W. Louie
Los Angeles, California

RE: Comments on the Proposed Rule of Incorporating Employee Compensation Criteria into the Risk Assessment System

The FDIC has requested comments on including employee compensation criteria into the risk assessment system to determine in part a depository institution's insurance premium. The FDIC's proposal is to charge higher insurance premiums for insured depository institutions that do not have compensation programs that reward employees for focusing on risk management.

While the proposal parallels the other populist calls to condemn excessive pay practices at banks, the proposal at best is misguided and sophomoric. The proposal falls far short of correcting the problems of excessive compensation at most insured depository institutions.

The revolting idea that the FDIC is willing to give a stamp of approval for banks and other insured depository institutions to pay a fine for excessive compensation is similar to saying that crime does pay.

While, Section 7 of the FDIA requires the FDIC to establish a risk-based assessment system that incorporates factors determined by the FDIC to be relevant in assessing the probability that DIF will incur a loss from the failure of an insured depository institution, the FDIC has greater legal authority to mandate permissible employee and director compensation. An insured depository institution does not have the right to accept deposits from the public, but rather has a privilege for doing so and doing so under the regulation of banking laws and the rules and regulations of the FDIC including traditional bank safety and soundness. To avoid future related losses to the DIF, the FDIC must act quickly to flex its muscle and mandate corrective actions in prohibiting excessive compensation at insured depository institutions.

Excessive compensation is pervasive in all elements and time horizons of compensation at too many insured depository institutions. If and only if, total compensation of the employee is considered, then can the FDIC effectively regulate excessive compensation. The word "total" can't be overemphasized.

Beginning with the initial employment of an executive, the elements of compensation include among others, the signing bonus, the base salary, short term and long term incentive compensation in the form of cash or equity, perquisites, nonqualified supplemental compensation and benefit plans, tax qualified and nonqualified retirement and welfare benefits, and long term employment agreements. Excessive compensation can be at any of these elements. Let's start with base salary. The base salary is already too high at many insured depository institutions. As a rule of thumb any annual base salary for the highest paid executive of an insured depository institution that is more than 12x to 15x the annualized base salary of the lowest paid employee of such insured depository institution is excessive. Other factors such as asset size and historical profitability of the Bank, experience, education, other relevant qualifications of the executive, and some other appropriate factors should also be considered in determining the proper base salary of a bank employee which should not be fixed in stone or an employment agreement. The use of peer group comparisons should be minimized to determine base salary as these do not provide accurate comparisons and only fuel compensation inflation because executives tend to see what his or her competitor-counterpart has that he or she does not have.

A full discussion of each element of compensation is beyond the scope of this

comment letter, though a few elements will be briefly discussed. Let's also look at perquisites. Bank executives often have perquisites such as generous automobile allowances or use of bank automobiles, reimbursement of country club and other club dues, use of private jets for travel, use of executive dining rooms and best restaurants, use of luxury boxes and premium seating at sporting and other concert events, "Cadillac" health, disability, life and other insurance benefits for the entire family for life, months of vacation and personal time off benefits, special security services for their homes and automobiles, special corporate housing, oversea luxury cruises for executive or director retreats, and etc. While some perquisites have a reasonable relationship to business development, many perquisites do not and often serve as complimentary or below fair market price compensation benefits. Some perquisites are not in any written record and even illegal such as the use of a Malibu, California ocean front home for partying. As to post-employment compensation, many executives have excessively generous nonqualified welfare and retirement plan benefits, severance agreements, salary continuation agreements, and change in control agreements. Some severance agreements and change in control agreements provide multiple years of salary upon termination without cause for termination or a change in control of the insured depository institution. Some salary continuation agreements provide lifetime full salary continuation benefits for as little as 7 or less years of service with salary continuation benefits beginning at or prior to age 65.

The omission of a more-than-passing discussion of incentive compensation in this letter is intentional because it is obvious that incentive compensation that rewards a metric or a combination of metrics such as volume of production of loans, generation of deposits and/or level of current revenues without regard or little regard to related risks is reckless. However, having said that there must be incentive to reward innovation and productivity gains in our capitalistic economy. The key is balancing these interests so as to effectively limit excessive compensation.

The FDIC has its work cut out to curb excessive compensation. The question is will it do it effectively and expeditiously to avoid related future losses to DIF.