



May 29, 2011

Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Proposed Rulemaking on Incentive-based Compensation Arrangements

Dear Chairman Bair,

I am submitting this comment letter in response to the Notice of Proposed Rulemaking on Incentive-based Compensation. My comments focus on deferral arrangements.

Professors Jennifer Carpenter and Professor Stephen Ross studied in two Journal of Finance articles how bonus schemes affect risk taking and showed that the size and sensitivity of the payments are important parameters to consider. Based on these I recently carried out a stylized analysis of bonus deferral arrangements entitled "Bonus Deferral does not Choke Excessive Risk-Taking," available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1662555

My paper cautions against the common thinking that deferral reduces risk taking. In fact, deferring payments will increase future payments further in those situations when a financial institution is already doing well; thus risk taking incentives may be strengthened instead of weakened. In addition to this size effect, deferral changes the sensitivity of incentive payments to the company performance.

I recommend regulating how deferred compensation is reduced at future payment dates. My analysis shows that the deferral ratio should not exceed the ratio of that sensitivity and the pay-for-performance sensitivity. For your proposed deferral ratio of 50% this means: when an executive's bonus increases by x dollars for each dollar of company performance, then her reduction in deferred compensation must be *at least* x/2 dollars for each dollar of shortfall.

Yours sincerely,

Dietmar Leisen, Professor of Banking