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Financing America's Economy

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Office of the Comptroller of the Currency
250 E Street, S.W., Mail Stop 2-3
Washington, D.C. 20219
Docket Number OCC-2011-0001

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Board of Governors of the F
Reserve System
20th Street and Constitution
Washington, D.C. 20551

Robert E. Feldman, Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, N.W.
Washington, D.C. 20552
Attention: OTS-2011-0037

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549
File Number S7-12-11

Mary Rupp
Secretary of the Board
National Credit Union Administration
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Alexandria, Virginia 22314–3428

Alfred M. Pollard
General Counsel
Attention: Comments/RIN 2590-AA42
Federal Housing Finance Agency
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Dear Sirs and Mesdames:

The Financial Services Roundtable is writing to provide you its comments on the Agencies' proposed rules to implement Section 956 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), which (i) requires the reporting of incentive-based compensation arrangements by a covered financial institution, and (ii) prohibits incentive-based compensation arrangements that encourage inappropriate risks by covered financial institutions by providing a covered person with excessive compensation, or that could lead to material financial loss to the covered financial institution. The Roundtable represents 100 of the largest integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. Roundtable member companies provide fuel for America's economic engine, accounting directly for $92.7 trillion in managed assets, $1.2 trillion in revenue, and 2.3 million jobs.

General Comments

The Roundtable appreciates the time and effort that the Agencies have devoted, and will continue to devote, to developing proposals and rules to meet the requirements of Section 956. The Roundtable generally supports the policy of tying compensation to risk and each of its members has taken significant steps to do so since the financial collapse of 2008. However, as a general matter, the Roundtable is concerned about four key points.

First, the Roundtable is concerned that the Agencies seem to be moving in a direction that financial institution regulators have never gone. Historically, financial institution regulators have not attempted to dictate or influence the form or amount of compensation that an institution provided to its officers and employees, but have only required full disclosure of such compensation. Financial institution regulators have focused on principles-based regulation and required the institution to establish the appropriate levels and forms of compensation, based on the characteristics, including risk profile, of the institution. The Roundtable does not believe that the regulators should change this principles-based approach. The concept of "excessive compensation" is vague, and rules that prescribe the deferral of a specific percentage of compensation are unprecedented, inappropriate, and troubling.

Second, the Roundtable is concerned that these overly prescriptive rules will inevitably lead to unintended consequences. For example, the proposed rules seem likely to push institutions and their officers toward more fixed compensation such as base salaries. This result would be counterproductive at a time when shareholders are demanding more performance-based compensation. Moreover, the proposed rules could create problems with existing incentive-based compensation arrangements, since institutions may be legally unable to change the terms of such arrangements.

Third, the Roundtable believes that the Agencies must revise the rules to clarify how they intend the rules to apply in the context of consolidated groups. In some cases, the rules are unclear. In other cases, the rules seem clear, but would appear to produce anomalous results.

Finally, the Roundtable believes that it is imperative that the final rules be coordinated or made consistent with the 2010 Interagency Guidance on Sound Incentive Compensation Policies adopted by the OCC, Board, FDIC and OTS, effective June 25, 2010 (the "2010 Interagency Guidance"), as well as interpretations issued by the Board under the horizontal review of incentive compensation practices at Large Complex Banking Organizations. There are significant differences between the 2010 Interagency Guidance and the proposed rules. Many financial institutions have been working with the Board to implement and comply with the 2010 Interagency Guidance for nearly two years.

Roundtable Study on Incentive-Based Compensation Practices

Roundtable members are cognizant of the risk that faulty compensation practices can result in a material financial loss. In order to help regulators understand what actions the industry is taking with respect to their incentive-based compensation practices, the Roundtable conducted a study of a portion of its membership. In all, the Roundtable collected detailed information and commentary from numerous member companies regarding both their risk management strategies and their procedures for determining compensation.

A. Roundtable Members are Committed to Robust Planning and Oversight of Incentive-Based Compensation Plans.

Each of the companies who participated in the study maintains a compensation committee of the board of directors that must approve all salary packages for the Chief Executive Officer and other high-level employees. The committee also must approve any material change in the compensation plans of the employees they monitor. At several companies, the compensation committee retains the discretion to reduce any award due to the overall financial performance of the company.

All the companies studied by the Roundtable make use of detailed data in creating their compensation plans for high-level executives. Nearly 90% of study respondents employ a board of director's compensation consultant that conducts a peer-review analysis of the compensation plans put before the board, and 87% establish maximum payout targets for high-level executives.

Each of the companies surveyed also employ policies and procedures concerning the incentive-based compensation of mid-level and low-level employees, though these practices vary widely. Some companies report centralized oversight of all incentive-based compensation arrangements. Other respondents make use of external audits. Over 75% of companies employ claw-back agreements or hold-back procedures for the vesting of incentive-based compensation beyond a certain level.

B. Industry Members are Actively Monitoring and Changing the Content of their Incentive-Based Compensation Programs.

All of the companies involved in the Roundtable study reported changes to their incentive-based compensation practices since 2008. An overwhelming majority of these companies, 83%, reported that the risk of material financial loss was a leading factor in instituting changes to their past incentive-based compensation systems.

The strategies used by Roundtable companies to address risk vary widely as each company attempts to devise and apply solutions that work for its circumstances. Study participants mentioned more than 15 different approaches that are currently being analyzed and implemented by either the compensation committee or their human resources departments. In all cases, a variety of three or more approaches is being used.

Greater use of clawback provisions was the most frequent change identified by survey respondents. Altogether, each of the following 10 strategies are being implemented by more than 30% of the survey's respondents:

- Clawback provisions (83%)
- Enhanced internal risk management (77%)
- Changes in performance metrics (69%)
- Changes in stock vs. cash compensation (59%)
- Greater use of restricted stock awards (52%)
- Enhanced performance reviews (45%)
- Holding requirements for stock awards (41%)
- Changes to bonus allocation formulas (38%)
- Greater use of performance-based stock awards (31%)
- Increase in base salary relative to incentive-based compensation (31%)

The results of the study indicate that Roundtable members are uniformly attentive to the important issues presented by incentive-based compensation practices. What is not uniform, however, are the strategies and practices employed by financial institutions as they seek to employ compensation strategies that effectively regulate risk while at the same time encouraging efficiency and innovation. Rather, each company tailors its compensation practices to fit its particular circumstances.

C. Roundtable Members Oppose the Implementation of Uniform Deferral Requirements.

One question in the Roundtable Study referenced the current rule's proposed requirement that large institutions defer at least 50% of their incentive-based compensation for a period of at least three years for some employees. More than 90% of the companies surveyed believe the requirement would be inappropriate considering the current policies and needs of their organization. Most of the companies who oppose the requirement cite the importance of flexibility in allowing the board's compensation committee to design plans that are attuned to the current market circumstances and institutional needs of the particular institution and to the risk profile of the particular executives in question.

Many companies mentioned that they employ risk management procedures beyond automatic deferral. Roundtable members stated that long-term performance review periods or contractual clawback provisions are their preferred tools for ensuring that executives take actions that are in keeping with the long-term health of the organization, in addition to the other changes identified above. The proposed rules recognize that: "Methods and practices for making compensation sensitive to risk-taking are likely to evolve during the next few years." A mandatory, prescriptive deferral requirement would prevent the evolution of these methods and practices.

Overall, the companies surveyed remain strongly committed to principles-based risk management standards for incentive-based compensation. In regards to the implementation of Section 956, the members surveyed cautioned against the adoption of arbitrary "one size fits all" concepts that may not, in practice, cause an increase in sensitivity to risk-based behaviors.

Specific Comments

A. Key Concepts and Terms Require Clarification and Revision (§ .3). [1]

1. The final rules should modify the definition of "incentive-based compensation" and provide illustrations for what constitutes "compensation" and "incentive-based compensation."

The Roundtable believes that the Agencies' final rules should modify the definition of "incentive-based compensation" to strike the oversimplified reference to "variable compensation" and make it more consistent with the 2010 Interagency Guidance, which provides:

> In this guidance, the term "incentive compensation" refers to that portion of an employee's current or potential compensation that is tied to achievement of one or more specific metrics (e.g., a level of sales, revenue, or income). Incentive compensation does not include compensation that is awarded solely for, and the payment of which is solely tied to, continued employment (e.g., salary). In addition, the term does not include compensation arrangements that are determined based solely on the employee's level of compensation and does not vary based on one or more performance metrics (e.g., a 401(k) plan under which the organization contributes a set percentage of an employee's salary). [footnote 4]

The Agencies' final rules also should clarify the distinction between the definitions of "compensation" and "incentive-based compensation" so that incentive compensation unambiguously refers to compensation that is tied to the performance of the institution and/or one or more employees over a defined period. The Roundtable urges the Agencies to ensure that the definition of incentive compensation should not be read to include broad-based (i) tax-qualified retirement benefits (such as pension, 401(k), profit sharing, and ESOP plans), or (ii) welfare benefit plans under ERISA (including fringe benefits and perquisites), even if a plan includes an incentive compensation amount in the definition of "compensation" used in calculating the benefit formula or the institution's contributions to the plan depend on attaining a specific performance measure. The interim final rules under TARP expressly excluded qualified

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[1] As each of the Agencies has issued a similar but separate set of proposed rules, this letter will refer to the proposed rules by the common number following the decimal point (*e.g.*, ".5(b)" for each of proposed rule §§ 12 CFR 42.5(b), 12 CFR 236.5(b), 12 CFR 372.5(b), 12 CFR 563h.5(b), 12 CFR 751.5(b), 17 CFR 248.2055(b), and 12 CFR 1232.5(b)).

retirement plans and benefits under a broad-based benefit plan from the definition of "Bonus." At a minimum, the final rules should do the same.

The Roundtable believes that the Agencies' final rules should include examples and illustrations of common forms of compensation that will not be considered to be incentive-based. For example, the Roundtable believes that the Agencies' final rules should clarify that the following compensation forms are never incentive-based compensation:

- Employees' voluntary compensation deferral contributions to a non-qualified deferred compensation plan.
- Non-qualified supplemental retirement plans (SERPs), which provide benefits under a defined benefit formula.
- Excess benefit plans under ERISA.
- A fixed payout amount, set forth in the executive's employment agreement, whether paid in a lump sum or installments, or in cash or employer stock.
- A sign-on or retention bonus of a fixed amount, even where paid partly or totally in employer stock, whether paid in a lump sum or installments.
- Dividends paid or appreciation realized on unvested deferred incentive compensation awards.
- Tax-equalization payments to expatriates.
- Severance payments.
- Relocation payments and other similar payments or benefits provided to new hires or employees who are relocating, provided such payments or benefits are not explicitly linked to performance criteria.
- Amounts paid to an employee that are not compensatory or are not material to an employee, such as a referral bonus for suggesting new employees or customers.

2. The final rules should clarify the definition of "covered financial institution" and how the rules apply in the context of consolidated groups.

Discussions among Roundtable members reveal widespread uncertainty regarding how the proposed rules are intended to apply in the context of consolidated groups. In some cases, the rules are unclear. In other cases, the rules seem clear, but would appear to produce anomalous results. Therefore, the Roundtable believes that the Agencies should revise the rules to clarify how they intend the rules to apply in the context of consolidated groups, including, by way of example, (1) a group that includes a holding company that is itself a covered financial institution, such as a bank or savings and loan holding company, and its depository institution subsidiary, (2) a group that includes a holding company, such as a bank or savings and loan holding company, its depository institution subsidiary and also one or more investment advisor, broker-dealer or other subsidiaries that may be covered financial institutions, and (3) a group in which the holding company is not itself a covered financial institution, but which includes one or more investment advisor, broker-dealer or other subsidiaries that may be covered financial institutions.

In each of these circumstances, the final rules should clarify (i) the method for determining "total consolidated assets" for each relevant entity within the group, (ii) the applicability of the rules to each relevant entity within the group and to each such entity's executive officers, employees, directors and principal shareholders, (iii) how the rules apply in the case of a group with multiple covered financial institutions, some with total consolidated assets above $1 billion but below $50 billion and some with total consolidated assets of $50 billion or more, and (iv) the Agency or Agencies that would administer compliance with the rules by each relevant entity within the group.

In providing such clarification, we believe that the Agencies must take care to ensure that certain groups are not anomalously subject to greater or more extensive regulation than others at either the holding company or subsidiary levels. The Roundtable also believes that any new requirement imposed by the Agencies' final rules should apply to covered financial institutions only, and not to other members of the same corporate family.

Further, we urge that the Agencies draft the final rules to avoid the potential for overlapping and inconsistent application of the rules to different entities in the case of groups that include covered financial institutions within the jurisdiction of two or more of the Agencies. Oversight by different regulators is inherently problematic when a financial institution must seek the views of multiple regulators when designing and awarding broad-based incentive compensation programs. To ensure consistent regulation, the final rules should provide that a consolidated group that contains more than one covered financial institution that would otherwise be subject to oversight by different Agencies or regulators shall be assigned one primary regulator, taking into account the organizational structure of the group and the relative sizes of the covered financial institutions within the group, and that such primary regulator shall be charged with interpreting and enforcing the final rules for each covered financial institution within the consolidated group.

The Agencies' proposal, "consistent with the principle of national treatment and equality of competitive opportunity," includes as covered financial institutions the uninsured branches and agencies of a foreign bank, as well as the other U.S. operations of foreign banking organizations that are treated as bank holding companies pursuant to section 8(a) of the International Banking Act of 1978. The Agencies' final rules should apply to all financial institutions equally to better promote the purpose of Section 956 and competitive equity. Therefore, the Roundtable believes that the Agencies' final rules should also include the Federal Home Loan Banks to maintain a level playing field among various types of banks.

Finally, the Agencies' rules should make clear that they would not apply to a financial institution for any period in which the amount of the institution's assets drops below one of the applicable thresholds. The Roundtable believes that the Agencies' final rules should clarify how the rules would apply to situations where a covered financial institution's total consolidated assets shrink or contract to a level below one of the applicable thresholds or otherwise ceases to be a covered financial institution. Additionally, should a financial institution no longer be a "covered financial institution" for reasons other than it no longer meets the applicable asset thresholds (*e.g.*, a savings and loan holding company that divests itself of a depository institution), the Roundtable believes that the Agencies' final rules should make it clear that the rules no longer apply (whether with respect to past or future incentive-based compensation).

3. The definition of "executive officer" should mirror that of Rule 3b-7 under the Securities Exchange Act of 1934.[2]

The Roundtable believes that the Agencies' final rules should adopt a single uniform definition of the term "executive officer" for all purposes of the Dodd-Frank Act. This definition should be the same as the definition of "executive officer" that publicly traded financial institutions use for SEC reporting in Rule 3b-7 under the Securities Exchange Act of 1934. There is no policy reason to regulate the same entities for the same purpose with different definitions of executive officers, each of which also differs from the definition of "executive officer" that the financial institutions use for SEC reporting in Rule 3b-7 under the Securities Exchange Act of 1934.

If the Agencies do not adopt a single uniform definition of the term "executive officer," which is consistent with the definition that financial institutions use for SEC reporting, the final rules should revise the definition of "executive officer" to conform to the 2010 Interagency Guidance, which applies to incentive compensation arrangements for senior executives and others who are responsible for oversight of the organization's firm-wide activities or material business lines. The 2010 Interagency Guidance indicates that senior executives include, at a minimum, "executive officers" within the meaning of the Federal Reserve's Regulation O and, for publicly traded companies, "named officers" within the meaning of the Securities and Exchange Commission's rules on disclosure of executive compensation. The Guidance indicates that savings associations also should refer to OTS's rule on loans by saving associations to their executive officers, directors, and principal shareholders.

Since the purpose of the final rules and the 2010 Interagency Guidance is essentially the same, covered financial institutions should not be required to maintain two separate lists.

Additionally, as noted above, the final rules should clarify the applicability of the rules to each relevant entity within the group and to each such entity's executive officers, employees, directors and principal shareholders, especially in situations where this rule is applied to mixed companies such as investment advisers, banks, and broker-dealers. For example, a larger

[2] Rule 3b-7 provides: "The term 'executive officer', when used with reference to a registrant, means its president, any vice president of the registrant in charge of a principal business unit, division or function (such as sales, administration or finance), any other officer who performs a policy making function or any other person who performs similar policy making functions for the registrant. Executive officers of subsidiaries may be deemed executive officers of the registrant if they perform such policy making functions for the registrant."

covered financial institution with consolidated assets of $50 billion or more might have one or more covered subsidiaries that themselves have assets of $50 billion or more. The rules as proposed would seem to require such a financial institution to compile multiple lists of executive officers for whom mandated deferral is required. In our view, this is overbroad.

Finally, the proposed rules include a list of positions that are deemed to be within the executive officer definition and the Agencies seek comment on whether the types of positions identified are appropriate or if certain positions should be removed. First, because titles vary widely among financial institutions, the final rules should not define "executive officer" by reference to identified types of positions. Additionally, the Roundtable believes that making certain positions, such as a chief legal officer, per se subject to the rules raises issues in how an institution constructs the list of those who can expose the covered financial institution to substantial losses, and whether it serves any purpose for the institution to restrict how it compensates some of those individuals listed as executive officers whose role might not involve much risk. The proposed rules already have a separate provision, § .5(b)(3)(ii), that requires the covered institution's board to identify persons who individually have the ability to expose the institution to possible substantial losses, and requires the board to balance risk with compensation for these potential risk persons. This approach is preferable to a per se list of covered persons for two reasons: first, one gets on the list only if one has the potential to subject the institution to substantial losses, so an executive officer who does not present the risk of substantial losses would not automatically get on the list; and second, the requirement allows a balancing of risk and does not mandate a specific deferral period. This approach also is consistent with the approach under the 2010 Interagency Guidance.

4. The Roundtable agrees that "other covered employees" should not be subject to the mandatory deferral requirements of the rules and believes that the definition should be modified.

In addition to executive officers, Dodd-Frank Section 956 and the proposed rules apply to individuals at very large institutions who have the ability to expose the institution to possible losses that are substantial in relation to the institution's size, capital, or overall risk tolerance, and requires the board of directors, or a committee thereof, of the covered institution to identify those covered persons (other than executive officers). For these individuals, the proposed rules require the board (or committee) to determine that any incentive compensation arrangement effectively balances the financial rewards to the covered person and the range and time horizon of risks associated with the covered person's activities. The Roundtable agrees that these individuals should not be subject to mandatory deferral.

The Roundtable also believes that the Agencies' final rules should allow a financial institution to use the same process and identify the same employees who are eligible to receive incentive compensation, including non-executive employees, and whose activities may expose the institution to material risks, as it does for compliance with the 2010 Interagency Guidance. As noted above, since the purpose of the final rules and the 2010 Interagency Guidance is essentially the same, covered financial institutions should not be required to maintain two separate lists.

Finally, particularly with respect to non-executive employees, but also for executive officers, the Roundtable also believes that the Agencies' final rules should distinguish between employees and executives who might be in a position to increase their compensation by taking risks and those employees and executives who are only involved in strategic risk decisions or monitoring of risk. The latter group should not be subject to the deferral or clawback provisions of the final rules, as they already have no ability to increase their pay by taking increased risks.

5. The rules should establish a uniform method for determining the assets of a covered institution.

The Roundtable believes that the Agencies' final rules should set forth a uniform method of calculation to be used by all Agencies to determine whether an institution has $1 billion or more in assets or $50 billion or more in assets.

B. Disclosure and Reporting Requirements Should be Clarified and Revised (§ .4).

1. Review of submitted plans and reports should occur within 30 days of submission.

Given the extreme time sensitivity of incentive plans and the need to set targets and make awards in the beginning of the year (before the beginning of the year, in many cases), the Roundtable believes that the Agencies' final rules should provide that, once a covered financial institution submits its annual report, the applicable regulator should have thirty (30)-days within which to comment on the report.

This schedule will allow the financial institution to make any corrections or changes in a timely manner. The 2010 Interagency Guidance recognizes the importance of certainty and communication in influencing risk-taking behavior:

> In order for the risk-sensitive provisions of incentive compensation arrangements to affect employee risk-taking behavior, the organization's employees need to understand that the amount of incentive compensation that they may receive will vary based on the risk associated with their activities.

The Agencies' final rules also should make it clear that a covered financial institution will not be subject to regulatory action with respect to the incentive-based compensation arrangements it accurately describes in the report after the deadline has passed for the applicable regulator to comment on the report. Covered financial institutions need and deserve some degree of certainty.

2. Reporting of actual compensation of individuals should not be required (§ .4(b)).

The Roundtable supports the proposed rules' approach that a covered financial institution is not required to report the actual compensation of particular covered persons as part of the required report.

3. Final rules should contain strict standards of confidentiality to protect the information received.

The Roundtable believes that the Agencies' final rules should unambiguously require the applicable regulator to maintain the confidentiality of the information submitted to them and provide that the information shall remain non-public. The proposed rules would require a covered financial institution to document its processes for establishing, implementing, modifying and monitoring incentive-based compensation arrangements. These documents would be expected to include, for example, copies of incentive-based compensation arrangements or plans, the names and titles of individuals covered by such arrangements or plans, records of the awards made under the arrangements or plans, and records reflecting the persons or units involved in the approval and ongoing monitoring of the arrangements or plans. To ensure the confidentiality of these documents, which would contain highly sensitive information, the Roundtable believes that the Agencies' final rules should provide that the institution would retain such documentation for inspection by the regulator (rather than, as with the annual reports, requiring the institution to submit such documentation to its appropriate regulator).

4. Updates to an institution's incentive-based compensation disclosure should not be required between annual disclosure cycles.

The Roundtable believes that the Agencies' final rules should <u>not</u> modify the proposed rules to require covered financial institutions to update their incentive-based compensation disclosure—between annual disclosure cycles— if any material changes to their respective incentive-based compensation plans occur. Almost all companies determine their compensation programs on an annual basis. A requirement to report updates more than once a year is unnecessary in practice and would be needlessly burdensome.

5. Proposed rules should be revised to allow for simpler methods of reporting.

The Roundtable believes that the Agencies' final rules should consider simpler and less burdensome methods of reporting. For example, the burden on financial institutions could be reduced if an electronic means of filing the required disclosure, similar to the EDGAR Database of Online Corporate Financial Information, were implemented.

C. <u>Rules Should Establish Principles that Allow Consideration of all Relevant Factors, but Leave Decisions to the Judgment of the Board (§ 5)</u>.

1. The final rules should leave the judgment of whether an incentive-based compensation arrangement encourages inappropriate risks by providing a covered person with excessive compensation to the covered institution and its board of directors.

The decision on what level of total compensation a financial institution provides to its officers, employees and directors should be made by the institution. Dodd-Frank Section 956(b) requires the Agencies to promulgate regulations or guidance that prohibits any incentive-based payment arrangement, or any feature of any such arrangement, that encourages inappropriate risks by a covered financial institution by providing a covered person with excessive compensation, fees, or benefits. What constitutes an arrangement that encourages inappropriate risks by providing a covered person with excessive compensation is an inherently subjective concept and is impossible to define. The Roundtable believes that the Agencies should not attempt to define this concept, but should only attempt to provide guidance that, if properly followed by a financial institution's board of directors (or a committee of the board) under standards similar to the business judgment rule, is not subject to being second-guessed by federal regulators or a court.

The Roundtable believes that § .5(a)(2) of the proposed rules is phrased to suggest objective certainty, when it should only attempt to provide guidance. The proposed rules reference to amounts paid that "are unreasonable or disproportionate to the services performed by a covered person" is even more subjective. The Roundtable believes that § .5(a)(2) could be revised as follows:

> (2) Standards. A covered institution's board of directors (or a committee thereof) shall determine whether an incentive-based compensation arrangement, or any feature of any such arrangement, encourages inappropriate risks by the covered institution by providing a covered person with excessive compensation in accordance with the business judgment rule. For example, an incentive-based compensation arrangement might encourage inappropriate risks by the covered institution by providing a covered person with excessive compensation when the arrangement provides substantial increases in the covered person's compensation for achieving performance goals that have not historically been achieved.

The Roundtable believes that the Agencies' final rules should not be setting compensation amounts or labeling an amount of compensation as "excessive." The decision on what level of total compensation an employee receives should be up to the institution and the employee, since no connection necessarily exists between total compensation and the amount of risk an employee brings to an institution. The Dodd-Frank Act requires that any regulation of excessive compensation should be connected to an inappropriate level of risk, and the Roundtable believes that the Agencies' final rules should not exceed that authority.

2. Any list of factors for examining compensation should be flexible, broadly inclusive, and connected to risk.

If the Agencies' final rules require the board or committee to determine when amounts paid are unreasonable or disproportionate to the services performed by a covered person, taking into consideration certain listed factors, then the Roundtable believes that the Agencies' final rules should permit the board or committee to take into consideration all of the factors that it considers relevant, including, but not limited to the factors listed in proposed rules §§ .5(a)(2)(i)-(vii). The Roundtable believes that the Agencies' final rules must allow the board of directors (or a committee thereof) to consider additional factors in evaluating whether compensation is excessive or could lead to a material financial loss, such as the need for the board to take into account the need to attract, retain and motivate top quality individuals.

The Roundtable believes that the Agencies' final rules should acknowledge that the application of these factors to a particular covered employee will involve judgment by the institution's management and/or compensation committee. Each covered financial institution should have the authority to determine which risk-based adjustment mechanisms apply to its deferred incentive compensation arrangements. A covered financial institution may determine that the most appropriate method to risk-adjust certain covered employees' deferred incentive compensation is to tie the value of such compensation to its stock price. The covered financial institution may determine that, for certain other covered employees, the most appropriate method to risk-adjust their deferred incentive compensation is to tie the value of such compensation to the performance of the business line for which the covered employees provide services. A covered financial institution's board or compensation committee is in the best position to ensure that its incentive compensation arrangements appropriately adjust for risks and other performance-related factors it is required to consider.

The Roundtable believes that the final rules should expressly acknowledge that both discretionary and formulaic approaches to risk-adjusting incentive compensation are appropriate provided the covered financial institution's decision regarding the most appropriate method of risk-adjusting incentive compensation is adequately documented and is timely disclosed to the appropriate regulators.

The Roundtable believes that the Agencies' final rules should clarify that board review of certain incentive-compensation arrangements should be limited to consideration of only those risks that could reasonably be expected to have a material impact on a covered financial institution's performance. The proposed rules require that the board of directors review the incentive compensation arrangements of certain covered employees and that such review requires the board to "make payments sensitive to <u>all</u> the risks arising from the employee's activities, including those that may be difficult to predict, measure or model." (Emphasis added.) The Roundtable believes that this review should be a limited to risks that could reasonably be expected to have a potential material impact on the covered financial institution's performance (including any such material risk that is difficult to predict, measure or model). Requiring the board or compensation committee to attempt to conceive and adjust compensation for every potential risk, however small, that may arise from any employee's activities will not be possible in practice and is not necessary in order to ensure that incentive compensation arrangements do not lead to material financial losses.

The final rules also should explicitly provide that the Agencies will not require deferral and risk-adjustment approaches that result in adverse accounting or tax results, including, but not limited to, under Internal Revenue Code Sections 162(m), 409A or 457A.

3. The judgment of the board (or committee) is entitled to deference by regulators and the courts.

The Roundtable believes that the Agencies' final rules should provide that the incentive compensation awarded to a covered person will be presumed not to provide excessive compensation that encourages inappropriate risk, in accordance with the business judgment rule, if the covered financial institution otherwise complies with the requirements of the final rules and there is appropriate documentation of the deliberative process that was followed by management and/or the compensation committee in determining the amount of incentive compensation awarded to the covered employee.

4. The final rules should recognize that the board will need input from management.

In placing this significant new responsibility on the covered institution's board of directors (or a committee thereof), the Agencies' final rules should recognize the traditional oversight role of the board of directors (or committee) and allow for substantial input from management. The proposed rules ask a committee of the board to "approve," "identify," "determine," and "evaluate" arrangements for non-executive individuals that can expose the institution to material risk (see for example § .5(b)(3)(ii)). Asking a board to undertake such specific tasks expands its traditional "oversight" role dramatically into areas that traditionally have been—and are best left to—the expertise and prerogative of management. The board does not have the detailed operational or administrative infrastructure to undertake the specified tasks. Continuous expansion of boards' duties (and potential liabilities) may impede a director's fiduciary responsibility to oversee (and not manage) the financial institution and institutions' ability to find qualified individuals to serve on boards. If these expanded duties are to remain in the final rule, they should be assigned to management, with the board providing oversight of management's conduct.

5. Mandatory deferral of a specific percentage of compensation or for a specific time is arbitrary and not supported by empirical evidence (§ .5(b)(3)(i)(A)).

The Roundtable believes that the Agencies' final rules should not mandate the deferral of any compensation and, specifically, should not dictate (a) the period for deferral of annual incentive-based compensation, or (b) the deferral of a specific percentage of the annual incentive-based compensation of any executive officer or employee of financial institutions. There is no empirical evidence that suggests that a deferral of a specified percentage of incentive-based compensation or that deferring such compensation for a specific period will prevent material losses at financial institutions.

6. Prescriptive deferral will hurt ability to attract and retain key employees.

Applying a prescriptive deferral for senior executives will make it more difficult for covered financial institutions to attract and retain key employees. If the Agencies' final rules require minimum deferral provisions for senior executives at larger financial institutions, larger financial institutions would be unfairly placed at a disadvantage to other institutions. The Roundtable believes that the Agencies should maintain a level playing field among financial institutions.

7. Recommendations if deferral is mandated.

The proposed rules require that, where deferral is used in connection with an incentive-based compensation arrangement, policies and procedures must provide for deferral of incentive-based compensation awards in amounts and for periods of time appropriate to the duties and responsibilities of the covered financial institution's covered persons, the risks associated with those duties and responsibilities, and the size and complexity of the covered financial institution, and must provide that the deferral amounts paid are adjusted to reflect actual losses or other measures or aspects of performance that are realized or become better known during the deferral period. The Roundtable believes that any deferral period should be discretionary.

(a) If the Agencies' final rules require the deferral of a percentage of the annual incentive-based compensation of executive officers of larger financial institutions, then the Roundtable believes that the Agencies' final rules should:

- Not be applied to a different group of individuals at larger covered financial institutions, such as the institution's top 25 earners of incentive-based compensation, since top earners are not necessarily the ones who take the risks and a top 25 requirement could pull in revenue driving staff that do not take on long-term risk. Inasmuch as the group of top 25 earners would change each year, significant practical difficulties would result from this rule. The Agencies' final rules would need to clarify how the regulations apply to individuals who were members of the top 25 one year but not the next year.

- Not specify the percentage of annual incentive-based compensation to be deferred or mandate a minimum deferral period.

- Clarify that a covered financial institution may credit interest or investment earnings to compensation required to be deferred (in addition to requiring adjustment of deferrals to reflect actual losses or other measures or aspects of performance that are realized or become better known during the deferral period). Certain technical problems would result if the final rules were to include all or a portion of dividends paid or appreciation realized on unvested incentive compensation awards in the definition of "incentive-based compensation," include the following: Are dividends paid and appreciation realized subject to the three-year 50% deferral requirement? If so, does the deferral commence on the date of the underlying award or the date the dividend is paid or the appreciation is considered realized? Would these amounts be included in the denominator for purposes of determining the amount of incentive compensation that must be deferred?

- Clarify that mandatory deferral need not continue to apply in the event of the employee's death, disability, commencement of government employment, or a change in control.

- Clarify that the requirement applies on a per-person rather than a per-award basis. For example, if an executive officer receives an annual bonus paid 50% in cash and

50% in stock, any or all of each of the cash and stock portions could be deferred, so long as 50% of the total bonus is deferred. It would not be necessary to defer 50% of each of the cash and stock portions.

- Clarify that the following forms of compensation would be considered deferred for the requisite period:
  - Cash or stock awards (*e.g.*, stock options, restricted stock units) that are vested at grant but that do not settle or become exercisable for three years.
  - Shares that are vested at grant but that are subject to transfer restrictions for three years.
  - Payments of cash or stock that are subject to a recoupment obligation that lapses after three years.
  - Long-term incentive plan payments made upon the completion of, or over, a three-year (or longer) performance period.
- Provide that, if a covered financial institution's compensation committee determines that deferral alone is sufficient to mitigate risk, the amount deferred need not be subject to additional adjustments to reflect performance. For example, the committee could conclude that the exercisability of a stock option that service vests over three years need not be subject to performance conditions.

(b) If the Agencies' final rules require a minimum deferral period for incentive-based compensation, then the Roundtable believes that the Agencies' final rules should:

- Not require a deferral period of longer than three years,
- Clarify that any performance measurement period, vesting period or other time period during which the compensation amount is not fully vested and transferable by the employee shall count toward the required "deferral period." For example, if an institution awards restricted stock or RSUs that cliff-vest on the third anniversary of the award date, the rules should not require that those shares must be deferred or remain forfeitable for an additional three years, and
- Clarify what it means to have the deferred amounts "adjusted to reflect actual losses or other measures or aspects of performance that are realized or become better known during the deferral period" (§ .5(b)(3)(i)(B)). For example, it would seem that an amount held in company stock would adjust automatically as the market price rises or falls.

D. Rules Should be Coordinated with the 2010 Interagency Guidance on Executive Compensation.

The OCC, Board, FDIC and OTS previously adopted the 2010 Interagency Guidance. In connection with the issuance of proposed guidance in 2009, the Federal Reserve commenced a special horizontal review of incentive compensation practices at Large Complex Banking Organizations. There is significant overlap between the 2010 Interagency Guidance and the proposed rules, and many financial institutions have been working with the Board to comply with the 2010 Interagency Guidance for nearly two years. The final rules should be coordinated with the 2010 Interagency Guidance, as well as interpretations issued by the Board under the horizontal review process.

Together with the emphasis on reduced risk in the 2010 Interagency Guidance, the final rules may cause covered financial institutions to become less competitive, as they are continuously forced to take the path of less incentives and risk. The Supplementary Information, Background Section of the 2010 Interagency Guidance and other written guidance from the Board has acknowledged that performance measures should be set at a floor level rather than encouraging higher performance, which could separate the interests of shareholders and covered employees.

The 2010 Interagency Guidance describes four methods that are "often used to make compensation more sensitive to risk": (i) risk adjustment of awards; (ii) deferral of payment; (iii) longer performance periods; and (iv) reduced sensitivity to short-term performance. The proposed rules would mandate one of those four methods – deferral of payment – thereby seemingly making the 2010 Interagency Guidance obsolete. This mandatory, prescriptive deferral requirement is inconsistent with the flexible, principles-based approach of the 2010 Interagency Guidance.

E. Rules Should Not Impose Limits on Personal Trading Strategies.

The Agencies' requested comment on whether the final rules should require covered financial institutions to limit personal trading strategies. The Roundtable does not believe the final rules should cover this point as many financial institutions have imposed such restrictions. Additionally, Dodd-Frank Act Section 955 addressed this issue by directing the SEC to issue rules requiring issuers to disclose whether any employee or director is permitted to purchase financial instruments designed to hedge or offset any decrease in the market value of equity securities held by them or received as compensation. It is not necessary for the Agencies to address this issue by imposing prohibitions when Congress only mandated disclosure.

F. Clarification Required with Respect to Effective Date and Phase-in of Rules.

1. Final rules should not apply to compensation arrangements that are already in force.

The Roundtable believes that the Agencies' final rules should not apply to existing incentive-based compensation arrangements, since institutions may be legally unable to change the terms of such plans. The final rules should only apply to grants of incentive compensation made for calendar years following the effective date of the final rules. Thus, for example, if the effective date of the final rules is April 12, 2012, for a calendar-year based plan, the final rules should not apply to:

- An annual incentive plan award for calendar year 2012, or
- A three-year long-term incentive plan running from January 1, 2013 (or earlier) through December 31, 2015.

Any earlier effective dates will not provide sufficient time for covered financial institutions to comply with the rule. Additionally, Internal Revenue Code Section 409A may prohibit or impose substantial penalties in situations where the parties change the distribution or pay-out date of an award after the grant date. Given the deferral requirements, more time may be needed to adopt compensation arrangements that will ensure interim continuity of affected employees' expected compensation. Importantly, TARP rules generally grandfathered pre-existing incentive-based compensation awards.

2. Rules should allow time for covered institutions to develop conforming compensation arrangements.

The Roundtable believes that the Agencies' final rules should also specify the first year in which reports are due. The first reports should not be due for any years prior to the year beginning after the year in which the rules become effective. Given the deferral requirements, institutions will need time to adopt compensation arrangements that will ensure interim continuity of affected employees' expected compensation.

3. Agencies should adopt a uniform implementation date for institutions covered by the rule.

The Roundtable believes that the Agencies' final rules should <u>not</u> designate different compliance dates for different types of covered financial institutions. There should be a level playing field for all covered financial institutions, without discrimination between large and small firms. Risk occurs regardless of firm size and appears in all sizes, and larger organizations often have more robust risk oversight operations.

G. <u>Guidelines are More Appropriate than Rules for Some Portions of Section 956</u>.

Finally, the Roundtable believes that the Agencies should adopt portions of the proposed rules as guidelines rather than final rules. Dodd-Frank Act Section 956 contemplates that the Agencies will prescribe "regulations or guidelines" regarding compensation disclosure requirements and prohibitions on certain compensation arrangements. We recognize that the Agencies must implement some portion of Dodd-Frank Act Section 956, such as the reporting requirements under Section 956(a), with formal rules. However, as discussed above, we believe that the Agencies should guide the evolution of policies and procedures by financial institutions rather than mandate a fixed, "one size fits all" approach. In fact, the evolution of best practices, policies and procedures is well underway as part of voluntary actions by financial institutions, encouraged by the 2010 Interagency Guidance (which is in the form of guidelines and not rules). Clearly, the Agencies will retain enforcement authority as to any guidelines they issue under existing laws, such as the Gramm-Leach-Bliley Act, and under Dodd-Frank Act Section 956(d).

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Thank you for considering our comments. Please do not hesitate to contact me or Brad Ipema of the Financial Services Roundtable at (202) 589-2424 if we can provide you with any further information.

Sincerely,

Richard M. Whiting

Executive Director & General Counsel

cc: