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Robert E. Feldman  
Executive Secretary  
Federal Deposit Insurance Corporation  
550 17th Street, NW  
Washington, D.C. 20429-9990

Mr. Feldman,

On behalf of SunTrust Bank, I would like to take this opportunity to provide certain comments to the Federal Deposit Insurance Corporation's ("FDIC") advance notice of proposed rulemaking addressing whether to incorporate employee compensation criteria into the risk assessment system, issued January 12, 2010 (the "APNR").

In the APNR, you ask for comment on whether an adjustment should be made to the risk-based assessment rate an institution would otherwise be charged if the institution could/could not attest (subject to verification) that it had a compensation system that including the certain listed elements. Those elements are the following:

- A significant portion of compensation for employees whose business activities can present significant risk to the institution and who also receive a portion of their compensation according to formulas based on meeting performance goals would be comprised of restricted, non-discounted company stock. The employees affected would include the institution's senior management, among others. Restricted, non-discounted company stock would be stock that becomes available to the employee at intervals over a period of years. Additionally, the stock would initially be awarded at the closing price on the day of the award.
- Significant awards of company stock would only become vested over a multi-year period and would be subject to a look-back mechanism (e.g., clawback) designated to account for the outcome of risks assumed in earlier periods.
- The compensation program would be administered by a committee of the Board composed of independent directors with input from independent compensation professionals.

As you may be aware, the Board of Governors of the Federal Reserve (the "Federal Reserve") also set forth proposed regulations to ensure the safety and soundness of banking organizations in October 2009 (Fed. Reg. Vol. 74, No. 206, October 27, 2009) (the "Proposed Regulations"). The guidelines in the Proposed Regulations were not as specific as the features of compensation plans designed to meet the FDIC's goals listed in the APNR and the Federal Reserve sought comment, and planned to conduct research, on a number of issues so the final guidelines can be effective. One concern we have regarding rate assessments based on compensation systems is we do not yet know whether the final guidance to be promulgated by the Federal Reserve would conflict with the requirements to be set forth by the FDIC for purposes of avoiding higher deposit insurance fees. These two regulations are developing independently

and we can imagine a scenario in which to comply with the Federal Reserve's guidelines would require we face higher deposit insurance fees. Moreover, navigating different regulations addressing the same issue and finding common ground may be a difficult, if not impossible, task. Furthermore, because these regulations will evolve separately, there can be no guarantee that if the regulations are initially complementary to each other, they won't later change in ways that make incentive compensation impossible to manage.

A second concern with the program set forth in the APNR is related to the possibility that financial institutions that fail to comply with the FDIC's goals will be assessed twice to the extent the APNR is consistent with the Federal Reserve's Proposed Regulations. The Proposed Regulations suggest that supervisory findings on compliance with the guidelines set forth therein will be incorporated that financial institution's CAMELS ratings. A financial institution's CAMELS rating is already used by the FDIC to determine a financial institution's deposit insurance assessment. Consequently, assuming the APNR goals are consistent with the Federal Reserve's Proposed Regulations, a financial institution's compensation practices will be counted against them twice thereby taking on a more prominent role than may be warranted in the FDIC's risk assessment. Worse, if the APNR's goals are inconsistent with the Federal Reserve's Proposed Regulation, then we can imagine a scenario in which a financial institution complies with the APNR's goals, but not the Proposed Regulations' guidelines, and pays a higher deposit assessment despite meeting the FDIC's goals.

A third concern would be the scope of the application of the FDIC's determination of risk to the depository institution. The APNR suggests that a depository institution's risk profile can be affected by affiliate activities. The example set forth in the APNR merely states that an employee may have dual responsibilities and be compensated by the depository institution and an affiliate, but fails to explain how being compensated by an affiliate increases the risk to the depository institution<sup>1</sup> or how employees who are solely employed by affiliates pose risks to the depository institution. It is our believe that Regulation W (12 CFR Part 223) meets the goal of shielding the FDIC's Deposit Insurance Fund from the affiliates of depository institutions by its requirements and, therefore, it would be ineffectual to regulate the compensation of employees of an affiliate that were not dual employees.

A fourth concern is the conclusion reached by the FDIC that there is a broad consensus that some compensation structures misalign incentives and induce imprudent risk taking within financial organizations and the implicit assumption that granting compensation in the form of restricted, non-discounted company stock with clawbacks does not misalign incentives or induce imprudent risk taking. A review of the scholarly works cited by the FDIC for that proposition reveals certain inconsistencies. "The Wages of Failure: Executive Compensation at Bear Stearns and Lehman 2000-2008,"<sup>2</sup> cited in a footnote, is an article that challenges the standard narrative that executives of the investment banks Bear Stearns and Lehman Brothers lost a lot of money when their firms failed because those executives had cashed out their stock awards prior to the failure of the company. Although the article discusses how short-term incentives may motivate executives to seek short-term gains at the expense of long-term growth, it also concedes that the executives at Bear Stearns and Lehman Brothers did loose substantial sums of money on the stock they didn't cash out, which loses may have been attributable to a failure to recognize or appreciate risks, not the incentives themselves. The second article cited, "Does Stock Option-

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1 If the purpose of regulating dual employees is to prevent affiliates from evading compensation limitations by paying an employee through the affiliate, then the only risk enunciated is with respect to dual employees, but not to employees of affiliates that are not dual employees.

2 Bebchuk, Lucian A., Alma Cohen and Holger Spamann, Yale Journal on Regulation, Forthcoming.

Based Executive Compensation Induce Risk-Taking? An Analysis of the Bank Industry,”<sup>3</sup> is interesting in that the conclusions reached by the article undermine the FDIC’s goal. In this second article, the authors discuss option-based compensation (options, like restricted stock, must be held by the employee for some time prior to execution) and note that because of the leverage and volatility associated with future ownership, managers may be incentivized to take greater risks in order to realize or exceed the net present value of what they would reasonably accept as compensation today for the job they do. This demonstrates that there may be a false assumption that restricted stock induces managers to be more risk averse in order to protect potential future income because the opposite may also be true. This is not to suggest that restricted stock is not a useful tool to incentivize managers to avoid excessive-risk; rather, that a “one-size fits all” approach to compensation fails to account for the complex issue of how each individual responds best to compensation. It is our belief that these difficult decisions and complex assessments are best made on a local level, provided institutions have the flexibility to reach the optimal balance of risk and encouraging innovation demanded by shareholders.

In brief, we appreciate the need for the FDIC to account for all the risks that financial institutions pose to the Deposit Insurance Fund, including employee compensation; however, potentially introducing conflicts and incentivizing financial institutions to eliminate tools to appropriately mitigate such risks may not be the ideal approach to the matter. There is the potential that the APNR overemphasizes compensation and ignores other factors, which appears to reflect the popular imagination that all banks (and bankers) are prospering during the economic tumult. This is not the case from our vantage point and finding a way through these difficult times may require innovation, including with respect to employee compensation. Consequently, we would counsel the FDIC to wait for the Federal Reserve to complete its analysis before effecting new regulations and to consider whether or not the issue is so complex that it can be adequately addressed by a broad mandate.

Regards,



McHenry Kane

Cc: Ray Fortin  
Jorge Arrieta  
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<sup>3</sup> Chen, Carl R.; Steiner, Thomas L.; Whyte, Ann Marie. Journal of Banking and Finance, March 2006, v. 30, iss.3, pp.915-945.