements could lead to fewer parent bank executives having the practical ability to serve in leadership and management roles in the United States, and the risk management and supervision benefits of such service would no longer be available to the parent foreign bank. It is also important to note that many institutions have already transformed their incentive compensation practices in order to comply with their home country requirements, some of which have been in effect for years. The Agencies should not require these institutions to engage in a costly process to redo or undo many of the programs they have put into practice.

In addition, several of the proposed rule's requirements overlap with requirements in place in the E.U. as part of Capital Requirements Directive IV ("CRD IV"). For example, CRD IV contains (i) a provision to identify individuals who have a material influence on the risk profile of an institution (called material risk takers in the E.U. and significant risk-takers in the proposed rule), (ii) a requirement that a substantial portion of compensation be deferred in the form of equity, (iii) a deferral requirement for variable compensation and (iv) a requirement to subject variable compensation to malus (similar to the proposed rule's clawback requirements), among several other similarities and overlapping requirements. These overlapping requirements demonstrate how the proposed rule will, in many ways, be unnecessary for institutions covered by CRD IV and the benefits of allowing coordination such that a single set of requirements apply to each institution instead of competing requirements.

The preamble discusses the Financial Stability Board's compensation principles and practices, along with various Selected Jurisdictions that are substantially or expected to be substantially compliant, including Canada, Australia and Switzerland. The Agencies can be comfortable with this exemption, given that provisions of the proposed rule are also generally consistent and compliant with aspects of the FSB Principles, including the proposed deferral requirements applicable to incentive-based pay.<sup>60</sup>

**G. The SEC should clarify that "investment adviser" does not include non-U.S. investment advisers.**

The SEC's version of the proposed rule defines "regulated institution" to include investment advisers as defined in Section 202(a)(11) of the Investment Advisers Act of 1940.<sup>61</sup>

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<sup>60</sup> 75 Fed. Reg. at 36,399, 36,405.

<sup>61</sup> Section 303.2(dd), 81 Fed. Reg. at 37,833.

Section 202(a)(11), however, defines investment advisers without reference to jurisdiction of organization, operations or clients. The proposal could therefore be read to include investment advisers without any connection to the United States.

We would first suggest that non-U.S. investment advisers be excluded from covered institutions. Excluding non-U.S. investment advisers from the definition of covered institution is particularly appropriate in the case of FBOs. As recognized by the Banking Agencies with their limited regulation of only FBOs' U.S. operations, compensation practices of FBOs' non-U.S. affiliates do not warrant regulation for risk mitigation purposes. In executing this exclusion, a minimum U.S. contacts test could be applied.

Alternatively, we suggest that the SEC version of the final rule, at a minimum, exclude from covered institutions any "foreign private adviser" as defined in Section 202(a)(30) of the Investment Advisers Act.<sup>62</sup> Among other things, a "foreign private adviser" may not have a place of business in the United States, may not hold itself out generally to the public in the United States as an investment adviser and may only have limited U.S. clients. Section 203 of the Investment Advisers Act exempts foreign private advisers from the registration requirements of the Act,<sup>63</sup> and we believe reference to foreign private advisers would provide a well-understood, consistent basis for determining whether an investment adviser is sufficiently disconnected from the United States to be excluded from U.S. regulation, including the final rule.

#### **H. The final rule should exclude intangible assets, including goodwill, from the measurement of average total consolidated assets.**

In proposing to distinguish covered institutions by their asset size, the proposed rule relied in part on "the general correlation of asset size with . . . potential risks."<sup>64</sup> The proposal would define "average total consolidated assets" by reference to assets as reported on the regulated institution's regulatory reports. However, measurement of total assets as reported on regulatory reports frequently includes significant intangible assets, such as capitalized goodwill, that do not represent financial assets that are fair valued on a recurring basis. Moreover, these intangible assets are not correlated or related to risk. We therefore ask the Agencies to clarify that intangible assets, including goodwill, are not to be included in an institution's calculation of average total consolidated assets, to the extent this standard is retained.

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<sup>62</sup> 15 U.S.C. § 80b-2.

<sup>63</sup> 15 U.S.C. § 80b-3.

<sup>64</sup> 81 Fed. Reg. at 37,687.

**X. Covered Persons (including Senior Executive Officer and Significant Risk-Taker Definitions)**

**A. The definition of “covered persons” should use the existing material risk taker framework and should not include every employee who receives incentive-based compensation; and all “covered persons” should have more limited requirements applied to them.**

The proposed rule defines “covered persons” to include every employee of a covered institution who receives incentive-based compensation, regardless of the amount or type.<sup>65</sup> Accordingly, the proposed rule would encompass countless roles far removed from inappropriate risk-taking and well outside the bounds of what Congress intended, including administrative, maintenance and other support roles. We suggest that the Agencies work with the already defined material risk taker groups at covered institutions and define “covered persons” to include category 1, 2 and 3 material risk takers, which would appropriately limit the final rule to only those individuals who could, either individually or collectively as part of a group, take the type of inappropriate risks that might lead to material financial loss. As part of the supervisory process that has already been in place and in accordance with the 2010 Guidance, financial institutions and their regulators have identified material risk takers at their institutions based on the facts and circumstances specific to each institution.

The established material risk taker framework not only works well for the definition of “covered persons,” but it also aligns with the proposed rule’s definitions of “senior executive officers,”—*i.e.*, category 1 material risk takers, and “significant risk-takers,”—*i.e.*, category 2 material risk takers. We believe that the Agencies should not abandon the work already done to identify material risk takers at covered institutions.

If the Agencies nevertheless maintain the proposed definition of “covered persons,” a quantitative minimum should be set such that employees who receive incentive-based compensation below a certain threshold (*e.g.*, \$50,000) are not considered “covered persons.” A quantitative minimum for incentive-based compensation arrangements generally is discussed in Section XV.A.2 below.

Regardless of how “covered persons” is defined, some of the requirements that would apply to all “covered persons” are unduly burdensome.

- The Agencies should revise the proposed rule’s balancing requirements to apply only to plans with significant risk-takers; applying it more broadly would be inconsistent with Section 956. Under the proposed rule, all incentive-based compensation arrangements for all covered persons must “appropriately balanc[e] risk and reward.”<sup>66</sup> Even an incentive-based compensation arrangement for a de minimis

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<sup>65</sup> Section 236.2(j), 81 Fed. Reg. at 37,807.

<sup>66</sup> Section 236.4(c)(1), 81 Fed. Reg. at 37,809.

amount to an employee who receives a moderate level of total compensation would be required to meet this requirement. In some instances, an arrangement may be so insignificant to the larger covered institution that it can be granted without concern for how it balances risk and reward. Put another way, the institution should be allowed to do its own balancing of de minimis awards without suffering the costs of compliance with the proposal.

- Section 956 clearly does not contemplate requiring risk balancing for all incentive-based compensation arrangements and instead is focused on preventing arrangements that could lead to a material financial loss. The proposal would impose a significant cost on covered institutions to ensure that each and every incentive-based compensation arrangement balances risk and reward, no matter how small the arrangement is. Accordingly, we urge the Agencies to only apply this balancing requirement to significant risk-takers, which should consist of those employees who truly can create the potential for material financial loss.
- If the proposed rule's broad balancing requirement continues to apply to all covered persons, covered institutions would be at a significant disadvantage relative to peers who can grant incentive awards to employees without concern for whether the award appropriately balances risk and reward. Notably, in the E.U., requirements to balance risk and reward do not extend broadly to all employees who receive any type of incentive-based compensation.<sup>67</sup>
- The final rule's recordkeeping requirements should be limited to senior executive officers and significant risk-takers and apply only to the top-tier parent covered institution. The proposed rule requires that all covered institutions create, and maintain for seven years, records that document the structure of all their incentive-based compensation arrangements.<sup>68</sup> The proposed rule has more strenuous requirements for Level 1 and Level 2 covered institutions, but notably applies recordkeeping requirements to all covered institutions and to all incentive-based compensation arrangements.
- The recordkeeping requirement would impose a significant cost on institutions, given the volume of incentive-based compensation arrangements that may be in place. The requirement is also incongruent with the proposal's seven-year clawback requirement, which would necessitate recordkeeping, but not apply to all covered persons, only to senior executive officers and significant risk-takers. Accordingly, the final rule's recordkeeping requirements should only apply to the incentive-based compensation arrangements that are provided to senior executive

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<sup>67</sup> Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC, 2013 O.J. (L 176) 338, 386.

<sup>68</sup> Section 236.4(f), 81 Fed. Reg. at 37,810.

officers and significant risk-takers. Recordkeeping requirements as broad as those contained in the proposed rule are overly burdensome and inconsistent with Section 956.

- The recordkeeping requirements also would place a significant cost on covered institutions that are subsidiaries of parent covered institutions and whose ordinary course practice may not include the sort of recordkeeping that is done at the parent level. Level 1 and Level 2 covered institutions would be required to keep records of material changes to incentive-compensation arrangements and policies for seven years,<sup>69</sup> but the only changes that should need to be recorded should be those that are material to a top-tier parent and not each covered subsidiary itself.
- The proposed rule's benchmarking requirements should be limited to senior executive officers and significant risk-takers. It is highly unreasonable to expect that all incentive-based compensation at all covered institutions be benchmarked against compensation at comparable institutions. The proposed rule requires benchmarking in order to ensure that compensation is not excessive,<sup>70</sup> and would require it for all covered persons and not simply senior executive officers and significant risk-takers. Covered persons would include administrative, maintenance and other employees who would present no risk of material financial loss and for whom the concern over excessive compensation is inappropriate. Accordingly, the final rule should limit the benchmarking requirement to senior executive officers and significant risk-takers.
- The proposed rule's anti-hedging provision should not apply to foreign-exchange hedging. The proposal's anti-hedging provision prohibits covered institutions from purchasing hedging or similar instruments to offset the value of a covered person's incentive-based compensation.<sup>71</sup> Such a provision should not prohibit foreign-exchange hedging, which may be necessary for employees to hedge against currency risk and would not relate to hedging against a covered institution's performance.

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<sup>69</sup> Section 236.5(a)(4), 81 Fed. Reg. at 37,810.

<sup>70</sup> Section 236.4(b)(4), 81 Fed. Reg. at 37,809.

<sup>71</sup> Section 236.8(a), 81 Fed. Reg. at 37,812.

**B. The senior executive officer definition should only be in reference to top-tier parent entities (or U.S. intermediate holding companies in the case of foreign banking organizations), should use an existing definition (category 1 material risk takers, which align with Rule 3b-7 executive officers and Section 16 officers) and, in any case, should not include control function heads or chief technology officers.**

**1. The senior executive officer definition should only be in reference to top-tier parent entities (or U.S. intermediate holding companies).**

The proposed rule imposes heightened requirements on those individuals at covered institutions that are identified as “senior executive officers,” including detailed governance requirements and, for Level 1 and Level 2 covered institutions, specific requirements for deferral, downward adjustment, forfeiture and clawback and limits on incentive-based compensation opportunities. As proposed, the senior executive officer definition would cover not only individuals serving as any of the 13 enumerated roles at a parent covered institution, but also individuals serving in such roles at any other covered institutions. When combined with the proposal’s current treatment of subsidiaries, all of these individuals would be subject to the same requirements. For example, a chief compliance officer at a \$1 billion subsidiary of a \$1 trillion covered institution would be subject to the same incentive-based compensation arrangement requirements as the chief executive officer of the parent institution (from whom she or he may be four or more reporting levels away). The proposed structure goes far beyond what might be necessary to protect against inappropriate risk-taking to include employees in no position to impose material financial loss, and imposes onerous restrictions on their compensation.

The final rule should state that a consolidated group has only one set of senior executive officers. The set should be comprised of individuals serving in specified roles (or as heads of major business lines or control functions) for the top-tier parent covered institution. In any case, some individuals who would be senior executive officers of a subsidiary would likely be included under the proposed rule’s definition of significant risk-takers. On the other hand, if a senior executive officer of a subsidiary would not be a significant risk-taker, there would be no additional risk-related benefit to including that individual as a senior executive officer.

With respect to foreign banking organizations, the Agencies should similarly redefine senior executive officers to apply only to the U.S. intermediate holding companies. For the same reasons it is appropriate to limit the definition of senior executive officer to U.S.-based covered institutions, it is appropriate only to apply the categorization to intermediate holding companies rather than each and every covered institution subsidiary of a covered foreign banking organization.

**2. Senior executive officer should be defined as category 1 material risk takers, consistent with the Rule 3b-7 executive officer and Section 16 officers definitions.**

The Agencies propose to define “senior executive officer” in a new manner that is not currently used by covered institutions for any other purpose, and captures a group of executive

officers never previously defined. Existing frameworks better serve to identify a discrete group of executives to whom applying the proposed rule's senior executive officer requirements would be appropriate. As discussed in Section X.A above, the existing material risk taker category 1 group should be leveraged for the definition of senior executive officer. The category 1 group is also consistent with existing definitions of senior executive officer used for other purposes. Using existing definitions will reduce confusion and the burden on covered institutions to identify several different groups and categories of senior executive officers, executive officers or officers.

Executive officers under Rule 3b-7 of the Securities and Exchange Act of 1934 and Section 16 officers, as defined in Rule 16a-1(f) of the Exchange Act, are almost the identical group of individuals. Rule 3b-7 defines executive officers as the president, vice presidents in charge of principal business units, divisions or functions and other persons who perform a policy-making function.<sup>72</sup> The Section 16 officer definition is identical, except it explicitly includes a company's principal financial officer and principal accounting officer.<sup>73</sup> In both cases, the definitions provide that officers of a subsidiary could be deemed officers of a parent company if those officers perform a policy-making function for the parent itself.

In many ways, the Rule 3b-7 or Section 16 officer definitions would likely overlap with the proposed rule's senior executive officer definition. However, these alternative definitions provide an already well-established set of individuals at each institution. The identification of officers who perform a policy-making function is a well-known and oft-considered question at covered institutions. The proposed rule's senior executive officer definition, on the other hand, includes the hard-to-define category of "a head of a major business line" that may be applied differently by each covered institution and would be subject to frequent change as business lines grow or shrink.

**3. To the extent the Agencies maintain the proposed definition of senior executive officer, the Agencies should remove control function heads and the chief technology officer, who already have major incentives not to take on risk.**

The proposed rule defines "control function" as "a compliance, risk management, internal audit, legal, human resources, accounting, financial reporting, or finance role responsible for identifying, measuring, monitoring, or controlling risk-taking."<sup>74</sup> As the preamble acknowledges, "covered persons in control functions generally do not perform activities designed to generate revenue" and, although the proposal concludes that they have the ability to expose covered institutions to risk of material financial loss, it is also the very nature of their duties to avoid risks of material losses.<sup>75</sup> Moreover, to the extent the senior executive officer

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<sup>72</sup> 17 C.F.R. § 240.3b-7.

<sup>73</sup> 15 U.S.C. § 78p.

<sup>74</sup> Section 236.2(h), 81 Fed. Reg. at 37,807.

<sup>75</sup> 81 Fed. Reg. at 37,700.



determination continues to apply on an entity-by-entity basis, including control function heads would potentially restrict the compensation of employees deep into the control organization (to the extent they serve as head of a control function of a covered institution subsidiary). Accordingly, the proposed rule's significant risk-taker definition is a more appropriate way to identify control function heads who actually have the ability to expose covered institutions to risk of material financial loss.

Including chief technology officers within the definition of senior executive officer and per se subjecting them to the most stringent restrictions on incentive-based compensation could cause the most talented and sought-after talent in information technology to depart to unregulated sectors, harming the safety and soundness of the regulated financial sector. The preamble recognizes that chief technology officers play a significant role in information technology management,<sup>76</sup> and covered institutions compete with a wide range of other companies—including technology-centric ones—for employees with that expertise. Unlike employees who have devoted years to acquiring expertise only applicable to working at large financial institutions and may have limited mobility outside the coverage of the proposed rule, chief technology officers will have little difficulty leaving the financial institution sector if covered institutions are unable to offer competitive compensation on terms consistent with the broader market. The exodus of chief technology officers and others with technology expertise from covered institutions could have serious systemic consequences. Cybersecurity is an increasingly important focus for large financial institutions,<sup>77</sup> and losing talent in this area is an unacceptable risk in and of itself.<sup>78</sup> The Agencies should ensure that covered institutions are not restricted in the manner in which they can compensate those who focus on cybersecurity and other information technology risks.

**4. To the extent the Agencies maintain the proposed definition of senior executive officer, the Agencies also should remove the chief lending officer and chief credit officer from the mandated group of individuals identified as senior executive officers at every covered institution.**

The roles of chief lending officer and chief credit officer may vary greatly from covered institution to covered institution. While it may be appropriate to classify individuals in those titles as senior executive officers at certain institutions, in other cases those titles may be several reporting lines down from the chief executive officer and without significant policy-making authority. Companies should have the flexibility to determine, based on their various roles, distribution of policy-making powers and organizational structure, whether or not their chief lending officer and chief credit officer are properly categorized as senior executive officers.

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<sup>76</sup> 81 Fed. Reg. at 37,692, citing Federal Financial Institutions Examination Council Information Technology Examination Handbook, *available at* <http://ithandbook.ffiec.gov/it-booklets.aspx>.

<sup>77</sup> *See generally* Bruce Radke, *Financial Institutions Will See More Focus on Cybersecurity*, Law360, Jan. 16, 2015, <http://www.law360.com/articles/611617/financial-institutions-will-see-more-focus-on-cybersecurity>.

<sup>78</sup> 2016 FSOC Ann. Rep., at 7, 113; 2015 FSOC Ann. Rep., at 9, 105; 2014 FSOC Ann. Rep., at 12, 120; 2013 FSOC Ann. Rep., at 15, 136; 2012 FSOC Ann. Rep., at 9, 6, 136-137; 2011 FSOC Ann. Rep., at 147.

There is no justification for mandating all individuals with those titles be deemed senior executive officers.

**C. The significant risk-taker definition should not involve bright-line tests, and to the extent the definition does involve bright-line tests, a dollar threshold test should replace the relative compensation test and the exposure test should be eliminated. In addition, there should be an exception for financial advisers and other categories of employees who do not deploy the capital of the covered institution.**

The proposed rule's significant risk-taker definition is a significant departure from past attempts to identify a group of individuals at a financial institution that can pose risk of material financial loss. We believe that it is more appropriate to build on the existing work that the institutions and Agencies have done together to identify covered persons under the 2010 Guidance. However, if the Agencies continue to believe that a bright-line standard only tangentially tied to risk-taking is appropriate, a specific dollar threshold would be equally effective and less costly to implement.

**1. Bright-line tests to determine the population of significant risk-takers, as proposed by the Agencies, are not contemplated by Section 956. Instead, the final rule should use the category 2 material risk taker framework.**

Since the financial crisis, financial institutions and their supervisors—including many of the same agencies that have issued the proposed rule—have worked cooperatively and made significant progress in understanding and revising incentive compensation arrangements. As part of this supervisory process and in accordance with the 2010 Guidance, financial institutions and their regulators have identified material risk takers at their institutions based on the facts and circumstances specific to each institution. Great strides have been made to reduce the risks associated with incentive compensation through this process. But with the proposed rule, the Agencies would change—we believe arbitrarily—their approach to identifying employees with the potential to expose an institution to material financial loss. In particular, the switch from material risk taker to the newly defined significant risk-taker replaces the customized work that institutions have done to identify the inherent risks specific to their businesses with an identifier that is only tangentially related to risk and preventing material financial loss. The Agencies should utilize the category 2 material risk taker framework, with a set of individuals to be agreed upon by financial institutions and their supervisors, to replace the proposal's definition of significant risk-taker.<sup>79</sup>

If the Agencies keep the new bright-line significant risk-taker test, at a minimum, it should be rectified by giving covered institutions the ability to exclude, on a case-by-case basis: (i) individuals who meet the bright-line test, but in the institution's judgment should not be

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<sup>79</sup> Category 1 material risk takers are largely reflected in the proposal's definition of senior executive officers and category 3 material risk takers would be inappropriate to include, given that it includes groups of employees who collectively could expose an institution to risk, which is outside the coverage of Section 956.

covered as significant risk-takers, and (ii) job titles, roles or functions that, although often within the bright-line definition of significant risk-taker, would not lead to material financial loss at the covered institution.<sup>80</sup> A bright-line test will inevitably include individuals who are not actually capable of exposing a covered institution to material financial loss. Allowing covered institutions to exclude individuals or roles on a case-by-case basis will ensure that the identified group of significant risk-takers is not over-inclusive. The proposed rule notably gives the applicable Agency discretion to include, but not to exclude,<sup>81</sup> additional employees from the significant risk-taker definition. We believe the Agencies should not have the discretion to include additional individuals who do not otherwise meet the significant risk-taker definition.

**2. If the Agencies continue to deploy a bright-line test, a dollar threshold should be used as a rebuttable presumption and the exposure test should be eliminated.**

- The relative compensation test should be replaced by a dollar threshold presumption. The preamble requests comment on the use of a dollar threshold test as an alternative to the relative compensation test.<sup>82</sup> Although we appreciate the attempt by the Agencies to employ a bright-line test that begins to differentiate among the business, employee population and geographic location of covered institutions, a dollar threshold presumption will be easier and less costly for institutions to apply while being equally effective at capturing the true risk takers at a covered institution. We conducted a survey of our members and found that, at certain covered institutions, the individuals covered by the relative compensation test would include those making less than \$200,000 per year in total compensation. However, at certain other covered institutions, no employees making less than \$700,000 per year would be included in the significant risk-taker population by the relative compensation test. The varying results, which have no obvious connection to business mix, asset size or geographic location of headquarters, highlight the challenges and seemingly arbitrary effect of the relative compensation test. A dollar threshold presumption would be favorable in that it would apply consistently across covered institutions. Regardless of which bright-line test is applied, the Agencies should only establish a rebuttable presumption such that a covered institution could determine that any particular employee is not a significant risk-taker, despite meeting the bright-line test.<sup>83</sup>

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<sup>80</sup> A self-governed exclusion process, such as the one in place in the E.U., would be an effective means for excluding specific individuals. Given the number of Agencies involved, a self-governed process is the most appropriate method for exclusions, since coordinating among multiple Agencies to grant exclusions in a uniform manner may be exceedingly difficult and time-consuming.

<sup>81</sup> See Section 236.2(hh)(2), 81 Fed. Reg. at 37,808.

<sup>82</sup> 81 Fed. Reg. at 37,697.

<sup>83</sup> Any bright-line significant risk-taker test that is put into place will have different effects on different covered institutions and such effects will be unrelated to risk-taking. As another alternative, the Agencies could provide covered institutions the flexibility with regard to which a bright-line test is most suitable and/or efficient for them. Similarly, a rebuttable presumption could combine a bright-line \$1 million threshold and a bright-line

- The Agencies should use a presumption that is set at \$1 million in target annual compensation.<sup>84</sup> Establishing a dollar-based presumption that applies to all covered institutions would be more equitable across covered institutions that compete with one another for talent. In contrast, a relative compensation test would likely see vastly different thresholds at different institutions.
  - It is crucial that any dollar-based presumption include an escalator component, such that the dollar threshold will adjust automatically over time to account for inflation. It will otherwise be difficult for the Agencies to periodically revisit and revise the threshold. Establishing an automatic escalator that adjusts based on the consumer price index (or another objectively determinable measure) will ensure that the dollar threshold continues to apply appropriately over time.
  - The dollar threshold test should establish a rebuttable presumption such that a covered institution could determine that any particular employee is not a significant risk-taker, despite his or her receiving target annual compensation in excess of the threshold.
  - In any event, we support that the significant risk-taker test be calculated on a combined basis with all Section 956 affiliates. As discussed above, we believe the senior executive officer definition should be similarly applied.
- The Agencies should eliminate the exposure test. The exposure test has fundamental problems that make it (i) costly and difficult, if not impossible, to meaningfully calculate, (ii) a poor measure of an individual's ability to expose a covered institution to risk of material financial loss and (iii) unclear in the way the Agencies have proposed it. A specific dollar presumption would be sufficiently inclusive, comprehensible and far more cost-effective.
- The exposure test would be very difficult and costly for covered institutions to calculate. Covered institutions typically do not track aggregate approvals for each employee, as contemplated by the proposal, and adding that capability would be a significant expense. The calculations are also subject to meaningfully change from year-to-year. Employees may move into and out of the definition of significant risk-taker, creating concern and confusion among covered institutions and covered persons alike.
  - An employee's ability to commit or expose capital is not a good measure of his or her ability to expose a covered institution to material financial loss. For example,

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relative compensation test so that only a portion of the employee population earning a minimum amount would be subject to a presumption of compensation prescriptions.

<sup>84</sup> Each covered institution should be given the flexibility to determine how best to measure "target annual compensation" under its own compensation program (for example, it could look to compensation for the prior year).

one employee may have the authority to trade in large amounts of low-risk treasuries, while another is able to trade in smaller amounts of highly volatile high-yield bonds. It may also underestimate the extent to which an employee is able to subject a covered institution to financial loss through actions outside of committing capital—for example, litigation risk, reputational risk or other types of operational risk.

- The proposal is also unclear as to what it means to “commit” or “expose” capital. Would, for example, approving a trade or a temporary limit count as “committing” or “exposing” capital? If so, the proposal would implicate second line of defense functions which do not, from a practical perspective, commit capital, but rather approve or deny transactions based on an established risk appetite. Employees in second line of defense functions, importantly, do not participate in the upside of transactions. Employees who serve on control function committees could also be included by virtue of their committee service alone. The Agencies should clarify exactly what is meant by committing or exposing capital and should ensure it is not overly broad, so as to include individuals who perform an oversight function or serve on an oversight function committee.

**3. Financial advisers, portfolio managers and similar categories of employees who do not deploy the capital of the covered institution should be explicitly excluded from the definition of significant risk-takers.**

As discussed in Section X.C.1 above, if the Agencies keep a bright-line significant risk-taker test, at a minimum, it should be rectified by giving covered institutions the ability to exclude job titles, roles or functions that, although often within the bright-line definition of significant risk-taker, would not lead to material financial loss at the covered institution. In any event, financial advisers, portfolio managers for an asset management business and similar employees should be specifically excluded from the definition of significant risk-takers since they represent a job category that is particularly inappropriate for such classification. Financial advisers and portfolio managers, who manage assets for unrelated third parties, do not place a covered institution’s own capital at risk and do not expose the firm to risk from inappropriate risk-taking. Subjecting financial advisers and portfolio managers to compensation restrictions in the final rule without a specific tie to risk-taking would place covered financial institutions at a dramatic competitive disadvantage because of the large number of competitive institutions that are not regulated and because of the high mobility of the most successful financial advisers and portfolio managers.

**D. The time-gap between the compensation identifying significant risk-takers and the application of requirements to that group could cause inappropriate results; the timing of significant risk-taker identification is better left to the judgment of individual institutions.**

In identifying significant risk-takers, the proposed rule’s relative compensation test uses compensation from the calendar year that ended at least 180 days prior to the applicable

performance period. The preamble explains that this 180-day time period was proposed because, “based on the experience of exceptional assistance recipients under TARP . . . 180 days would be a reasonable period of time for Level 1 and Level 2 covered institutions to finalize compensation paid to and awarded to covered persons and to perform the necessary calculations to determine which covered persons are significant risk-takers.”<sup>85</sup> However, the 180-day time period means there could be a two-year gap between compensation that determines the identity of significant risk-takers and the application of the requirements to that group of individuals.

For example, if a covered institution begins a performance period in March of 2017, the significant risk-takers identified for purposes of that performance period would be based on 2015 compensation. That result could mean individuals who have seen a significant change in their ability to expose the covered institution to inappropriate risk are either inappropriately picked up or omitted from the group of significant risk-takers. Institutions vary greatly in the amount of time required to finalize compensation awards. Covered institutions should be given the flexibility to determine the appropriate year to use when identifying their own significant risk-takers under each of the relative compensation test (or dollar threshold test) and the exposure test (to the extent it is not eliminated).

## **XI. Minimum Deferral Requirements for Level 1 and Level 2 Covered Institutions**

Covered institutions already face level playing field issues, particularly in technology-focused areas. We are concerned that the extreme deferral requirements proposed (discussed in this section), together with the lengthy post-vesting clawback requirements proposed (discussed in Section XIII below), will make level playing field issues untenable. The cost imposed on senior executive officers and significant risk-takers by mandating a significant delay for a substantial portion of the compensation already earned for past performance would put covered institutions at a very significant disadvantage relative to unregulated companies. This presents an especially significant problem in technology-focused areas, where mobility is common.

Annex 1 to this letter attempts to illustrate the full impact of the proposal on one employee. The example provided in Part 1 of Annex 1, which is based off the preamble’s Ms. Ledger example, demonstrates the minimum amounts required to be deferred for senior executive officers at Level 1 covered institutions under the proposed rule. As shown in Part 1, at any given time, Ms. Ledger would have over three times her total annual incentive compensation (qualifying-incentive based and long-term) deferred and over ten times her total annual incentive compensation at risk. To require any employee to have such a significant amount of their compensation subject to downward adjustment at any given time is (i) not based on any meaningful tie to inappropriate risk-taking; (ii) arbitrary; and (iii) highly likely to motivate departure to an unregulated firm.

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<sup>85</sup> 81 Fed. Reg. at 37,698.

**A. The deferral requirements are overly complex and should be simplified so that a single deferral percentage is applied to total incentives for each senior executive officer or significant risk-taker.**

Rather than the proposal's complicated deferral requirements, which apply separately to qualifying incentive-based compensation and then to long-term incentive plans on a plan-by-plan basis, the final rule should be simplified by requiring that a single percentage (we suggest 50% for senior executive officers and 25% for significant risk-takers) of incentive-based compensation must be deferred for each senior executive officer and significant risk-taker at a Level 1 or Level 2 covered institution. This approach would reduce the burden of complying with the proposal, provide a framework that is easier for covered employees to understand and allow covered institutions to apply their own compensation program as they see fit. The deferral requirements, especially when coupled with the clawback requirements, are so complex that it would be difficult for many employees to know exactly where their compensation stood at any given point in time. Simplifying the requirements would allow more covered employees to understand exactly how their compensation is being structured, and to appropriately consider and weight each element. Requiring different deferral treatments (based on type of incentive-based compensation plan and on a plan-by-plan basis) would be overly prescriptive and limit an institution's flexibility to select the right methods of deferral, depending on its structure and the particular interests of select groups of employees.

Once an institution selects its method of deferral, we suggest that requirements as to length of deferral and vesting then be applied consistently with the final rule (albeit in shorter time periods, as discussed in Section XI.C below, as the proposal's minimum deferral requirements are too long). For example, if a significant risk-taker at a Level 1 covered institution received \$600,000 in annual incentive-based compensation, the covered institution would be required to defer \$150,000. If the institution chose to defer the \$150,000 in a long-term incentive plan, that plan would be subject to a three-year performance period followed by a two-year minimum deferral period with vesting of a maximum of \$75,000 annually.

**B. The minimum deferral percentages are too high and should be set at 50% for senior executive officers and 25% for significant risk-takers (at both Level 1 and Level 2 covered institutions).**

We do not believe the Agencies should prescribe specific deferral percentages, periods or forms. However, if the Agencies continue with the proposed approach and reject our simpler model for deferral requirements, the deferral percentages should be reduced significantly.

The Agencies propose minimum deferrals ranging from 60% to 40%, depending on factors associated with the individual and the institution. Requiring deferral at these percentages, particularly for individuals below the level of public company executive officers and those in control functions, represents a profound shift in compensation practices and will have substantial

liquidity impacts on covered employees and competitive impacts on covered institutions.<sup>86</sup> As shown in Part 1 of Annex 1, deferrals at 60% would result in two-and-a-half times (for qualifying incentive-based compensation) or four times (for long-term incentive plan compensation) a covered person's incentive compensation being subject to deferral at any given time. Before imposing these types of costs, the Agencies should identify the basis for concluding that the deferral percentages are appropriate (for example, why a 60% minimum represents the appropriate balance between the benefit of reduced risk-taking, on one hand, and the costs imposed on individuals and institutions, on the other hand, as opposed to 40%, 30% or 25%). It is worth pausing at this point to consider how far a departure from the statutory authorization of Section 956 such a requirement truly is. Section 956 authorizes the Agencies to prohibit structures that are likely to cause material financial loss through inappropriate risk-taking. The Agencies here are effectively finding, based on no evidence whatsoever, that deferral of 59% of compensation, or any lower amount, is likely to cause the individual to engage in inappropriate risk-taking, and consequently cause a material financial loss. We submit that this conclusion is not only unsupported but unsupportable.

We believe more appropriate deferral percentages are: (i) 50% for senior executive officers and (ii) 25% for significant risk-takers, which should apply to both Level 1 and Level 2 covered institutions, as there is no justification for applying different requirements. The appropriate deferral percentages would, of course, depend on how senior executive officers and significant risk-takers are defined, as discussed in Section X.A above. The more broadly those terms are defined, the more inappropriate and excessive the proposed rule's deferral requirements are. As shown in Part 2 of Annex 1, requiring significant risk-takers to defer 25% of incentive-based compensation would impose a less punitive and more reasonable result. Deferrals at 25% would result in one-and-a-half times (for qualifying incentive-based compensation) or three-and-a-quarter times (for long-term incentive plan compensation) a covered person's incentive compensation being subject to deferral at any given time. This outcome, while still keeping a substantial portion of compensation at risk—and certainly enough to deter inappropriate risk-taking—is a more balanced and judicious approach.

In particular, it is important to emphasize that any minimum deferral requirements imposed below the level of public company executive officers should be limited. The proposed group of employees that would be subject to these minimum deferral requirements (as much as 5% of the employee population for Level 1 covered institutions) comprises a wide range of seniorities, duties, businesses, sophistication and life stages. For example, young professionals could be adversely affected by these requirements, and it may harm covered institutions' ability to bring them into their institutions and the financial industry in general. As noted in the 2010 Guidance:

The portion of the incentive compensation of other covered employees that is deferred or paid in the form of equity-based instruments should appropriately take

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<sup>86</sup> As noted in Section X.B.3 above, competitive impacts in control functions could present safety and soundness concerns for covered institutions.



into account the level, nature, and duration of the risks that the employees' activities create for the organization and the extent to which those activities may materially affect the overall performance of the organization and its stock price. Deferral of a substantial portion of an employee's incentive compensation may not be workable for employees at lower pay scales because of their more limited financial resources.<sup>87</sup>

The 2011 Proposal included no deferral requirements for anyone other than executive officers at larger covered financial institutions,<sup>88</sup> and we encourage the Agencies to return to that approach. In all cases, to avoid unintended consequences and to remain consistent with the intent of Section 956, the Agencies should limit minimum deferral requirements to the lowest level required, which should be 25%. Through the normal management and supervisory process, institutions will continue to be able to impose heightened deferral requirements tailored to specific employees or situations.

### **C. The minimum deferral periods are too long.**

A minimum deferral period of longer than three years is both excessive and inconsistent with current practices at covered institutions. Imposing four- and five-year deferral requirements on any category of covered persons would be arbitrary and costly. The 2011 Proposal included a minimum three-year deferral requirement for a limited group of executives.<sup>89</sup> We encourage the Agencies to consider returning to that approach.

For Level 1 covered institutions, the proposed rule would extend the deferral period beyond three years for senior executive officers and significant risk-takers. Extending the deferral period beyond three years for a sub-set of covered persons is an inequitable outcome and one with no justification. As shown in Part 1 of Annex 1, the result of a five-year deferral period is that compensation earned is not fully realized and free of risk for 12 years from the date it is granted. In the preamble, the Agencies note that four to five years is the majority of a traditional business cycle, allowing companies to identify outcomes associated with performance and risk-taking activities.<sup>90</sup> However, it is unclear how four to five years is a traditional business cycle for Level 1 covered institutions, but three years is a traditional business cycle for Level 2 covered institutions.

In any event, as evident from the example provided in Part 2 of Annex 1, there will be substantial compensation unvested and deferred at any one point even if a three-year deferral period were implemented. A deferral beyond three years is unnecessary for long-term plans, in particular given the proposed limits on maximum incentive opportunities. If long-term incentive arrangements can only provide a minimal incentive beyond target, the performance period

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<sup>87</sup> 75 Fed. Reg. at 36,410.

<sup>88</sup> Section 236.5(b)(3)(i), 76 Fed. Reg. 21,170, 21,207 (Apr. 14, 2011).

<sup>89</sup> Section 236.5(b)(3)(i)(A), 76 Fed. Reg. at 21,207.

<sup>90</sup> See 81 Fed. Reg. at 37,732.

effectively does double-duty as a deferral period. Thus, an additional period to re-review performance and reconsider risk-taking is unnecessary.

**D. The final rule should allow acceleration on certain specified events beyond death and disability.**

Acceleration should be permitted on the occurrence of the following events:

- Public service. The Agencies should allow acceleration of deferred compensation to permit employees of covered institutions to enter public service. A significant number of public service positions, including positions for the U.S. federal government,<sup>91</sup> would disqualify an individual with continuing, variable ties to her or his former employer due to conflicts of interest. To permit citizens to exercise the privilege of public service, a number of regulatory regimes allow companies and individuals to settle those ties to avoid conflicts of interest—the most significant of which is Section 409A of the Internal Revenue Code, which allows acceleration of deferred compensation in exactly this circumstance.<sup>92</sup>

Absent the relief we are requesting, a significant percentage of employees at larger covered institutions would effectively be barred from public service for a minimum of three to five years, because of the proposed deferral period required for this group. We are not aware of any other circumstance where a group of U.S. citizens will have been barred from engaging in public service for such a meaningful period by a mandatory requirement instituted by an instrumentality of the federal agencies.

- Payment of associated taxes. To the extent a covered person has a tax obligation related to mandatorily deferred incentive compensation, the final rule should allow the obligation to be met through the acceleration of a portion of the applicable award. For example, vested deferred compensation is subject to Federal Insurance Contributions Act (FICA) and Federal Unemployment Tax Act (FUTA) taxation before payment to the employee, and, outside of the United States, payment of taxes may be required before payment, including under Section 457A of the Internal Revenue Code.<sup>93</sup> Applicable federal income tax regulations permit employers to withhold (which employers regularly do) from deferred compensation to allow employees to satisfy related tax obligations.<sup>94</sup> To avoid arbitrary liquidity constraints on covered employees and to be consistent with other aspects of the federal

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<sup>91</sup> See U.S. Office of Gov't Ethics, *Employees Entering Government*, (Jan. 4, 2016), <https://www.oge.gov/web/oge.nsf/Financial%20Conflicts%20of%20Interest/E07A0C541EF92CF385257E96006364E1?opendocument> (“[S]ome regulatory agencies prohibit employees from owning stock in any regulated entity . . . Also, employees of some agencies are subject to statutory provisions that restrict the holding of certain financial interests.”).

<sup>92</sup> 26 C.F.R. § 1.409A-3(j)(4)(iii).

<sup>93</sup> See 26 U.S.C. § 457A.

<sup>94</sup> 26 C.F.R. § 1.409A-3(j)(4)(vi).

regulatory regime, we encourage the Agencies to permit acceleration to pay taxes required in respect of deferred compensation before payout.

- Retirement. As employees near retirement, their liquidity and investment-risk profiles change. To require employees to defer receipt of earnings for three to five years after retirement and to require it to be invested in their former employer represents an inappropriate and arbitrary limit on the ability to plan for retirement. This is especially true given that the clawback period will provide an appropriate method to recover compensation in the event of inappropriate risk-taking. Institutions should have the freedom, in their management's discretion, to accelerate awards in the event of retirement. As shown in Part 1 of Annex 1, Level 1 senior executive officers' incentive compensation will remain subject to risk for 12 years following grant, which is an especially excessive and punitive amount of time for employees who are near retirement age. It will also make it exceedingly difficult for covered institutions to recruit experienced employees who are nearing retirement, including those in control functions whose job it is to prevent risk.
- Unexpected financial hardship. The proposal would extend mandatory deferral to a wide group of employees of Level 1 and Level 2 covered institutions. Given the number of institutions covered, the size of the covered employee pool and the length of the minimum deferral period, members of the restricted population will inevitably experience unexpected financial hardship. Circumstances that may give rise to such unexpected hardship include sudden and unexpected illness or accident (of the employee, a spouse or a dependent), loss of property due to casualty, or other similar extraordinary and unforeseeable events beyond the control of the employee.

Federal tax and retirement rules governing both qualified and nonqualified deferred compensation consistently permit plan sponsors to accelerate payout in the event of unexpected hardship or unforeseeable emergency.<sup>95</sup> We believe the analysis that has driven the ability to accelerate for financial hardship in these other areas is equally applicable to employees of financial institutions, and the final rule should similarly allow such acceleration. In all cases, the relevant covered employee would expect the compensation to be deferred for the full period, and therefore allowing acceleration for unexpected financial hardship should not undermine the policy concerns underlying the proposal. We are unaware of instances of gaming under any other regime permitting acceleration under these circumstances.

- Change in control. The final rule should permit acceleration on a change in control of the covered institution. A change in control often fundamentally alters the nature of a company and of an employment relationship and, in some cases, the equity and debt structure of the company affected. For these reasons, almost all equity plans permit some form of acceleration on a change in control. From the technical perspective,

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<sup>95</sup> See, e.g., 26 U.S.C. § 409A(a)(2)(A)(vi)–(a)(2)(B)(ii).

acquiring companies sometimes do not have suitable equity plans to assume or convert target equity awards, or are unwilling to comply with necessary regulatory regimes (such as U.S. public reporting). In the case of sales of subsidiaries or business lines, spin-offs or divestitures, it may be inappropriate for employees to retain incentives to support the performance of their prior employer. If the final rule does not permit acceleration in these circumstances, the market for control of covered financial institutions will be inconsistent with that for all other public companies. (Similar technical issues may arise around deferred cash as well.)

From a policy perspective, change-in-control protection is often implemented so that managers and employees do not unnecessarily avoid or resist change-in-control proposals. By prohibiting acceleration, the proposal would inefficiently discourage change-in-control activity with respect to covered institutions.

- Involuntary termination of employment without cause. Finally, the final rule should permit acceleration in the event of involuntary termination without cause. Not allowing acceleration would cause employees to either forfeit deferred compensation or retain deferred compensation in a company by which they are no longer employed. By prohibiting acceleration on any involuntary termination, the proposal would effectively encourage adoption of a more E.U.-centric model where severance protection offsets the lack of ability to accelerate. In the E.U., employment contracts and severance are commonplace and allow employees to receive substantial compensation on an involuntary termination without cause. Conversely, among U.S. financial institutions, employment agreements and severance are less common.

We believe that the additional cost represented by such additional severance is unnecessary, and institutions should be able to more efficiently provide appropriate termination protection through a combination of acceleration and clawback provisions. We encourage the Agencies to continue to permit this approach, particularly given the large number of employees potentially subject to the minimum deferral requirements.

#### **E. The final rule should allow more flexibility with respect to deferral.**

We believe that the final rule's minimum deferral requirements should be less prescriptive and allow for more flexibility in the following ways:

- The final rule should not require a "substantial portion" of deferred compensation be in cash and should instead allow covered institutions the flexibility to select the appropriate mix of cash and equity. In all cases, officers and employees have a debt-equivalent stake in the continued viability of their employer that will far exceed any deferred cash holdings. If an employer fails, 100% of the expected future cash flows from employment are at risk and, by definition, all equity holdings will become worthless. Finally, all retirement savings and access to benefit arrangements will potentially be threatened. In that context, we believe adding a limited amount of deferred cash will have, at best, limited risk-balancing effects. The final rule should

instead allow institutions the flexibility to select deferral instruments that are most appropriate for their institution and for each specific employee.

Requiring deferred cash will have a meaningful cost. First, if the final rule requires deferred cash, covered institutions will either need to decrease the use of deferred equity to a level below what they previously determined to be optimal, or they will need to increase overall compensation to make room for the required minimum deferred cash component. Any interest paid on deferred cash will also represent an additional cost not associated with the increase in value of equity awards over time.

To the extent the Agencies retain the requirement that a “substantial portion” of deferred compensation must be in deferred cash, we ask for confirmation that awards tied to the market value of contingent capital securities (and potentially able to be settled in such securities) will be treated as deferred cash for purposes of the “substantial portion” requirement. The market value of these instruments varies directly with the market perception of the risk profile of the covered institution. In addition, to the extent the requirement that a substantial portion of deferred compensation be in equity-like instruments be retained, we ask for confirmation that notional awards that track the performance of investment funds be treated as equity-like instruments that would fulfill the requirement for employees whose positions relate to those funds.

- The Agencies should permit quarterly vesting for long-term incentive plans. The proposed rule would limit vesting for long-term incentive plans to pro rata annual vesting.<sup>96</sup> Although annual vesting may be appropriate in some circumstances, some long-term plans (particularly plans with longer terms and limited separation protection) use quarterly or even monthly vesting. In light of the long-term nature of these plans and additional deferral and clawback requirements, quarterly vesting would continue to support appropriate risk-taking while permitting increased flexibility.
- The final rule should base the deferral requirements for long-term incentive plans on the combined long-term incentive program for each applicable covered person. The deferral requirements for long-term incentive plans should apply to all long-term incentive compensation paid to a specific individual rather than to each long-term incentive plan individually.<sup>97</sup> The requirement to defer long-term incentives on a plan-by-plan basis unnecessarily restricts covered institutions. Allowing flexibility may reduce costs and administrative hurdles for certain institutions.
- The final rule should permit performance features during the deferral period. The proposed rule’s exceptions for changes in share price or interest rates are appropriate

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<sup>96</sup> Section 236.7(a)(2)(iii), 81 Fed. Reg. at 37,810–11.

<sup>97</sup> Section 236.7, 81 Fed. Reg. at 37,810–11.

and should be expanded to allow covered institutions to invest deferred compensation, either directly or at the instruction of a covered person, in other market securities. For example, an index fund would allow a covered person to receive the benefits of overall changes in the market without tying their deferred compensation in any way to the equity performance of their employer. Accordingly, such features should not prevent deferred cash treatment under the final rule. Given the length of the deferral period and what may be a significant amount of compensation restricted, allowing covered persons to receive some expected return will substantially enhance the expected value covered employees place on their deferred compensation. The Agencies should, at a minimum, permit deferred compensation to be invested in certain types of investments that have upside, including a basket of funds, index funds, other index-like instruments, a notional investment in an individual fund (at a minimum 401(k) type funds), or a notional investment in an individual security (other than that of the covered institution) that pay out in cash.

In addition, the Agencies should permit performance features during the deferral period as long as they do not exceed the final rule's incentive limits (even if based on the covered institution's own performance). Otherwise, incentive-based compensation that is deferred into awards with a performance feature would have to essentially be deferred twice as it would constitute a "new" award when first deferred.

- The final rule should not require covered institutions to discount to present value when determining amounts to be deferred. The preamble states that, in determining deferral amounts, covered institutions "generally should use the present value of the incentive-based compensation at the time of the award."<sup>98</sup> The Agencies should clarify that covered institutions are not required to use present value in their calculations of deferral amounts. Covered institutions may want to take advantage of other methods to determine the appropriate amount of compensation to be deferred, and should not be unnecessarily restricted by the final rule.
- The final rule should permit dividend equivalent rights to be paid immediately and not be subject to deferral. The proposed rule is unclear whether dividend equivalent rights granted to an employee in connection with, for example, a performance stock unit, could be paid immediately at the end of the performance period, or would have to be deferred. It would be administratively difficult and burdensome to defer dividend equivalent rights and, given that the underlying awards will still be subject to deferral, it would not meaningfully deter risk-taking to defer payment of dividends.
- In no case should amounts voluntarily deferred in excess of minimum requirements set by the proposed rule be at risk of forfeiture. Subjecting voluntary deferrals to risk of forfeiture would, in effect, make the minimum percentage requirements meaningless and strongly discourage voluntary deferral in anticipation of retirement.

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<sup>98</sup> 81 Fed. Reg. 37,718 (emphasis added).

**F. We agree that options should be permitted, but do not believe there is a principled reason to limit options to count toward only 15% of the amount of deferred compensation.**

We support the proposal's allowance of options (to the extent received by senior executive officers or significant risk-takers) to count toward minimum deferral requirements. However, the Agencies have provided no justification for why they are only permitted to account for up to 15% of the incentive-based compensation used to meet minimum deferral requirements for senior executive officers or significant risk-takers.<sup>99</sup> We agree that "options can be a significant and important part of incentive-based compensation arrangements."<sup>100</sup> Any limitation on the amount options can account toward minimum deferral requirements should be based on sound reason and not be set arbitrarily.

**XII. Forfeiture and Downward Adjustment Requirements for Level 1 and Level 2 Covered Institutions**

We support the concept of forfeiture and downward adjustment in incentive programs for certain events, but the minimum adjustment requirements should be more narrowly tailored to the purpose of discouraging inappropriate risk-taking (and we do not support the mandatory "one size fits all" approach taken by the proposal).

**A. The final rule's triggering events should include an element of intent.**

We support the use of downward adjustment to reduce incentives for inappropriate risk-taking, but not the mandatory use of these features to reduce compensation when the applicable individual did not intend or was not aware of the negative outcome. We therefore believe that each of the proposed triggering events should be revised to include an element of intent on the part of the applicable covered person. By requiring intent, the triggering events would serve the purpose of deterring intentional deviation from risk parameters or intentional inappropriate risk-taking while providing employees the comfort that mandatory downward adjustment will not be applied for inadvertent matters or matters that only in hindsight appear to be inappropriate. In particular, triggers (i) ("Poor financial performance attributable to a significant deviation from the risk parameters set forth in the covered institution's policies and procedures") and (iv) ("Non-compliance with statutory, regulatory or supervisory standards") should only be triggering events to the extent the applicable covered person intended to deviate from firm policies and procedures and/or not comply with statutory, regulatory or supervisory standards. In addition, such events should only trigger a forfeiture and downward adjustment review if they are material to the institution and only when enforcements or legal actions are final, as to avoid having to reverse a prior downward adjustment or forfeiture.

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<sup>99</sup> Section 236.7(a)(4)(ii), 81 Fed. Reg. at 37,811.

<sup>100</sup> 81 Fed. Reg. at 37,727.

At a minimum, we urge the Agencies to include a recklessness standard to ensure forfeiture and downward adjustment reviews are not triggered merely by inadvertent deviations from company policies or non-compliance with supervisory standards. If no element of intent is required before forfeiture or downward adjustment can occur, it would further harm covered institutions' ability to compete in the market for talent. Employees contemplating work for a covered institution would be significantly deterred if their compensation could be reduced through no fault of their own, while at an unregulated institution their compensation would not be similarly at risk.

**B. The final rule should acknowledge that an individual must have a minimum connection to the triggering event before forfeiture or downward adjustment review must occur.**

The triggering events are based on adverse outcomes to the covered institution, and factors considered include “responsibility due to the senior executive officer’s or significant risk-taker’s role or position in the covered institution’s organizational structure . . .”<sup>101</sup> The final rule, however, should explicitly state or acknowledge that the covered person’s role or position in the institution alone is not enough to hold the individual responsible. Only covered persons with responsibility and a minimum connection to the triggering event should have their compensation subject to forfeiture or downward adjustment to avoid an inequitable outcome. If an individual is held responsible merely because a triggering event occurs several reporting levels from their position—at a level where they have virtually no control over the event—it will create a sense of distance between forfeiture and downward adjustment review and the actions of covered persons. For example, if a triggering event occurs at the trading desk of a covered institution, there is virtually no limit to the number of people who could be subject to forfeiture or downward adjustment review. It is also important to note that financial institutions use a number of mechanisms to hold senior officers accountable for creating an environment conducive to prudent risk management and a culture of compliance. A reflective or automatic trigger may disincentivize individuals from taking senior positions in an institution that may have had management or compliance weaknesses in the past and are ultimately hired to remedy those issues. The Agencies should ensure that covered institutions have the discretion to determine when a review is appropriate and when a covered person is so far removed from the triggering event such that spending the resources on a review is unwarranted.

**C. The final rule should explicitly confirm that a determination that no amount of downward adjustment, forfeiture or clawback is appropriate should be a permitted determination.**

Should a Level 1 or Level 2 covered institution conduct a review and determine that the factors in Section \_\_.7(b)(4) do not merit downward adjustment or forfeiture, that determination should be explicitly recognized as allowed.

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<sup>101</sup> Section 236.7(b)(3), 81 Fed. Reg. at 37,811.



### **XIII. Clawback Requirements for Level 1 and Level 2 Covered Institutions**

We support the concept of requiring clawback provisions in incentive-compensation arrangements for certain misconduct. When senior executive officers and significant risk-takers take certain egregious actions or make egregious omissions, clawback may be appropriate. However, we believe the Agencies should limit the clawback requirements such that they are tied more directly to the misconduct.

#### **A. The minimum clawback period is too long.**

A minimum clawback period of seven years from vesting is both excessive and inconsistent with current practices at covered institutions. As justification for the clawback period, the proposal notes that seven years is the length of the average business cycle in the United States. However, the clawback triggers are unrelated to risk-related factors but instead center on misconduct. As such, the relationship to a business cycle is limited. There is no empirical data to suggest that a seven-year clawback period is necessary or helpful—to the contrary, and as Annex 1 demonstrates, the lengthy period would have the unintended consequence of deterring prudent employees from employment at covered institutions, given that over a decade would pass before pay finality.

Moreover, as illustrated in Part 1 of Annex 1, a senior executive officer such as Ms. Ledger will have over seven times her annual incentive-based compensation subject to deferral or clawback at any given time (and, combined with a minimum deferral period of five years for certain individuals, keep some compensation at risk for twelve years), which is far more than sufficient to deter misconduct. We believe it is also excessive and potentially punitive. Finally, the proposed clawback period is longer than many state law statutes of limitation on breaches of contract (which generally vary between three to six years, excluding some outliers).<sup>102</sup> Requiring minimum clawback periods that exceed these relevant maximums is unnecessary and inappropriate.

We believe a clawback period of seven years from the grant of the award would be more than sufficient to deter imprudent risk-taking. As discussed below, a clawback period running from the date of award, as opposed to the date of vesting, is more appropriate. As the preamble notes, a clawback period that is too long could result in covered persons ignoring or discounting the clawback period entirely or be too difficult to implement.<sup>103</sup> Furthermore, the lengthy clawback period would pose problems with regard to recruitment and retention, especially with regard to more experienced employees. For example, a covered person at age 45 would be faced with the possibility that compensation would be subject to risk of clawback until age 57, leading to a strong incentive for those employees to seek employment at unregulated institutions and making it difficult for covered institutions to attract experienced talent that has developed the judgment, knowledge and skills to lead a covered institution over the next decade. The lengthy

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<sup>102</sup> See Westlaw 50 State Statutory Surveys, Civil Statutes of Limitation, 0020 Surveys 1 (West 2007).

<sup>103</sup> 81 Fed. Reg. at 37,732.

clawback period could also lead to a loss of institutional knowledge, which may increase risk to the safety and soundness of the covered institution. In addition, the time value risk of money will likely increase compensation costs. The SEC proposal on mandatory clawback explicitly acknowledges that the existence of a clawback feature will increase executive demands for compensation and increase fixed and variable compensation costs.<sup>104</sup> To the extent the Agencies agree with our proposed revisions to the definitions of senior executive officer and significant risk-taker, as discussed in Sections X.B and X.C above, a clawback period running seven years from the date of award would be appropriate. However, to the extent the Agencies keep the proposed rule's overly broad definitions of senior executive officer and significant risk-taker, it would be inappropriate and overly burdensome to apply a seven-year clawback to such a large group of employees even if the period starts at the date compensation is awarded. Accordingly, in that case, we believe a clawback period of five years from the date of award would be appropriate to deter imprudent risk-taking without creating excessive costs, given such a large population of employees, many of whom could not individually create material risks for their institution. Reducing the clawback period to five years from the grant of the award would appropriately balance these considerations and more effectively achieve the policy goals underlying the proposal.

**B. The clawback period should run from the date of award and not, as proposed, from the date compensation vests.**

Deferral periods and clawback periods should be coextensive. To do otherwise would encourage use of no more than the minimum deferral periods and the most aggressive vesting terms. Tying the clawback to award date, however, would still allow the full period determined appropriate for recovery. This revision also would be consistent with the interpretation of the E.U. requirements. As shown in Part 1 of Annex 1, senior executive officers at a Level 1 covered institution will have incentive compensation subject to risk for 12 years following its grant. Twelve years is an excessive period of time for employees to wait before being able to spend their earned compensation free and clear of any potential clawback. As shown in Part 2 of Annex 1, even beginning the clawback period from the date of award, as opposed to the date compensation vests, would keep compensation subject to risk for seven years following its grant.

**C. Clawback should apply only to compensation having a performance period during which the misconduct occurred.**

It would be punitive to claw back incentive-based compensation that was earned before or after an event of misconduct and is unrelated to the misconduct. If, for example, incentive-based compensation has a performance period from 2017-2019 and misconduct is found to have occurred in 2016, it would be inappropriate to claw back compensation that was not even granted at the time of the misconduct. Rather, it would be appropriate to claw back compensation that was earned during 2016, when the misconduct actually occurred and when performance was falsely inflated; to the extent another year's performance was falsely inflated, it could be subject

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<sup>104</sup> 81 Fed. Reg. 37,790.

to clawback as well. Similarly, if misconduct occurred in 2020, it would be unrelated to compensation that had already been earned for previous performance. Allowing an entire seven years' worth of compensation to be subject to clawback for a single event of misconduct is a punitive, and unjust, outcome.

**D. The clawback period should close on (i) death, (ii) disability and (iii) government service.**

Although the clawback triggers are limited, we believe that the clawback period should be permitted to close on certain events that would be uncorrelated with risk-taking in order to avoid unintended and costly outcomes. First, the clawback period should be permitted to close on the death of an employee so as to avoid the unreasonable outcome of holding estates open for years after the covered person's death. As drafted, it is possible that an estate would be unable to close for up to seven years after an employee's death. Second, should an employee become disabled, the clawback period should also end so as to allow employees to design financial plans with as much certainty as possible. Finally, to the extent that the clawback would preclude chosen public service,<sup>105</sup> the clawback period should be permitted to close.

**E. The Agencies should clarify that clawbacks should only be after taxes, such that covered persons are left in the same position as if they had never received the compensation.**

The Agencies should require clawback only of incentive-based compensation received after taxes (but giving effect to any credits resulting from the clawback) such that covered persons would not be required to return a greater amount of compensation than was actually received. Employees may or may not be able to recoup taxes that have already been paid. This is particularly important in light of the fact many covered persons will be subject to taxation outside of the United States, where unique rules might limit the ability to restate an individual's tax liability. Limiting clawbacks to after-tax amounts would leave the covered person in the same position they would have been in had the incentive-based compensation never been paid. To require a covered person to repay more than what was actually received would be punitive.

**F. The Agencies should confirm that, to the extent a clawback is unenforceable in a given jurisdiction due to local law, not requiring the clawback in such jurisdiction will not be treated as a violation of the final rule.**

In some foreign jurisdictions, and even in certain U.S. states, clawback may be a violation of applicable labor law. The Agencies should confirm that, if this situation arises, the covered institution may choose to forgo the clawback without violating the final rule. It would

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<sup>105</sup> See U.S. Office of Gov't Ethics, *Employees Entering Government*, (Jan. 4, 2016), <https://www.oge.gov/web/oge.nsf/Financial%20Conflicts%20of%20Interest/E07A0C541EF92CF385257E96006364E1?opendocument>.

be unreasonable to require a covered institution to violate local law in order to comply with the final rule's requirements.<sup>106</sup>

**G. The final rule should clarify that covered institutions need not resort to unreasonable or detrimental methods to claw back compensation.**

The preamble notes that while clawback provisions must be included in incentive-based compensation arrangements, they need not be exercised in a prescribed way.<sup>107</sup> The final rule should explicitly state that covered institutions are permitted to consider the costs and benefits of utilizing the clawback, including factors such as the likelihood of success and the potential magnitude of legal and other costs (for example, the outside experts noted in the SEC's economic analysis).<sup>108</sup> While the proposal indicates that the provisions must "allow" the covered institution to recover compensation "if" the institution determines one of the triggers occurred,<sup>109</sup> it should specifically allow for consideration of additional factors to avoid forcing institutions to resort to unreasonable or detrimental methods to claw back incentive compensation.

**XIV. Incentive Limits for Level 1 and Level 2 Covered Institutions**

**A. The final rule should eliminate or, at a minimum, revise the limits on maximum incentive opportunity.<sup>110</sup>**

The proposed rule would limit the maximum amount of incentive-based compensation opportunity (referred to as leverage) paid to senior executive officers and significant risk-takers at Level 1 and Level 2 covered institutions to 125% and 150% of the target amounts, respectively.<sup>111</sup> These limits, however, are arbitrary and unnecessary, particularly in light of the extensive deferral and clawback periods proposed. Although the preamble argues that these limits are in line with current industry practice,<sup>112</sup> we do not believe that is correct and note that, in any event, current practice has been influenced by the application of the 2010 Guidance.

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<sup>106</sup> Rules proposed by the SEC in July 2015, under Section 954 of the Dodd-Frank Act, titled "Recovery of Erroneously Awarded Compensation Policy," recognize several of the difficulties of imposing a clawback provision on compensation that already has been paid to an employee or former employee.

<sup>107</sup> 81 Fed. Reg. at 37,732.

<sup>108</sup> 81 Fed. Reg. at 37,791.

<sup>109</sup> Section 236.7(c), 81 Fed. Reg. at 37,811.

<sup>110</sup> As written, the limits on maximum incentive opportunity could be applied to umbrella plans that are implemented by covered institutions for purposes of compliance with Section 162(m) of the U.S. Internal Revenue Code and under which sub-plans or arrangements detail the specific terms of incentive-based compensation. The Agencies should clarify that umbrella plans designed for compliance with Section 162(m) are not subject to the maximum incentive limits prescribed by the proposed rule.

<sup>111</sup> Section 236.8(b), 81 Fed. Reg. at 37,812.

<sup>112</sup> See 81 Fed. Reg. at 37,734.

Limits on leverage are only one way to promote balance in incentive compensation programs and could be unnecessary if other provisions of the proposed rule are implemented and appropriately assess and limit risk. The threats of downward adjustment, forfeiture and clawback, for example, would serve as a powerful deterrent to inappropriate risk-taking—even more so if a greater amount of compensation is at risk.<sup>113</sup>

To the extent the Agencies insist on leverage limits, the limits should be set at 200% of target for both senior executive officers and significant risk-takers. Raising the limits on maximum compensation opportunities would allow covered institutions to develop compensation programs that are appropriate for each category of covered person. Allowing for a higher maximum incentive-based compensation opportunity would simply allow the covered institution appropriate flexibility to design targets and maximums. Importantly, a 200% limit would allow an incentive-based compensation opportunity that is symmetric up or down (down to 0% or up to 200%). This amendment to the proposed rule would also be consistent with current practices at many covered institutions, familiar to and accepted by covered institutions, covered persons and shareholders alike.

**B. The final rule should not prohibit reliance on relative performance measures and volume-based measures and should not require non-financial performance measures.<sup>114</sup>**

Relative performance measures reveal whether a covered institution's performance results from general market conditions or is specific to an institution. Rather than being misleading, as the preamble indicates,<sup>115</sup> relative performance measures can be informative. Danger lies in measuring an institution's performance in isolation, where employees could be compensated for their institution's seemingly notable performance (and related risks outcomes) when in fact the performance is due to general market conditions rather than their individual efforts. The use of relative performance measures protects against this potential outcome. Relative performance measures are also often supported by shareholders and shareholder advisory firms, including Institutional Shareholder Services.<sup>116</sup> We believe that the proposed deferral and clawback requirements are more than sufficient to balance well-designed plans that incorporate relative performance.

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<sup>113</sup> We note that these limits on leverage are superfluous, given the other provisions in the proposal and other regulations that disincentivize risk-taking.

<sup>114</sup> At a minimum, umbrella plans designed for compliance with Section 162(m) should be exempt from compliance with restrictions against sole reliance on relative performance measures and volume-based measures. It is important for a covered institution to maintain flexibility in its umbrella plans, while sub-plans and arrangements would still be subject to the requirements. Accordingly, imposing the restrictions on umbrella plans would be both restrictive and unnecessary.

<sup>115</sup> See 81 Fed. Reg. at 37,735.

<sup>116</sup> *E.g.*, INSTITUTIONAL SHAREHOLDER SERVICES, UNITED STATES PROXY VOTING MANUAL: 2016 BENCHMARK POLICY RECOMMENDATIONS, 141-42 (2016).

Similarly, the proposed rule's prohibition on the use of volume-based performance measures (for any employee of a covered institution, not only senior executive officers and significant risk-takers) is too broad and unnecessary. Uncomplicated and inexpensive volume-based measures may be particularly appropriate for covered persons who are not significant risk-takers. For example, a volume bonus program for customer service representatives solely based on the number of customers they meet with would be prohibited under the proposed rule. It is difficult to see how this practice would expose the institution or incentivize participants to take inappropriate risks.

At a minimum, given the broad application of this prohibition, the final rule should include a de minimis exception for plans such as referral programs and commission-based plans. As discussed in Section XV.A.4 below, the Agencies should follow the lead of the Department of the Treasury, which in 2009 exempted certain commission compensation from the definition of "bonus,"<sup>117</sup> and exclude commissions from the definition of incentive-based compensation in the final rule or, at a minimum, exempt commissions from the prohibition on volume-based measures.

Finally, the proposed rule's requirement that incentive-based compensation arrangements include both financial and non-financial performance measures in order to appropriately balance risk and reward is misguided. This requirement would apply to all incentive-based compensation arrangements, no matter how small and immaterial. The proposal would classify even a \$1 incentive-based compensation arrangement that does not include non-financial performance measures as an arrangement that could lead to material financial loss. The proposed rule goes even further by then requiring that incentive-based compensation arrangements be designed to allow non-financial measures to override financial measures of performance.<sup>118</sup> Although non-financial performance measures may be an appropriate consideration for certain incentive-based compensation arrangements, they should not be mandated for all of them. Further, as discussed in Section XVII below, non-financial performance measures could also lead to potentially problematic liability accounting.

## **XV. Incentive-Based Compensation**

### **A. The definition of "incentive-based compensation" should be clarified to address regular grants of restricted stock grants and options. It should also provide quantitative and qualitative exceptions and explicitly exclude commissions.**

The proposed rule defines "incentive-based compensation" as "any variable compensation, fees, or benefits that serve as an incentive or reward for performance."<sup>119</sup> The preamble clarifies that "compensation, fees, and benefits that are paid for reasons other than to

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<sup>117</sup> TARP Standards for Compensation and Corporate Governance, 74 Fed. Reg. 28,394 (June 15, 2009).

<sup>118</sup> Section 236.4(d), 81 Fed. Reg. at 37,809.

<sup>119</sup> Section 236.2(r), 81 Fed. Reg. at 37,807.

induce performance would not be included”<sup>120</sup> and goes on to list examples of types of compensation, such as those tied solely to continued employment and signing bonuses, among others, that are not “incentive-based compensation.” We support the Agencies’ exclusion of awards tied solely to continued employment and ask the Agencies to clarify and limit further the scope of the definition to only arrangements that present the potential of inappropriate risk-taking and/or material financial loss.

**1. Regular grants of restricted stock or options should be permitted to be treated as within the scope of “incentive-based compensation.”**

Many covered institutions have a program of regular grants of restricted stock or options. Although the grants tend to have limited variability over time, they are intended to reward prior achievements and provide incentives for future performance, as well as retention. Although it is possible to view such grants as tied solely to continued employment (which the preamble indicates are not incentive-based compensation), they form a meaningful part of many institutions’ incentive programs and contribute to performance due to vesting, deferral and forfeiture conditions. Accordingly, we believe the final rule should clarify that a covered institution has appropriate discretion as to whether to treat these regular grants as incentive-based compensation.

**2. The definition should have a quantitative minimum (e.g., \$50,000), below which variable compensation is not deemed to be incentive-based compensation, or below which an employee receiving the variable compensation is not a covered person.**

Although certain of the most limiting requirements of the proposed rule only apply to senior executive officers and significant risk-takers, other elements apply to all covered persons and all incentive-based compensation arrangements. The final rule should acknowledge that below a certain quantitative threshold (we would suggest \$50,000), incentive-based compensation arrangements are presumed not to be excessive. Without such a quantitative minimum, the proposed rule would affect incentive-based compensation provided to even those employees at covered institutions who receive relatively modest compensation and impose a compliance cost on covered institutions for providing such incentive-based arrangements. Moreover, such minimal arrangements should be scoped out of the rule entirely, as they could not lead to material financial loss and are not what Congress intended the Agencies to prohibit through implementing Section 956. Any set quantitative minimum should include an escalator component, such that the minimum will adjust automatically over time to account for inflation.

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<sup>120</sup> 81 Fed. Reg. at 37,702.

**3. The definition should allow for qualitative exclusions, such that programs that cannot influence risk-taking (e.g., recognition and service awards) are excluded from incentive-based compensation.**

In addition to a quantitative exclusion, the Agencies should also explicitly exclude arrangements that by their nature could not lead to material financial loss because they do not encourage risk-taking. The current construction of the proposed rule would apply to compensation that is in no way tied to risk—including incentive-based compensation arrangements that are trying to provide an incentive for employees to avoid risk. For example, recognition and customer service awards that recognize employees' job performance (which may include recognizing those in a corporate risk department who have worked to ensure their institution does not take on inappropriate risks) would be unnecessarily subject to the requirements. We urge the Agencies to create an exception for incentive compensation that is clearly unrelated to risk-taking and that could not lead to material financial loss.

**4. Commissions should be excluded from the definition of “incentive-based compensation.”**

The Agencies should clarify that the proposed rule will treat commission-based compensation consistently with the Department of the Treasury's 2009 TARP Standards for Compensation and Corporate Governance, which exempted “certain commission compensation for sales to, and investment management services for, unrelated parties” from the definition of “bonus.”<sup>121</sup> The TARP preamble explained that those types of commission payments “characteristically are viewed as a component of base salary rather than bonus compensation.”<sup>122</sup> So long as an employee's commission meets similar requirements to those contained in TARP (that the rate of commission be pre-established, reasonable and applied consistently to the same of substantially similar goods or services), the final rule should exempt commissions from the definition of incentive-based compensation or, at a minimum, exempt commissions from the prohibition on volume-based measures (see Section XIV.B above). Commissions are also subject to the same tax treatment as base salary, further demonstrating their more appropriate categorization as fixed, rather than incentive-based, compensation. Employees whose compensation is largely comprised of commissions are often highly mobile and the most productive employees are often the most-sought after. Subjecting employees whose incentive compensation is largely commission-based to the proposed rule would put covered institutions at a significant disadvantage and push those employees into unregulated institutions.

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<sup>121</sup> 74 Fed. Reg. at 28,400.

<sup>122</sup> *Id.*



**5. The final rule should clarify that carried interest arrangements are not incentive-based compensation or, if they are included, explain how the final rule’s requirements would be applied to such arrangements.**

The proposed rule defines incentive-based compensation as including “any variable compensation, fees, or benefits”<sup>123</sup>, which could arguably include carried interest arrangements which are subject to variation. Although we appreciate the Agencies desire to create a broad definition that can be flexible as compensation programs evolve,<sup>124</sup> it is important to separate compensation arrangements that could pose risk to the covered institution from those that relate only to client assets.

Carried interest arrangements are those in which an employee shares in a percentage of the profits of a private equity fund or other portfolio of investments that the employee manages. Carried interest arrangements, importantly, do not relate to the performance of the covered institution itself, but the performance of client-owned assets. Furthermore, the allocation of carried interest is not based on a decision by the covered institution, but rather the value of the portfolio being managed. Accordingly, carried interest arrangements that meet certain conditions (*e.g.*, paid primarily out of gains realized from the disposition or partial disposition of a portfolio investment) should not be treated as incentive-based compensation under the final rule, as they could not pose a threat of material financial loss to the institution. If an employee were to take excessive risk and cause material financial loss to an investment based on a carried interest arrangement, it would only affect the underlying investment and the applicable client, not the covered institution. Of course, employees also have significant reputational incentives and fiduciary responsibilities not to take excessive risk in carried interest arrangements.

If carried interest arrangements are included in the definition of incentive-based compensation, it is entirely unclear how the proposed rule’s requirements should apply to them. When is the “performance period”? How is the carried interest arrangement valued? How would deferral requirements apply? The final rule should explicitly exclude carried interest arrangements from the definition of incentive-based compensation. At a minimum, if the Agencies insist on counting carried interest arrangements as incentive-based compensation, the Agencies should clarify when a carried interest arrangement is considered to have been “awarded” and “vested” for purposes of the final rule and should explain how the final rule’s requirements would apply to carried interest arrangements. Once the Agencies have determined how the requirements would apply, it is important that the public be given an opportunity to comment on any proposed application.

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<sup>123</sup> Section 236.2(r), 81 Fed. Reg. at 37,807.

<sup>124</sup> 81. Fed. Reg. at 37,702.

**B. The definitions of “long-term incentive plan” and “qualifying incentive-based compensation” should be amended to be less prescriptive and eliminate a three-year performance period requirement for long-term incentive plans.**

The final rule should not be prescriptive in the definitions of “long-term incentive plan” and “qualifying incentive-based compensation.” Doing so would eliminate institutional flexibility to design plans meeting individual and specific needs. For example, some covered institutions may utilize “combination plans” that are long-term in nature, but include shorter-term performance measures. These plans should not fall outside the definition of “long-term incentive plan” merely due to the use of performance measures that fall short of three years, as the length of the plan itself still achieves the policy goal of allowing for adequate information about a covered person’s risk-taking to become apparent. This is especially true in tandem with the minimum deferral requirements to which such pay would still be subject. The final rule should allow covered institutions flexibility in the plans they implement and not include rigid definitions of long-term incentive plan or qualifying incentive-based compensation to be applied in a uniform manner to all covered institutions.

If the Agencies proceed with prescribing definitions, however, the three-year performance period requirement to qualify as a “long-term incentive plan” should be eliminated and/or revised to acknowledge that a three-year performance period does not require only a single measurement date at the end of the period. The final rule should include long-term incentive plans (as traditionally used by covered institutions) in its definition of “long-term incentive plan” even if they do not have a three-year performance period in the traditional sense. For example, an incentive plan may have a three-year performance period, but performance may be measured annually throughout the plan’s life, rather than simply once at the end. An incentive plan might also include catch-up provisions whereby three one-year performance periods are interrelated and in some cases dependent on one another.

**XVI. Governance Requirements Applicable to All Covered Institutions**

**A. The proposed rule’s governance and risk management framework requirements would be unduly onerous, would limit a board’s flexibility, may interfere with a board’s ability to take a holistic approach to risk management and should be permitted to be on a consolidated basis.**

As proposed, the governance and risk management framework requirements would be unduly burdensome, particularly if, as proposed, they are required for every covered institution on its own (*i.e.*, applied on an entity-by-entity basis).<sup>125</sup> Although the requirements apply to only Level 1 and Level 2 covered institutions, as discussed in Section IX.B above, the proposed rule scopes subsidiaries into the level of their parent. For example, the requirements that are explicit for a compensation committee (contained in Section \_\_.10) would be applied to a \$1 billion

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<sup>125</sup> While Section \_\_.3(c) states that “[a] covered institution that is a subsidiary of another covered institution may meet any requirements of this part if the parent covered institution complies with the requirement[.]” it is unclear exactly which requirements can be met via this provision.

subsidiary of a \$500 billion parent institution. Consider that a given top-tier parent may have hundreds of covered institution subsidiaries (that would each be required to maintain their own compensation committee), and the burden of the proposal's entity-by-entity approach (and the small chance of a material financial loss) becomes obvious. Furthermore, coordinating reviews and approvals of senior executive officer compensation among the individual compensation committees of hundreds of covered institution subsidiaries would lead to an absurd and unwieldy result.

The compensation committee of a parent institution typically sets compensation standards throughout or for a large part of the organization. The Agencies should clarify the meaning of Section \_\_.3(c) of the proposed rule and eliminate the requirement that covered institution subsidiaries of parent covered institutions maintain their own compensation committee with independent committee members. Similarly, the risk management framework requirements contained in Section \_\_.9 of the proposed rule would be difficult for each covered institution subsidiary of a larger covered institution to meet; implementing an independent compliance program with testing and monitoring would be overly burdensome. The Agencies should clarify whether Section \_\_.3(c) was intended to exempt covered institutions that are subsidiaries of other covered institutions from all of the governance and risk management framework requirements of the proposal to the extent appropriately covered by their parent institution.

Even if applied on a consolidated basis, the proposed rule's requirements are excessive in the responsibility and oversight requirements placed on a board of directors. While we support board oversight of incentive-based compensation arrangements, the proposal goes too far in mandating tasks that would monopolize the board's time. Under the proposed rule, a covered institution's board, or a committee thereof, would be required to approve incentive-based compensation arrangements for senior executive officers—including the amounts, time of vesting and payouts under such arrangements.<sup>126</sup> While this would not be a terribly demanding task if the universe of senior executive officers was limited to a few individuals, the proposed definition of senior executive officer is overly broad and could sweep in a large number of individuals who are heads of major business lines or control functions, and could also cover groups of senior executive officers at hundreds of subsidiary covered institutions. Needing to conduct downward adjustment reviews at vesting and at payout of each senior executive officers' award would, in practice, mandate that the board spend multiple meetings per year on these matters alone. Regardless of whether the requirements are implemented on a consolidated or entity-by-entity basis, the burden on boards would be tremendous.

Our recent report, *The Role of the Board of Directors in Promoting Effective Governance and Safety and Soundness for Large U.S. Banking Organizations*,<sup>127</sup> notes that senior U.S.

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<sup>126</sup> Section 236.4(e)(2), 81 Fed. Reg. at 37,810.

<sup>127</sup> The Clearing House, *The Role of the Board of Directors in Promoting Effective Governance and Safety and Soundness for Large U.S. Banking Organizations* (May 2016), <https://www.theclearinghouse.org/issues/articles/2016/05/20160505-tch-publishes-the-role-of-the-board-of-directors-report>.

regulators have expressed concerns relating to the increasing regulatory compliance-related obligations of directors, which may divert attention from core board functions. For example:

- “There are many important regulatory requirements applicable to large financial firms. Boards must of course be aware of those requirements and must help ensure that good corporate compliance systems are in place. But it has perhaps become a little too reflexive a reaction on the part of regulators to jump from the observation that a regulation is important to the conclusion that the board must certify compliance through its own processes.” (Daniel Tarullo, June 2014).
- “We don’t expect directors to manage the bank, but we do expect the board to look at high level issues that relate to culture . . .” (Thomas Curry, June 2015).

Although we acknowledge that one of a board’s core functions should be talent management, including evaluating the performance and compensation for certain executive officers, the proposed rule prescribes too many tasks for the board of directors.

**B. The final rule should require only one annual written assessment of a covered institution’s incentive compensation program, consistent with the requirements contained in the Federal Reserve’s Regulation YY and the OCC’s Heightened Standards for Large Financial Institutions.**

The proposed rule would require the compensation committee of a covered institution to obtain at least annually two written assessments of the incentive compensation program: one from management and one from an independent source.<sup>128</sup> Requiring two written assessments is excessive, redundant and unnecessary. The Agencies have previously determined that a single risk assessment is adequate. For example, the Federal Reserve’s Regulation YY requires the risk committee of a bank holding company with over \$50 billion in assets to receive and review reports from the institution’s chief risk officer at least quarterly,<sup>129</sup> and the OCC’s Heightened Standards for Large Financial Institutions provides for independent risk management and quarterly reporting to the board of directors or risk committee.<sup>130</sup> Neither regulation requires reports from two or more sources.

Requiring a single report from management, done at the consolidated level, would be more than adequate to assess a covered institution’s compensation program. If, as the proposed rule dictates, the management’s report is developed with input from the risk and audit committees (or groups performing similar functions) and from individuals in risk and audit functions, the assessment should be more than adequate to assess the institution’s incentive compensation program and processes. We understand that risk is part of the compensation

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<sup>128</sup> Section 236.10(b)(2)-(3), 81 Fed. Reg. at 37,812.

<sup>129</sup> 12 C.F.R. § 252.33.

<sup>130</sup> OCC Guidelines Establishing Heightened Standards for Certain Large Insured National Banks, Insured Federal Savings Associations, and Insured Federal Branches; Integration of Regulations, 79 Fed. Reg. 54518-01 (proposed Sept. 11, 2014) (to be codified at 12 C.F.R. pt. 30, 168 & 170).

structuring process, but the Agencies have failed to explain why a single risk report is sufficient in other regulations but inadequate in this instance.

**XVII. The final rule should accommodate accounting guidance in order to avoid liability accounting of equity awards.**

Neither the preamble nor the proposed rule itself appropriately considers the potential accounting implications on covered institutions' financial reporting. The proposal could change the accounting treatment for certain types of incentive-based compensation arrangements, particularly equity-based awards. We urge the Agencies to carefully consider these potential accounting implications before adopting the final rule. In particular, the final rule should be carefully constructed to avoid the risk that equity-based awards be deemed liabilities and subject to liability accounting.

Equity-based incentive compensation is often valued based on its grant date fair value, which is computed in accordance with the Financial Accounting Standards Board's Accounting Standards Codification (or "ASC") 718 Compensation-Stock Compensation. However, the proposal could, in certain circumstances and depending on the exact terms of the particular award, require equity-based awards to be subject to liability accounting.

The most significant impact of liability accounting is that it would require the remeasurement of an award to its fair-value each reporting cycle. This mark-to-market requirement would create a significant administrative burden on covered institutions by requiring them to determine the fair value of equity-based awards each reporting period, rather than merely once at the grant date. It also, and perhaps more significantly, would subject the covered institution's earnings to unwanted volatility as the value of outstanding equity-based awards are revalued each period and could experience significant changes. For these reasons, it is important that the final rule not inadvertently require liability accounting for incentive-based compensation arrangements. Aspects of the proposed rule that the Agencies should carefully evaluate include:

- Non-financial performance measures in award terms. Under ASC 718, awards with conditions or other features that are indexed to something other than a market are classified as liabilities (and, accordingly, subject to liability accounting). The final rule should be clarified that such conditions or features are not required.<sup>131</sup>
- Forfeiture and downward adjustment triggers. The proposal requires that long-term incentive plans be eligible for downward adjustment while the awards are being earned. Given that the list of items that could trigger a downward adjustment is not formally defined, it could be interpreted that there is no "grant date" under ASC 718. The lack of a mutual understanding could lead to liability accounting. The final rule should be clarified that covered institutions may sufficiently define forfeiture and downward adjustment events to the extent necessary to avoid liability accounting treatment.

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<sup>131</sup> Section 236.4(d), 81 Fed. Reg. at 37,809.

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Thank you for your consideration of these comments. Should you have any questions or need further information, please do not hesitate to contact me by phone at (212) 613-0138 or by email at greg.baer@theclearinghouse.org.

Respectfully submitted,



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## Annex 1: Example

The following example is based on the Example Incentive-Based Compensation Arrangement and Forfeiture and Downward Adjustment Review provided in the preamble to the proposed rule.<sup>1</sup> Unless otherwise specified, assumptions are identical to those in the preamble. Part 1 demonstrates the impact of the proposed rule's deferral and clawback requirements, while Part 2 demonstrates the impact of the alternative deferral and clawback requirements proposed in our letter.

### Part 1

In Part 1, we have assumed that Ms. Ledger is a senior executive officer at a bank holding company, henceforth "ABC," which has \$300 billion (rather than \$200 billion, as assumed in the preamble's example) in average total consolidated assets. Under the definitions of the proposed rule, ABC would be a Level 1 covered institution (rather than a Level 2 covered institution, as assumed in the preamble's example). Our assumptions are designed in every instance to present the scenario under which Ms. Ledger is the least affected by the proposal. The example assumes ABC makes decisions to minimize deferrals and amounts subject to clawback, when in actual practice amounts subject to deferral and clawback could be significantly greater than shown in this example.

Additional assumptions:

- Ms. Ledger has three incentive-compensation arrangements, which, consistent with the preamble's description, include two annual incentive plans and one long-term plan with a three-year performance period.<sup>2</sup>
- Ms. Ledger's target and actual incentive awards remain constant year-after-year. She receives total qualifying incentive-based compensation of \$115,000 per year (earned at target)<sup>3</sup> and total long-term incentive plan compensation of \$140,000 (earned at target).
- Compensation awards are granted to Ms. Ledger in March of each year with performance periods that end on December 31.
- In each case, only the minimum required amount is deferred by ABC and ABC elects to vest the deferred compensation as quickly as allowed under the proposed rule (*i.e.*, pro rata annual vesting). This means each year:

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<sup>1</sup> 81 Fed. Reg. at 37,743-46.

<sup>2</sup> *See* 81 Fed. Reg. at 37,743.

<sup>3</sup> The preamble's example assumes a target of \$140,000, which is earned at \$115,000, but for purposes of our example we have assumed all incentives are earned at target.

- 60% of Ms. Ledger's \$115,000 qualifying incentive-based compensation (\$69,000), is deferred and vests pro rata over four years.
  - 60% of Ms. Ledger's \$140,000 long-term incentive plan compensation (\$84,000) is deferred and vests pro rata over two years.
- All incentive-based compensation is subject to clawback for seven years from the date the compensation vests.
- We do not differentiate between cash and equity for purposes of this example and assume a substantial portion of each is deferred each year.

Part 1 of the following chart illustrates that once Ms. Ledger's incentive-based compensation arrangements have run for an entire cycle, in any given year Ms. Ledger has 2.5x her annual qualifying incentive-based compensation (\$287,500)<sup>4</sup> and almost 4x her annual long-term incentive plan compensation (\$546,000) deferred and, accordingly, subject to downward adjustment and/or forfeiture. At the same time, in any given year, Ms. Ledger has 7x her annual qualifying incentive-based compensation (\$805,000) and 7x her annual long-term incentive plan compensation (\$980,000) subject to clawback.

This means in any given year Ms. Ledger has 9.5x her annual qualifying incentive-based compensation (\$1,092,500) and nearly 11x her long-term incentive plan compensation (\$1,526,000) subject to some form of risk, whether it be clawback or downward adjustment or forfeiture. In total, Ms. Ledger has \$2,618,500 in incentive compensation, or just over 10.25x her combined annual and long-term incentive plan compensation, that is subject to some form of risk.

Assuming Ms. Ledger receives a base salary of \$115,000, which would be consistent with a compensation program that paid approximately 30% in base salary, 30% in annual incentive and 40% in long-term incentive, the total compensation deferred for Ms. Ledger at any given time would be more than 2.25x her total annual compensation (\$833,500 deferred vs. \$370,000 in total annual compensation) and the total compensation subject to clawback at any given time would be more than 4.75x her total annual compensation (\$1,785,000 subject to clawback vs. \$370,000 in total annual compensation).

## **Part 2**

In Part 2, we have continued all of the assumptions made in Part 1 above with the following exceptions.

- We assume that our proposed deferral percentage of 25% for significant risk-takers is applied to Ms. Ledger as opposed to the proposed rule's 60% deferral percentage for senior executive officers. This assumption is applied to both qualifying incentive-based compensation and long-term incentive plan compensation.

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<sup>4</sup> This includes Ms. Ledger's annual incentive plan compensation for the applicable year, which was granted in March and subject to performance during the year of grant.



- 25% of Ms. Ledger's \$115,000 qualifying-incentive based compensation (\$28,750), is deferred and vests pro rata over four years.
- 25% of Ms. Ledger's \$140,000 long-term incentive plan compensation (\$35,000) is deferred and vests pro rata over two years.
- We assume that our proposal to subject incentive-based compensation to clawback for seven years from the date of grant, as opposed to the proposed rule's seven years from the date the compensation vests, is applied.
- Compensation that is both deferred and subject to clawback at the same time is counted only as deferred in order to avoid double counting.

Part 2 of the following chart illustrates that once Ms. Ledger's incentive-based compensation arrangements have run for an entire cycle, in any given year Ms. Ledger has over 1.5x her annual qualifying incentive-based compensation (\$186,875) and over 3.25x her annual long-term incentive plan compensation (\$472,500) deferred and, accordingly, subject to downward adjustment and/or forfeiture. At the same time, in any given year, Ms. Ledger has over 6.25x her annual qualifying incentive-based compensation (\$733,125) and over 4.5x her annual long-term incentive plan compensation (\$647,500) subject to clawback.

This means in any given year Ms. Ledger has 8x her annual qualifying incentive-based compensation (\$920,000) and 8x her long-term incentive plan compensation (\$1,120,000) subject to some form of risk, whether it be clawback or downward adjustment or forfeiture. In total, Ms. Ledger has \$2,040,000 total incentive compensation, or 8x her combined annual and long-term incentive plan compensation, that is subject to some form of risk.

Assuming Ms. Ledger receives a base salary of \$115,000, which would be consistent with a compensation program that paid approximately 30% in base salary, 30% in annual incentive and 40% in long-term incentive, the total compensation deferred for Ms. Ledger at any given time would be more than 1.75x her total annual compensation (\$659,375 deferred vs. \$370,000 in total annual compensation) and the total compensation subject to clawback at any given time would be just under 3.75x her total annual compensation (\$1,380,625 subject to clawback vs. \$370,000 in total annual compensation).

Annex 1 - 4

**PART 1: Chart of Ms. Ledger's Incentive-Based Compensation Granted Over 12 Years**

			2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034	2035	2036	2037	2038	2039	2040	2041	2042	2043	2044	2045	2046	
March 2024 Comp Awards	QI Comp	Deferred	\$115,000	\$69,000	\$51,750	\$34,500	\$17,250	\$0	\$0	\$0	\$0	\$0	\$0	\$0												
		Subject to Clawback	\$0	\$46,000	\$63,250	\$80,500	\$97,750	\$115,000	\$115,000	\$115,000	\$69,000	\$51,750	\$34,500	\$17,250	\$0											
	LTIP Comp	Deferred	\$140,000	\$140,000	\$140,000	\$84,000	\$42,000	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0											
		Subject to Clawback	\$0	\$0	\$0	\$56,000	\$98,000	\$140,000	\$140,000	\$140,000	\$140,000	\$140,000	\$140,000	\$84,000	\$42,000											
March 2025 Comp Awards	QI Comp	Deferred		\$115,000	\$69,000	\$51,750	\$34,500	\$17,250	\$0	\$0	\$0	\$0	\$0	\$0	\$0											
		Subject to Clawback		\$0	\$46,000	\$63,250	\$80,500	\$97,750	\$115,000	\$115,000	\$115,000	\$69,000	\$51,750	\$34,500	\$17,250	\$0										
	LTIP Comp	Deferred		\$140,000	\$140,000	\$140,000	\$84,000	\$42,000	\$0	\$0	\$0	\$0	\$0	\$0	\$0											
		Subject to Clawback		\$0	\$0	\$0	\$56,000	\$98,000	\$140,000	\$140,000	\$140,000	\$140,000	\$140,000	\$84,000	\$42,000											
March 2026 Comp Awards	QI Comp	Deferred			\$115,000	\$69,000	\$51,750	\$34,500	\$17,250	\$0	\$0	\$0	\$0	\$0	\$0											
		Subject to Clawback			\$0	\$46,000	\$63,250	\$80,500	\$97,750	\$115,000	\$115,000	\$115,000	\$69,000	\$51,750	\$34,500	\$17,250	\$0									
	LTIP Comp	Deferred			\$140,000	\$140,000	\$140,000	\$84,000	\$42,000	\$0	\$0	\$0	\$0	\$0	\$0											
		Subject to Clawback			\$0	\$0	\$0	\$56,000	\$98,000	\$140,000	\$140,000	\$140,000	\$140,000	\$140,000	\$84,000	\$42,000										
March 2027 Comp Awards	QI Comp	Deferred				\$115,000	\$69,000	\$51,750	\$34,500	\$17,250	\$0	\$0	\$0	\$0	\$0											
		Subject to Clawback				\$0	\$46,000	\$63,250	\$80,500	\$97,750	\$115,000	\$115,000	\$115,000	\$69,000	\$51,750	\$34,500	\$17,250	\$0								
	LTIP Comp	Deferred				\$140,000	\$140,000	\$140,000	\$84,000	\$42,000	\$0	\$0	\$0	\$0	\$0											
		Subject to Clawback				\$0	\$0	\$0	\$56,000	\$98,000	\$140,000	\$140,000	\$140,000	\$140,000	\$84,000	\$42,000										
March 2028 Comp Awards	QI Comp	Deferred					\$115,000	\$69,000	\$51,750	\$34,500	\$17,250	\$0	\$0	\$0	\$0											
		Subject to Clawback				\$0	\$46,000	\$63,250	\$80,500	\$97,750	\$115,000	\$115,000	\$115,000	\$69,000	\$51,750	\$34,500	\$17,250	\$0								
	LTIP Comp	Deferred					\$140,000	\$140,000	\$140,000	\$84,000	\$42,000	\$0	\$0	\$0	\$0											
		Subject to Clawback					\$0	\$0	\$0	\$56,000	\$98,000	\$140,000	\$140,000	\$140,000	\$84,000	\$42,000										
March 2029 Comp Awards	QI Comp	Deferred						\$115,000	\$69,000	\$51,750	\$34,500	\$17,250	\$0	\$0	\$0											
		Subject to Clawback					\$0	\$46,000	\$63,250	\$80,500	\$97,750	\$115,000	\$115,000	\$115,000	\$69,000	\$51,750	\$34,500	\$17,250	\$0							
	LTIP Comp	Deferred						\$140,000	\$140,000	\$140,000	\$84,000	\$42,000	\$0	\$0	\$0											
		Subject to Clawback						\$0	\$0	\$0	\$56,000	\$98,000	\$140,000	\$140,000	\$140,000	\$84,000	\$42,000									
March 2030 Comp Awards	QI Comp	Deferred							\$115,000	\$69,000	\$51,750	\$34,500	\$17,250	\$0	\$0											
		Subject to Clawback					\$0	\$46,000	\$63,250	\$80,500	\$97,750	\$115,000	\$115,000	\$115,000	\$69,000	\$51,750	\$34,500	\$17,250	\$0							
	LTIP Comp	Deferred							\$140,000	\$140,000	\$140,000	\$84,000	\$42,000	\$0	\$0											
		Subject to Clawback							\$0	\$0	\$0	\$56,000	\$98,000	\$140,000	\$140,000	\$140,000	\$140,000	\$84,000	\$42,000							
March 2031 Comp Awards	QI Comp	Deferred								\$115,000	\$69,000	\$51,750	\$34,500	\$17,250	\$0											
		Subject to Clawback						\$0	\$46,000	\$63,250	\$80,500	\$97,750	\$115,000	\$115,000	\$115,000	\$69,000	\$51,750	\$34,500	\$17,250	\$0						
	LTIP Comp	Deferred								\$140,000	\$140,000	\$140,000	\$84,000	\$42,000	\$0	\$0										
		Subject to Clawback								\$0	\$0	\$0	\$56,000	\$98,000	\$140,000	\$140,000	\$140,000	\$140,000	\$84,000	\$42,000						
March 2032 Comp Awards	QI Comp	Deferred									\$115,000	\$69,000	\$51,750	\$34,500	\$17,250	\$0										
		Subject to Clawback						\$0	\$46,000	\$63,250	\$80,500	\$97,750	\$115,000	\$115,000	\$115,000	\$69,000	\$51,750	\$34,500	\$17,250	\$0						
	LTIP Comp	Deferred									\$140,000	\$140,000	\$140,000	\$84,000	\$42,000	\$0	\$0									
		Subject to Clawback									\$0	\$0	\$0	\$56,000	\$98,000	\$140,000	\$140,000	\$140,000	\$140,000	\$84,000	\$42,000					
March 2033 Comp Awards	QI Comp	Deferred										\$115,000	\$69,000	\$51,750	\$34,500	\$17,250	\$0									
		Subject to Clawback						\$0	\$46,000	\$63,250	\$80,500	\$97,750	\$115,000	\$115,000	\$115,000	\$69,000	\$51,750	\$34,500	\$17,250	\$0						
	LTIP Comp	Deferred										\$140,000	\$140,000	\$140,000	\$84,000	\$42,000	\$0	\$0								
		Subject to Clawback										\$0	\$0	\$0	\$56,000	\$98,000	\$140,000	\$140,000	\$140,000	\$140,000	\$84,000	\$42,000				
March 2034 Comp Awards	QI Comp	Deferred											\$115,000	\$69,000	\$51,750	\$34,500	\$17,250	\$0								
		Subject to Clawback						\$0	\$46,000	\$63,250	\$80,500	\$97,750	\$115,000	\$115,000	\$115,000	\$69,000	\$51,750	\$34,500	\$17,250	\$0						
	LTIP Comp	Deferred										\$140,000	\$140,000	\$140,000	\$84,000	\$42,000	\$0	\$0								
		Subject to Clawback										\$0	\$0	\$0	\$56,000	\$98,000	\$140,000	\$140,000	\$140,000	\$140,000	\$84,000	\$42,000				
March 2035 Comp Awards	QI Comp	Deferred												\$115,000	\$69,000	\$51,750	\$34,500	\$17,250	\$0							
		Subject to Clawback						\$0	\$46,000	\$63,250	\$80,500	\$97,750	\$115,000	\$115,000	\$115,000	\$69,000	\$51,750	\$34,500	\$17,250	\$0						
	LTIP Comp	Deferred												\$140,000	\$140,000	\$140,000	\$84,000	\$42,000	\$0	\$0						
		Subject to Clawback												\$0	\$0	\$56,000	\$98,000	\$140,000	\$140,000	\$140,000	\$140,000	\$140,000	\$84,000	\$42,000		
<b>Totals</b>	<b>QI Comp</b>	<b>Deferred</b>												<b>\$287,500</b>												
		<b>Subject to Clawback</b>													<b>\$805,000</b>											
	<b>Total at Risk</b>													<b>\$1,092,500</b>												
	<b>LTIP Comp</b>	<b>Deferred</b>													<b>\$546,000</b>											
<b>Subject to Clawback</b>														<b>\$980,000</b>												
		<b>Total at Risk</b>												<b>\$1,526,000</b>												
<b>Percent of Annual Incentive Compensation</b>	<b>QI Comp</b>	<b>Deferred</b>												<b>250%</b>												
		<b>Subject to Clawback</b>													<b>700%</b>											
	<b>Total at Risk</b>													<b>950%</b>												
	<b>LTIP Comp</b>	<b>Deferred</b>													<b>390%</b>											
<b>Subject to Clawback</b>														<b>700%</b>												
		<b>Total at Risk</b>												<b>1090%</b>												
<b>Percent of Total Annual Incentive Compensation at Risk</b> <b>(total deferred + total subject to clawback) divided by (total incentive compensation per year)</b>														<b>1027%</b>												

**PART 2: Chart of Ms. Ledger's Incentive-Based Compensation Granted Over 8 Years**

			2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034	2035	2036	2037	2038	
March 2024 Comp Awards	QI Comp	Deferred	\$115,000	\$28,750	\$21,563	\$14,375	\$7,188	\$0	\$0	\$0								
		Subject to Clawback	\$0	\$86,250	\$93,438	\$100,625	\$107,813	\$115,000	\$115,000	\$115,000								
	LTIP Comp	Deferred	\$140,000	\$140,000	\$140,000	\$35,000	\$17,500	\$0	\$0	\$0								
		Subject to Clawback	\$0	\$0	\$0	\$105,000	\$122,500	\$140,000	\$140,000	\$140,000								
March 2025 Comp Awards	QI Comp	Deferred		\$115,000	\$28,750	\$21,563	\$14,375	\$7,188	\$0	\$0	\$0							
		Subject to Clawback		\$0	\$86,250	\$93,438	\$100,625	\$107,813	\$115,000	\$115,000	\$115,000							
	LTIP Comp	Deferred		\$140,000	\$140,000	\$140,000	\$35,000	\$17,500	\$0	\$0	\$0							
		Subject to Clawback		\$0	\$0	\$0	\$105,000	\$122,500	\$140,000	\$140,000	\$140,000							
March 2026 Comp Awards	QI Comp	Deferred			\$115,000	\$28,750	\$21,563	\$14,375	\$7,188	\$0	\$0	\$0						
		Subject to Clawback			\$0	\$86,250	\$93,438	\$100,625	\$107,813	\$115,000	\$115,000	\$115,000						
	LTIP Comp	Deferred			\$140,000	\$140,000	\$140,000	\$35,000	\$17,500	\$0	\$0	\$0						
		Subject to Clawback			\$0	\$0	\$0	\$105,000	\$122,500	\$140,000	\$140,000	\$140,000						
March 2027 Comp Awards	QI Comp	Deferred				\$115,000	\$28,750	\$21,563	\$14,375	\$7,188	\$0	\$0	\$0					
		Subject to Clawback				\$0	\$86,250	\$93,438	\$100,625	\$107,813	\$115,000	\$115,000	\$115,000					
	LTIP Comp	Deferred				\$140,000	\$140,000	\$140,000	\$35,000	\$17,500	\$0	\$0	\$0					
		Subject to Clawback				\$0	\$0	\$0	\$105,000	\$122,500	\$140,000	\$140,000	\$140,000					
March 2028 Comp Awards	QI Comp	Deferred					\$115,000	\$28,750	\$21,563	\$14,375	\$7,188	\$0	\$0	\$0				
		Subject to Clawback					\$0	\$86,250	\$93,438	\$100,625	\$107,813	\$115,000	\$115,000	\$115,000				
	LTIP Comp	Deferred					\$140,000	\$140,000	\$140,000	\$35,000	\$17,500	\$0	\$0	\$0				
		Subject to Clawback					\$0	\$0	\$0	\$105,000	\$122,500	\$140,000	\$140,000	\$140,000				
March 2029 Comp Awards	QI Comp	Deferred						\$115,000	\$28,750	\$21,563	\$14,375	\$7,188	\$0	\$0	\$0			
		Subject to Clawback						\$0	\$86,250	\$93,438	\$100,625	\$107,813	\$115,000	\$115,000	\$115,000			
	LTIP Comp	Deferred						\$140,000	\$140,000	\$140,000	\$35,000	\$17,500	\$0	\$0	\$0			
		Subject to Clawback						\$0	\$0	\$0	\$105,000	\$122,500	\$140,000	\$140,000	\$140,000			
March 2030 Comp Awards	QI Comp	Deferred							\$115,000	\$28,750	\$21,563	\$14,375	\$7,188	\$0	\$0	\$0		
		Subject to Clawback							\$0	\$86,250	\$93,438	\$100,625	\$107,813	\$115,000	\$115,000	\$115,000		
	LTIP Comp	Deferred							\$140,000	\$140,000	\$140,000	\$35,000	\$17,500	\$0	\$0	\$0		
		Subject to Clawback							\$0	\$0	\$0	\$105,000	\$122,500	\$140,000	\$140,000	\$140,000		
March 2031 Comp Awards	QI Comp	Deferred								\$115,000	\$28,750	\$21,563	\$14,375	\$7,188	\$0	\$0	\$0	
		Subject to Clawback								\$0	\$86,250	\$93,438	\$100,625	\$107,813	\$115,000	\$115,000	\$115,000	
	LTIP Comp	Deferred								\$140,000	\$140,000	\$140,000	\$35,000	\$17,500	\$0	\$0	\$0	
		Subject to Clawback								\$0	\$0	\$0	\$105,000	\$122,500	\$140,000	\$140,000	\$140,000	
<b>Totals</b>	<b>QI Comp</b>	<b>Deferred</b>								<b>\$186,875</b>								
		<b>Subject to Clawback</b>								<b>\$733,125</b>								
	<b>Total at Risk</b>									<b>\$920,000</b>								
	<b>LTIP Comp</b>	<b>Deferred</b>									<b>\$472,500</b>							
<b>Subject to Clawback</b>										<b>\$647,500</b>								
		<b>Total at Risk</b>								<b>\$1,120,000</b>								
<b>Percent of Annual Incentive Compensation</b>	<b>QI Comp</b>	<b>Deferred</b>								<b>163%</b>								
		<b>Subject to Clawback</b>								<b>638%</b>								
	<b>Total at Risk</b>									<b>800%</b>								
	<b>LTIP Comp</b>	<b>Deferred</b>									<b>338%</b>							
<b>Subject to Clawback</b>										<b>463%</b>								
		<b>Total at Risk</b>								<b>800%</b>								
<b>Percent of Total Annual Incentive Compensation at Risk</b> (total deferred + total subject to clawback) divided by (total incentive compensation per year)										<b>800%</b>								

## **Annex 2: Selected Responses to Requests for Comment**

*1.1. The Agencies invite comment on whether this timing would be sufficient to allow covered institutions to implement any changes necessary for compliance with the proposed rule, particularly the development and implementation of policies and procedures. Is the length of time too long or too short and why? What specific changes would be required to bring existing policies and procedures into compliance with the rule? What constraints exist on the ability of covered institutions to meet the proposed deadline?*

Please see the discussion in Section VIII.

*1.2. The Agencies invite comment on whether the compliance date should instead be the beginning of the first performance period that starts at least 365 days after the final rule is published in the Federal Register in order to have the proposed rule's policies, procedures, risk management, and governance requirements begin when the requirements applicable to incentive-compensation plans and arrangements begin. Why or why not?*

Please see the discussion in Section VIII.

*2.1 The Agencies invite comment on whether other financial institutions should be included in the definition of "covered institution" and why.*

TCH has no specific comment on this question.

*2.2. The Agencies invite comment on whether any additional financial institutions should be included in the proposed rule's definition of subsidiary and why.*

Please see the discussion in Section IX.

*2.3. The Agencies invite comment on whether any additional financial institutions (such as registered investment companies) should be excluded from the proposed rule's definition of subsidiary and why.*

Please see the discussion in Section IX.

*2.4. The Agencies invite comment on the definition of average total consolidated assets.*

Please see the discussion in Section IX.H.

*2.5. The Agencies invite comment on the proposed rule's approach to consolidation. Are there any additional advantages to the approach? For example, the Agencies invite comment on the advantages of the proposed rule's approach for reinforcing the ability of an institution to establish and maintain effective risk management and controls for the entire consolidated organization and enabling holding company structures to more effectively manage human resources. Are there advantages to the approach of the proposed rule in helping to reduce the*

*possibility of evasion of the more specific standards applicable to certain individuals at Level 1 or Level 2 covered institutions? Are there any disadvantages to the proposed rule's approach to consolidation? For example, the Agencies invite comment on any disadvantages smaller subsidiaries of a larger covered institution may have by applying the more specific provisions of the proposed rule to these smaller institutions that would not otherwise apply to them but for being a subsidiary of a larger institution. Is there another approach that the proposed rule should take? The Agencies invite comment on any advantages and disadvantages of the SEC's proposal to not consolidate subsidiaries of broker-dealers and investment advisers that are not themselves subsidiaries of depository institution holding companies. Are the operations, services, and products of broker-dealers and investment advisers not typically effected through subsidiaries? Should the SEC adopt an express requirement to treat two or more affiliated investment advisers or broker-dealers that are separate legal entities (e.g., investment advisers that are operationally integrated) as a single investment adviser or broker-dealer for purposes of the proposed rule's thresholds?*

Please see the discussion in Section V and see generally the discussion in Section IX.

*2.6. The Agencies invite comment on whether the three-level structure would be a workable approach for categorizing covered institutions by asset size and why.*

Please see the discussion in Sections IX.A and IX.B.

*2.7. The Agencies invite comment on whether the asset thresholds used in these definitions would divide covered institutions into appropriate groups based on how they view the competitive marketplace. If asset thresholds are not the appropriate methodology for determining which requirements apply, which other alternative methodologies would be appropriate and why?*

Please see the discussion in Section IX.A.

*2.8. Are there instances where it may be appropriate to modify the requirements of the proposed rule where there are multiple covered institutions subsidiaries within a single parent organization based upon the relative size, complexity, risk profile, or business model, and use of incentive-based compensation of the covered institution subsidiaries within the consolidated organization? In what situations would that be appropriate and why?*

Please see the discussion in Section V and see generally the discussion in Section IX.

*2.9. Is the Agencies' assumption that incentive-based compensation programs are generally designed and administered at the holding company level for the organization as a whole correct? Why or why not? To what extent do broker-dealers or investment advisers within a holding company structure apply the same compensation standards as other subsidiaries in the parent company?*

Please see the discussion in Section V and see generally the discussion in Section IX.

*2.10. Bearing in mind that section 956 by its terms seeks to address incentive-based compensation arrangements that could lead to material financial loss to a covered institution, commenters are asked to provide comments on the proposed method of determining asset size for investment advisers. Are there instances where it may be appropriate to determine asset size differently, by for example, including client assets under management for investment advisers? In what situations would that be appropriate and why?*

TCH believes that the determination of average total consolidated assets for investment advisers should exclude non-proprietary assets. Please also see the discussion in Section IX.H.

*2.11. Should the determination of average total consolidated assets for investment advisers exclude non-proprietary assets that are included on a balance sheet under accounting rules, such as certain types of client assets under management required to be included on an investment adviser's balance sheet? Why or why not?*

TCH believes that the determination of average total consolidated assets for investment advisers should exclude non-proprietary assets.

*2.12. Should the determination of average total consolidated assets be further tailored for certain types of investment advisers, such as charitable advisers, non-U.S.-domiciled advisers, or insurance companies and, if so, why and in what manner?*

Please see the discussion in Section IX.G.

*2.13. The Agencies invite comment on the methods for determining whether foreign banking organizations and Federal branches and agencies are Level 1, Level 2, or Level 3 covered institutions. Should the same method be used for both foreign banking organizations and Federal branches and agencies? Why or why not?*

Please see the discussion in Section IX.F.

*2.14. The Agencies invite comment on whether the definition of "principal shareholder" reflects a common understanding of who would be a principal shareholder of a covered institution.*

TCH has no specific comment on this question.

*2.15. The Agencies invite comment on whether the types of positions identified in the proposed definition of senior executive officer are appropriate, whether additional positions should be included, whether any positions should be removed, and why.*

Please see the discussion in Section X.B.

2.16. *The Agencies invite comment on whether the term “major business line” provides enough information to allow a covered institution to identify individuals who are heads of major business lines. Should the proposed rule refer instead to a “core business line,” as defined in FDIC and FRB rules relating to resolution planning (12 CFR 381.2(d)), to a “principal business unit, division or function,” as described in SEC definitions of the term “executive officer” (17 CFR 240.3b-7), or to business lines that contribute greater than a specified amount to the covered institution’s total annual revenues or profit? Why?*

Please see the discussion in Section X.B.

2.17. *Should the Agencies include the chief technology officer (“CTO”), chief information security officer, or similar titles as positions explicitly listed in the definition of “senior executive officer”? Why or why not? Individuals in these positions play a significant role in information technology management. The CTO is generally responsible for the development and implementation of the information technology strategy to support the institution’s business strategy in line with its appetite for risk. In addition, these positions are generally responsible for implementing information technology architecture, security, and business resilience.*

Please see the discussion in Section X.B.3.

2.18. *For purposes of a designation under paragraph (2) of the definition of significant risk-taker, should the Agencies provide a specific standard for what would constitute “material financial loss” and/or “overall risk tolerance”? If so, how should these terms be defined and why?*

Please see the discussion in Section III.

2.19. *The Agencies specifically invite comment on the one-third threshold in the proposed rule. Is one-third of the total of annual base salary and incentive-based compensation an appropriate threshold level of incentive-based compensation that would be sufficient to influence risk-taking behavior? Is using compensation from the last calendar year that ended at least 180 days before the beginning of the performance period for calculating the one-third threshold appropriate?*

TCH believes that the significant risk-taker definition should not involve bright-line tests such as the one-third threshold in the Proposal and that using compensation from the last calendar year that ended at least 180 days before the beginning of the performance period is inappropriate. Please also see the discussion in Sections X.C and X.D.

2.20. *The Agencies specifically invite comment on the percentages of employees proposed to be covered under the relative compensation test. Are 5 percent and 2 percent reasonable levels? Why or why not? Would 5 percent and 2 percent include all of the significant risk-takers or include too many covered persons who are not significant risk-takers?*

TCH believes the proposed percentages under the relative compensation test would include too many covered persons who are not significant risk-takers. Please see the discussion in Section X.C.

*2.21. The Agencies specifically invite comment on the time frame needed to identify significant risk-takers under the relative compensation test. Is using compensation from the last calendar year that ended at least 180 days before the beginning of the performance period appropriate? The Agencies invite comment on whether there is another measure of total compensation that would be possible to measure closer in time to the performance period for which a covered person would be identified as a significant risk-taker.*

Please see the discussion in Section X.D.

*2.22. The Agencies invite comment on all aspects of the exposure test, including potential costs and benefits, the appropriate exposure threshold and capital equivalent, efficacy at identifying those non-senior executive officers who have the authority to place the capital of a covered institution at risk, and whether an exposure test is a useful complement to the relative compensation test. If so, what specific types of activities or transactions, and at what level of exposure, should the exposure test cover? The Agencies also invite comment on whether the exposure test is workable and why. What, if any, additional details would need to be specified in order to make the exposure test workable, such as further explanation of the meanings of “commit” or “expose”? In addition to committees, should the exposure test apply to groups of persons, such as traders on a desk? If so, how should it be applied?*

Please see the discussion in Section X.C.2.

*2.23. With respect to the exposure test, the Agencies specifically invite comment on the proposed capital commitment levels. Is 0.5 percent of capital of a covered institution a reasonable proxy for material financial loss, or are there alternative levels or dollar thresholds that would better achieve the statutory objectives? If alternative methods would better achieve the statutory objectives, what are the advantages and disadvantages of those alternatives compared to the proposed level? For depository institution holding company organizations with multiple covered institutions, should the capital commitment level be consistent across all such institutions or should it vary depending on specified factors and why? For example, should the levels for covered institutions that are subsidiaries of a parent who is also a covered institution vary depending on: (1) the size of those subsidiaries relative to the parent; and/or (2) whether the entity would be subject to comparable restrictions if it were not affiliated with the parent? What are the advantages and disadvantages of any such variation, and what would be the appropriate levels? The Agencies recognize that certain covered institutions under the Board’s, the OCC’s, the FDIC’s, and the SEC’s proposed rules, such as Federal and state branches and agencies of foreign banks and investment advisers that are not also depository institution holding companies, banks, or broker-dealers or subsidiaries of those institutions, are not otherwise required to calculate common equity tier 1 capital or tentative net capital, as applicable. How should the capital commitment level be determined under the Board’s, the OCC’s, the FDIC’s, and the SEC’s proposed rules for those covered institutions? Is there a*



*capital or other measure that the Agencies should consider for those covered institutions that would achieve similar objectives to common equity tier 1 capital or tentative net capital? If so, what are the advantages and disadvantages of such a capital or other measure?*

Please see the discussion in Section X.C.2.

*2.24. The Agencies invite comment on whether it is appropriate to limit the exposure test to market risk and credit risk and why. What other types of risk should be included, if any and how would such exposures be measured? Should the Agencies prescribe a method for measurement of market risk and credit risk? Should exposures be measured as notional amounts or is there a more appropriate measure? If so, what would it be? Should the exposure test take into account hedging? How should the exposure test be applied to an individual in a situation where a firm calculates an exposure limit for a trading desk comprised of a group of people? Should a de minimis threshold be introduced for any transaction counted toward the 0.5 percent annual exposure test?*

Please see the discussion in Section X.C.2.

*2.25. Should the exposure test consider the authority of a covered person to initiate or structure proposed product offerings, even if the covered person does not have final decision-making authority over such product offerings? Why or why not? If so, are there specific types of products with respect to which this approach would be appropriate and why?*

Please see the discussion in Section X.C.2.

*2.26. Should the exposure test measure a covered person's authority to commit or expose (a) through one transaction or (b) as currently proposed, through multiple transactions in the aggregate over a period of time? What would be the benefits and disadvantages of applying the test on a per-transaction versus aggregate basis over a period of time? If measured on an aggregate basis, what period of time is appropriate and why? For example, should paragraph (1)(iii) of the definition of significant risk-taker read: "A covered person of a covered institution who had the authority to commit or expose in any single transaction during the previous calendar year 0.5 percent or more of the capital of the covered institution or of any section 956 affiliate of the covered institution, whether or not the individual is a covered person of that specific legal entity"? Why or why not?*

Please see the discussion in Section X.C.2.

*2.27. If the exposure test were based on a single transaction, would 0.5 percent of capital be the appropriate threshold for significant risk-taker status? Why or why not? If not, what would be the appropriate percentage of capital to include in the exposure test and why?*

Please see the discussion in Section X.C.2.

2.28. *Should the Agencies introduce an absolute exposure threshold in addition to a percentage of capital test if a per-transaction test was introduced instead of the annual exposure test? Why or why not? For example, would a threshold formulated as “the lesser of 0.5 percent of capital or \$100 million” help to level the playing field across Level 1 covered institutions and the smallest Level 2 covered institutions and better ensure that the right set of activities is being considered by all institutions? The Agencies’ supervisory experience indicates that many large institutions, for example, require additional scrutiny of significant transactions, which helps to ensure that the potential risks posed by large transactions are adequately considered before such transactions are approved. Would \$100 million be the appropriate level at which additional approval procedures are required before a transaction is approved, or would a lower threshold be appropriate if an absolute dollar threshold were combined with the capital equivalent threshold?*

TCH believes the Agencies should not introduce an absolute exposure threshold. Such a threshold is not risk-based, nor is it appropriately tied to material risk to the institution. Please also see the discussion in Section X.C.2.

2.29. *Should the exposure test measure exposures or commitments actually made, or should the authority to make an exposure or commitment be sufficient to meet the test and why? For example, should paragraph (1)(iii) of the definition of significant risk-taker read: “A covered person of a covered institution who committed or exposed in the aggregate during the previous calendar year 0.5 percent or more of the common equity tier 1 capital, or in the case of a registered securities broker or dealer, 0.5 percent or more of the tentative net capital, of the covered institution or of any section 956 affiliate of the covered institution, whether or not the individual is a covered person of that specific legal entity”?*

Please see the discussion in Section X.C.2.

2.30. *Would a dollar threshold test, as described above, achieve the statutory objectives better than the relative compensation test? Why or why not? If using a dollar threshold test, and assuming a mechanism for inflation adjustment, would \$1 million be the right threshold or should it be higher or lower? For example, would a threshold of \$2 million dollars be more appropriate? Why or why not? How should the threshold be adjusted for inflation? Are there other adjustments that should be made to ensure the threshold remains appropriate? What are the advantages and disadvantages of a dollar threshold test compared to the proposed relative compensation test?*

Please see the discussion in Section X.C.2.

2.31. *The Agencies specifically invite comment on replacement of the relative compensation test in paragraphs (1)(i) and (ii) of the definition of significant risk-taker with a dollar threshold test, as follows: “a covered person of a Level 1 or Level 2 covered institution who receives annual base salary and incentive-based compensation of \$1 million or more in the last calendar year that ended at least 180 days before the beginning of the performance period.” Under this*

*alternative, the remaining language in the definition of “significant risk-taker” would be unchanged.*

Please see the discussion in Section X.C.2.

*2.32. The Agencies invite comment on all aspects of a dollar threshold test, including potential costs and benefits, the appropriate amount, efficacy at identifying those non-senior executive officers who have the ability to place the institution at risk, time frame needed to identify significant risk-takers, and comparison to a relative compensation test such as the one proposed. Is the last calendar year that ended at least 180 days before the beginning of the performance period an appropriate time frame or for the dollar threshold test or would using compensation from the performance period that ended in the most recent calendar year be appropriate? The Agencies specifically invite comment on whether to use an exposure test if a dollar threshold test replaces the relative compensation test and why.*

Please see the discussion in Section X.C.2.

*2.33. The Agencies invite comment on all aspects of the definition of “significant risk-taker.” The Agencies specifically invite comment on whether the definition should rely solely on the relative compensation test, solely on the exposure test, or on both tests, as proposed. What are the advantages and disadvantages of each of these options?*

Please see the discussion in Section X.C.

*2.34. In addition to the tests outlined above, are there alternative tests of, or proxies for, significant risk-taking that would better achieve the statutory objectives? What are the advantages and disadvantages of alternative approaches? What are the implementation burdens of any of the approaches, and how could they be addressed?*

Please see the discussion in Section X.C.

*2.35. How many covered persons would likely be identified as significant risk-takers under the proposed rule? How many covered persons would likely be identified under only the relative compensation test with the one-third threshold? How many covered persons would likely be identified under only the exposure test as measured on an annual basis with the one-third threshold? How many covered persons would be identified under only an exposure test formulated on a per transaction basis with the one-third threshold? How many covered persons would be identified under only the dollar threshold test, assuming the dollar threshold is \$1 million, with the one-third threshold? How many covered persons would be identified under each test individually without a one-third threshold?*

Please see the discussion in Section X.C.2.

*2.36. The Agencies invite comment on whether the proposed rule’s definition of “to award” should include language on when incentive-based compensation is awarded for purposes of the*

*proposed rule. Specifically, the Agencies invite comment on whether the definition should read: “To award incentive-based compensation means to make a final determination, conveyed to a covered person, at the end of the performance period, of the amount of incentive-based compensation payable to the covered person for performance over that performance period.” Why or why not?*

TCH has no specific comment on this question.

*2.37. The Agencies invite comment on whether and in what circumstances, the proposed definition of “control function” should include additional individuals and organizational units that (a) do not engage in activities designed to generate revenue or reduce expenses; (b) provide operational support or servicing to any organizational unit or function; or (c) provide technology services.*

Please see the discussion in Sections X.B.2 and X.B.3.

*2.38. To the extent covered institutions are already deferring incentive-based compensation, does the proposed definition of deferral reflect current practice? If not, in what way does it differ?*

TCH believes that the proposed definition of deferral does not reflect current practice. Please see the discussion in Section XI in addition to comments made throughout our letter.

*2.39. Are there any financial instruments that are used for incentive-based compensation and have a value that is dependent on the performance of a covered institution’s shares, but are not captured by the definition of “equity-like instrument”? If so, what are they, and should such instruments be added to the definition? Why or why not?*

Please see the discussion in Section XI.E.

*2.40. The Agencies invite comment on the proposed definition of incentive-based compensation. Should the definition be modified to include additional or fewer forms of compensation and in what way? Is the definition sufficiently broad to capture all forms of incentive-based compensation currently used by covered institutions? Why or why not? If not, what forms of incentive-based compensation should be included in the definition?*

Please see the discussion in Section XV.

*2.41. The Agencies do not expect that most pensions would meet the proposed rule’s definition of “incentive-based compensation” because pensions generally are not conditioned on performance achievement. However, it may be possible to design a pension that would meet the proposed rule’s definition of “incentive-based compensation.” The Agencies invite comment on whether the proposed rule should contain express provisions addressing the status of pensions in relation to the definition of “incentive-based compensation.” Why or why not?*

Please see the discussion in Sections XV.A.4 and XV.A.5.

*2.42. The Agencies invite comment on whether the proposed definition of “long-term incentive plan” is appropriate for purposes of the proposed rule. Are there incentive-based compensation arrangements commonly used by financial institutions that would not be included within the definition of “long-term incentive plan” under the proposed rule but that, given the scope and purposes of section 956, should be included in such definition? If so, what are the features of such incentive-based compensation arrangements, why should the definition include such arrangements, and how should the definition be modified to include such arrangements?*

Please see the discussion in Section XV.B.

*2.43. Does the proposed rule’s definition of “performance period” meet the goal of providing covered institutions with flexibility in determining the length and start and end dates of performance periods? Why or why not? Would a prescribed performance period, for example, periods that correspond to calendar years, be preferable? Why or why not?*

Please see the discussion in Sections X.D and XV.B.

*2.44. The Agencies invite comment generally on the proposed rule’s definitions.*

Our comments on the Proposed Rule’s definitions are addressed throughout our letter.

*2.45. Is the interplay of the award date, vesting date, performance period, and deferral period clear? If not, why not?*

TCH believes the Agencies should clarify whether the date of “vesting” is the date of delivery/payment or the date on which all forfeiture conditions lapse.

*2.46. Have the Agencies made clear the distinction between the proposed definitions of clawback, forfeiture, and downward adjustment? Do these definitions align with current industry practice? If not, in what way do they differ and what are the implications of such differences for both the operations of covered institutions and the effective supervision of compensation practices?*

Please see the discussion in Sections XII and XIII.

*3.1. The Agencies invite comment on whether a covered institution’s average total consolidated assets (a rolling average) is appropriate for determining a covered institution’s level when its total consolidated assets increase. Why or why not? Will 540 days provide covered institutions with adequate time to adjust incentive-based compensation programs to comply with different requirements? If not, why not? In the alternative, is 540 days too long to give covered institutions time to comply with the requirements of the proposed rule? Why or why not?*

Please see the discussion in Section VIII.

*3.2. The Agencies invite comment on whether the date described in section \_\_.3(a)(2) should instead be the beginning of the first performance period that begins at least 365 days after the date on which the regulated institution becomes a Level 1, Level 2, or Level 3 covered institution in order to have the date on which the proposed rule's corporate governance, policies, and procedures requirements begin coincide with the date on which the requirements applicable to plans begin. Why or why not?*

Please see the discussion in Section VIII.

*3.3. The Agencies invite comment on whether four consecutive quarters is an appropriate period for determining a covered institution's level when its total consolidated assets decrease. Why or why not?*

TCH has no specific comment on this question.

*3.4. Should the determination of total consolidated assets for covered institutions that are investment advisers be by reference to a periodic report or similar concept? Why or why not? Should there be a concept of a rolling average for asset size for covered institutions that are investment advisers and, if so, how should this be structured?*

TCH has no specific comment on this question.

*3.5. Should the transition period for an institution that changes levels or becomes a covered institution due to a merger or acquisition be different than an institution that changes levels or becomes a covered institution without a change in corporate structure? If so, why? If so, what transition period would be appropriate and why?*

TCH has no specific comment on this question.

*3.6. The Agencies invite comment on whether covered institutions transitioning from Level 1 to Level 2 or Level 2 to Level 3 should be permitted to modify incentive-based compensation plans with performance periods that began prior to their transition in level in such a way that would cause the plans not to meet the requirements of the proposed rule that were applicable to the covered institution at the time when the performance periods for the plans commenced. Why or why not?*

TCH has no specific comment on this question.

*4.1. The Agencies invite comment on the requirements for performance measures contained in section \_\_.4(d) of the proposed rule. Are these measures sufficiently tailored to allow for incentive-based compensation arrangements to appropriately balance risk and reward? If not, why?*

Please see the discussion in Sections XIV.B and XVII.

*4.2. The Agencies invite comment on whether the terms “financial measures of performance” and “non-financial measures of performance” should be defined. If so, what should be included in the defined terms?*

Please see the discussion in Sections XIV.B and XVII.

*4.3. Would preparation of annual records be appropriate or should another method be used? Would covered institutions find a more specific list of topics and quantitative information for the content of required records helpful? Should covered institutions be required to maintain an inventory of all such records and to maintain such records in a particular format? If so, why? How would such specific requirements increase or decrease burden?*

Please see the discussion in Section X.A.

*4.4. Should covered institutions only be required to create new records when incentive-based compensation arrangements or policies change? Should the records be updated more frequently, such as promptly upon a material change? What should be considered a “material change”?*

Please see the discussion in Section X.A.

*4.5. Is seven years a sufficient time to maintain the records required under section \_\_.4(f) of the proposed rule? Why or why not?*

Please see the discussion in Section X.A.

*4.6. Do covered institutions generally maintain records on incentive-based compensation arrangements and programs? If so, what types of records and related information are maintained and in what format? What are the legal or institutional policy requirements for maintaining such records?*

Please see the discussion in Section X.A.

*4.7. For covered institutions that are investment advisers or broker-dealers, is there particular information that would assist the SEC in administering the proposed rule? For example, should the SEC require its reporting entities to report whether they utilize incentive-based compensation or whether they are Level 1, Level 2 or Level 3 covered institutions?*

TCH has no specific comment on this question.

*5.1. Should the level of detail in records created and maintained by Level 1 and Level 2 covered institutions vary among institutions regulated by different Agencies? If so, how? Or would it be helpful to use a template with a standardized information list?*

TCH believes that the scope of the proposed recordkeeping requirements is too broad and would be overly burdensome. With respect to the content of the recordkeeping requirements, TCH believes that the level of detail in records should not be required to vary among institutions regulated by different Agencies. Additionally, any proposed template with a standardized information list should allow for an appropriate level of flexibility given the wide range of covered institutions. Please also see the discussion in Section X.A.

*5.2. In addition to the proposed records, what types of information should Level 1 and Level 2 covered institutions be required to create and maintain related to deferral and to forfeiture, downward adjustment, and clawback reviews?*

Please see the discussion in Section X.A.

*6.1. The Agencies invite general comment on the reservation of authority in section \_\_\_\_.6 of the proposed rule.*

TCH has no specific comment on this question.

*6.2. The Agencies based the \$10 billion dollar floor of the reservation of authority on existing similar reservations of authority that have been drawn at that level. Did the Agencies set the correct threshold or should the floor be set lower or higher than \$10 billion? If so, at what level and why?*

TCH has no specific comment on this question.

*6.3. Are there certain provisions in section \_\_\_\_.5 and sections \_\_\_\_.7 through \_\_\_\_.11 of the proposed rule that would not be appropriate to apply to a covered institution with total consolidated assets of \$10 billion or more and less than \$50 billion regardless of its complexity of operations or compensation practices? If so, which provisions and why?*

Please see the discussion in Section IX.

*6.4. The Agencies invite comment on the types of notice and response procedures the Agencies should use in determining that the reservation of authority should be used. The SEC invites comment on whether notice and response procedures based on the procedures for a proceeding initiated upon the SEC's own motion under Advisers Act rule 0-5 would be appropriate for this purpose.*

TCH has no specific comment on this question.

*6.5. What specific features of incentive-based compensation programs or arrangements at a Level 3 covered institution should the Agencies consider in determining such institution should comply with some or all of the more rigorous requirements within the rule and why? What process should be followed in removing such institution from the more rigorous requirements?*



TCH has no specific comment on this question.

*7.1 The Agencies invite comment on the proposed requirements in sections \_\_\_\_7(a)(1) and (a)(2).*

Please see the discussion in Section XI.

*7.2 Are minimum required deferral periods and percentages appropriate? If not, why not? Should Level 1 and Level 2 covered institutions be subject to different deferral requirements, as in the proposed rule, or should they be treated more similarly for this purpose and why? Should the minimum required deferral period be extended to, for example, five years or longer in certain cases and why?*

Please see the discussion in Section XI.

*7.3 Is a deferral requirement for senior executive officers and significant risk-takers at Level 1 and Level 2 covered institutions appropriate to promote the alignment of employees' incentives with the risk undertaken by such covered persons? If not, why not? For example, comment is invited on whether deferral is generally an appropriate method for achieving incentive-based compensation arrangements that appropriately balance risk and reward for each type of senior executive officer and significant risk-taker at these institutions or whether there are alternative or more effective ways to achieve such balance.*

Please see the discussion in Section XI.

*7.4 Commenters are also invited to address the possible impact that the required minimum deferral provisions for senior executive officers and significant risk-takers may have on larger covered institutions and whether any deferral requirements should apply to senior executive officers at Level 3 institutions.*

Please see the discussion in Section XI and our comments on the definitions of senior executive officers and significant risk-takers in Sections X.B and X.C.

*7.5 A number of commenters to the 2011 Proposed Rule suggested that applying a prescriptive deferral requirement, together with other requirements under that proposal, would make it more difficult for covered institutions to attract and retain key employees in comparison to the ability of organizations not subject to such requirements to recruit and retain the same employees. What implications does the proposed rule have on "level playing fields" between covered institutions and non-covered institutions in setting forth minimum deferral requirements under the rule?*

For the reasons stated throughout our letter, TCH believes a prescriptive deferral requirement, as well as other requirements of the Proposed Rule, would present "level playing fields" issues for covered institutions. Please also see the discussion in Section XI.

*7.6 The Agencies invite comment on whether longer performance periods can provide risk balancing benefits similar to those provided by deferral, such that the shorter deferral periods for incentive-based compensation awarded under long-term incentive plans in the proposed rule would be appropriate.*

Please see the discussion in Sections XI.A, XI.C and XI.E.

*7.7 Would the proposed distinction between the deferral requirements for qualifying incentive-based compensation and incentive-based compensation awarded under a long-term incentive plan pose practical difficulties for covered institutions or increase compliance burdens? Why or why not?*

Please see the discussion in Sections XI.A, XI.E and XV.

*7.8 Would the requirement in the proposed rule that amounts awarded under long-term incentive plans be deferred result in covered institutions offering fewer long-term incentive plans? If so, why and what other compensation plans will be used in place of long-term incentive plans and what negative or positive consequences might result?*

Please see the discussion in Sections XI.E and XV.

*7.9 Are there additional considerations, such as tax or accounting considerations, that may affect the ability of Level 1 or Level 2 covered institutions to comply with the proposed deferral requirement or that the Agencies should consider in connection with this provision in the final rule? Commenters on the 2011 Proposed Rule noted that employees of an investment adviser to a private fund hold partnership interests and that any incentive allocations paid to them are typically taxed at the time of allocation, regardless of whether these allocations have been distributed, and consequently, employees of an investment adviser to a private fund that would have been subject to the deferral requirement in the 2011 Proposed Rule would have been required to pay taxes relating to incentive allocations that they were required to defer. Should the determination of required deferral amounts under the proposed rule be adjusted in the context of investment advisers to private funds and, if so, how? Could the tax liabilities immediately payable on deferred amounts be paid from the compensation that is not deferred?*

Please see the discussion in Section XVII for a general discussion of accounting considerations. Please see the discussion in Sections XI.D and XIII.E for a discussion of certain tax considerations.

*7.10 The Agencies invite comment on the circumstances under which acceleration of payment should be permitted. Should accelerated vesting be allowed in cases where employees are terminated without cause or cases where there is a change in control and the covered institution ceases to exist and why? Are there other situations for which acceleration should be allowed? If so, how can such situations be limited to those of necessity?*

Please see the discussion in Section XI.D.

*7.11 The Agencies received comment on the 2011 Proposed Rule that stated it was common practice for some private fund adviser personnel to receive payments in order to enable the recipients to make tax payments on unrealized income as they became due. Should this type of practice to satisfy tax liabilities, including tax liabilities payable on unrealized amounts of incentive-based compensation, be permissible under the proposed rule, including, for example, as a permissible acceleration of vesting under the proposed rule? Why or why not? Is this a common industry practice?*

Please see the discussion in Section XI.D.

*7.12 The Agencies invite comment on the requirement in section \_\_.7(a)(3).*

Please see the discussion in Section XI.E.

*7.13 The Agencies invite comment on the composition requirement set out in section .7(a)(4)(i) of the proposed rule.*

Please see the discussion in Section XI.E.

*7.14 In order to allow Level 1 and Level 2 covered institutions sufficient flexibility in designing their incentive-based compensation arrangements, the Agencies are not proposing a specific definition of “substantial” for the purposes of this section. Should the Agencies more precisely define the term “substantial” (for example, one-third or 40 percent) and if so, should the definition vary among covered institutions and why? Should the term “substantial” be interpreted differently for different types of senior executive officers or significant risk-takers and why? What other considerations should the Agencies factor into level of deferred cash and deferred equity required? Are there particular tax or accounting implications attached to use of particular forms of incentive-based compensation, such as those related to debt or equity?*

Please see the discussion in Sections XI.E and XVII.

*7.15 The Agencies invite comment on whether the use of certain forms of incentive-based compensation in addition to, or as a replacement for, deferred cash or deferred equity-like instruments would strengthen the alignment between incentive-based compensation and prudent risk-taking.*

Please see the discussion in Section XI.E.

*7.16 The Agencies invite commenters’ views on whether the proposed rule should include a requirement that a certain portion of incentive-based compensation be structured with debt-like attributes. Do debt instruments (as opposed to equity-like instruments or deferred cash) meaningfully influence the behavior of senior executive officers and significant risk-takers? If so, how? How could the specific attributes of deferred cash be structured, if at all, to limit the amount of interest that can be paid? How should such an interest rate be determined, and how*

*should such instruments be priced? Which attributes would most closely align use of a debt-like instrument with the interest of debt holders and promote risk-taking that is not likely to lead to material financial loss?*

Please see the discussion in Section XI.E.

*7.17 The Agencies invite comment on the restrictions on the use of options in incentive-based compensation in the proposed rule. Should the percent limit be higher or lower and if so, why? Should options be permitted to be used to meet the deferral requirements of the rule? Why or why not? Does the use of options by covered institutions create, reduce, or have no effect on the institution's risk of material financial loss?*

Please see the discussion in Section XI.F.

*7.18 Does the proposed 15 percent limit appropriately balance the benefits of using options (such as aligning the recipient's interests with that of shareholders) and drawbacks of using options (such as their emphasis on upside gains)? Why or why not? Is the proposed 15 percent limit the appropriate limit, or should it be higher or lower? If it should be higher or lower, what should the limit be, and why?*

Please see the discussion in Section XI.F.

*7.19 Are there alternative means of addressing the concerns raised by options as a form of incentive-based compensation other than those proposed?*

Please see the discussion in Section XI.F.

*7.20 The Agencies invite comment on the forfeiture and downward adjustment requirements of the proposed rule.*

Please see the discussion in Section XII.

*7.21 Should the rule limit the events that require a Level 1 or Level 2 covered institution to consider forfeiture and downward adjustment to adverse outcomes that occurred within a certain time period? If so, why and what would be an appropriate time period? For example, should the events triggering forfeiture and downward adjustment reviews be limited to those events that occurred within the previous seven years?*

Please see the discussion in Section XII.

*7.22 Should the rule limit forfeiture and downward adjustment reviews to reducing only the incentive-based compensation that is related to the performance period in which the triggering event(s) occurred? Why or why not? Is it appropriate to subject unvested or unawarded incentive-based compensation to the risk of forfeiture or downward adjustment, respectively, if*

*the incentive-based compensation does not specifically relate to the performance in the period in which the relevant event occurred or manifested? Why or why not?*

Please see the discussion in Sections XII.A, XII.B and XIII.C.

*7.23 Should the rule place all unvested deferred incentive-based compensation, including amounts voluntarily deferred by Level 1 and Level 2 covered institutions or senior executive officers or significant risk-takers, at risk of forfeiture? Should only that unvested deferred incentive-based compensation that is required to be deferred under section \_\_\_\_.7(a) be at risk of forfeiture? Why or why not?*

Please see the discussion in Section XI.E.

*7.24 Are the events triggering a review that are identified in section \_\_\_\_.7(b)(2) comprehensive and appropriate? If not, why not? Should the Agencies add “repeated supervisory actions” as a forfeiture or downward adjustment review trigger and why? Should the Agencies add “final enforcement or legal action” instead of the proposed “enforcement or legal action” and why?*

Please see the discussion in Sections XII.A and XII.B.

*7.25 Is the list of factors that a Level 1 or Level 2 covered institution must consider, at a minimum, in determining the amount of incentive-based compensation to be forfeited or downward adjusted by a covered institution appropriate? If not, why not? Are any of the factors proposed unnecessary? Should additional factors be included?*

Please see the discussion in Section XII.

*7.26 Are the proposed parameters for forfeiture and downward adjustment review sufficient to provide an appropriate governance framework for making forfeiture decisions while still permitting adequate discretion for covered institutions to take into account specific facts and circumstances when making determinations related to a wide variety of possible outcomes? Why or why not?*

Please see the discussion in Section XII.

*7.27 Should the rule include a presumption of some amount of forfeiture for particularly severe adverse outcomes and why? If so, what should be the amount and what would those outcomes be?*

TCH does not believe that the rule should include a presumption of forfeiture for particularly severe adverse outcomes. Please also see the discussion in Section XII.C.

*7.28 What protections should covered institutions employ when making forfeiture and downward adjustment determinations?*

Please see the discussion in Section XII.

*7.29 In order to determine when forfeiture and downward adjustment should occur, should Level 1 and Level 2 covered institutions be required to establish a formal process that both looks for the occurrence of trigger events and fulfills the requirements of the forfeiture and downward adjustment reviews under the proposed rule? If not, why not? Should covered institutions be required as part of the forfeiture and downward adjustment review process to establish formal review committees including representatives of control functions and a specific timetable for such reviews? Should the answer to this question depend on the size of the institution considered?*

TCH believes that imposing a requirement to establish a formal process for determining forfeiture and downward adjustment will add to the already excessive compliance burden of these rules.

*7.30 The Agencies invite comment on the clawback requirements of the proposed rule.*

Please see the discussion in Section XIII.

*7.31 Is a clawback requirement appropriate in achieving the goals of section 956? If not, why not?*

Please see the discussion in Section XIII.

*7.32 Is the seven-year period appropriate? Why or why not?*

Please see the discussion in Section XIII.A.

*7.33 Are there state contract or employment law requirements that would conflict with this proposed requirement? Are there challenges that would be posed by overlapping Federal clawback regimes? Why or why not?*

Please see the discussion in Section XIII.F.

*7.34 Do the triggers discussed above effectively achieve the goals of section 956? Should the triggers be based on those contained in section 954 of the Dodd-Frank Act?*

Please see the discussion in Sections XII.A and Section XIII.

*7.35 Should the Agencies provide additional guidance on the types of behavior that would constitute misconduct for purposes of section \_\_.7(c)(1)?*

TCH has no specific comment on this question.

*7.36 Should the rule include a presumption of some amount of clawback for particularly severe adverse outcomes? Why or why not? If so, what should be the amount and what would those outcomes be?*

TCH does not believe that the rule should include a presumption of some amount of clawback for particularly severe adverse outcomes. Circumstances relating to adverse outcomes are necessarily fact-specific and should be approached on a case-by-case basis. Please also see generally the discussion in Section XIII.G.

*8.1. The Agencies invite comment on whether this restriction on Level 1 and Level 2 covered institutions prohibiting the purchase of a hedging instrument or similar instrument on behalf of covered persons is appropriate to implement section 956 of the Dodd-Frank Act.*

TCH has no specific comment on this question.

*8.2. Are there additional requirements that should be imposed on covered institutions with respect to hedging of the exposure of covered persons under incentive-based compensation arrangements?*

TCH has no specific comment on this question.

*8.3. Should the proposed rule include a prohibition on the purchase of a hedging instrument or similar instrument on behalf of covered persons at Level 3 institutions?*

TCH has no specific comment on this question.

*8.4. The Agencies invite comment on whether the proposed rule should establish different limitations for senior executive officers and significant risk-takers, or whether the proposed rule should impose the same percentage limitation on senior executive officers and significant risk-takers.*

Please see the discussion in Section XIV.A.

*8.5. The Agencies also seek comment on whether setting a limit on the amount that compensation can grow from the time the target is established until an award occurs would achieve the goals of section 956.*

Please see the discussion in Section XIV.A.

*8.6. The Agencies invite comment on the appropriateness of the limitation, i.e., 125 percent and 150 percent for senior executive officers and significant risk-takers, respectively. Should the limitations be set higher or lower and, if so, why?*

Please see the discussion in Section XIV.A.

*8.7. Should the proposed rule apply this limitation on maximum incentive-based compensation opportunity to Level 3 institutions?*

TCH has no specific comment on this question.

*8.8. The Agencies invite comment on whether the restricting on the use of relative performance measures for covered persons at Level 1 and Level 2 covered institutions in section \_\_.8(d) of the proposed rule is appropriate in deterring behavior that could put the covered institution at risk of material financial loss. Should this restriction be limited to a specific group of covered persons and why? What are the relative performance measures being used in industry?*

Please see the discussion in Section XIV.B.

*8.9. Should the proposed rule apply this restriction on the use of relative performance measures to Level 3 institutions?*

Please see the discussion in Section XIV.B.

*8.10. The Agencies invite comment on whether there are circumstances under which consideration of transaction or revenue volume as a sole performance measure goal, without consideration of risk, can be appropriate in incentive-based compensation arrangements for Level 1 or Level 2 covered institutions.*

Please see the discussion in Section XIV.B.

*8.11. Should the proposed rule apply this restriction on the use of volume-driven incentive-based compensation arrangements to Level 3 institutions?*

Please see the discussion in Section XIV.B.

*9.1 Some Level 1 and Level 2 covered institutions are subject to separate risk management and controls requirements under other statutory or regulatory regimes. For example, OCC-supervised Level 1 and Level 2 covered institution are subject to the OCC's Heightened Standards. Is it clear to commenters how the risk management and controls requirements under the proposed rule would interact, if at all, with requirements under other statutory or regulatory regimes?*

Please see the discussion in Section XVI.

*10.1. The Agencies invite comment on this provision generally and whether the written assessments required under sections \_\_.10(b)(2) and \_\_.10(b)(3) of the proposed rule should be provided to the compensation committee on an annual basis or at more or less frequent intervals?*

Please see the discussion in Section XVI.B.



*10.2. Are both reports required under § \_\_.10(b)(2) and (3) necessary to aid the compensation committee in carrying out its responsibilities under the proposed rule? Would one or the other be more helpful? Why or why not?*

Please see the discussion in Section XVI.B.

*11.1. The Agencies invite general comment on the proposed policies and procedures requirements for Level 1 and Level 2 covered institutions under section \_\_.11 of the proposed rule.*

TCH has no specific comment on this question.

*12.1. Commenters are invited to address all aspects of section \_\_.12, including any examples of other indirect actions that the Agencies should consider.*

TCH has no specific comment on this question.

*13.1. The Agencies invite comment on all aspects of section \_\_.13.*

TCH has no specific comment on this question.

*14.1. Commenters are invited to address all aspects of section \_\_.14 of the proposed rule.*

TCH has no specific comment on this question.