William H. Ferguson
Senior Partner

777 South Figueroa Street, Suite 1900
Los Angeles, CA 90017
213 346 2240
Fax +1 213 346 2680
will.ferguson@mercer.com
www.mercer.com

MERCER

Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, NW.
Washington DC 20429

Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

May 31, 2011

Subject: Incentive-Based Compensation Arrangements; Federal Reserve System Docket No. R-1410; RIN No. 7100-AD69; FDIC RIN 3064-AD56

Dear Mr. Feldman and Ms. Johnson:

Mercer is submitting comments in response to a request by the Federal Deposit Insurance Corporation and the Board of Governors of the Federal Reserve System for input into its proposed rules on incentive-based compensation arrangements as required under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank).

Mercer, a wholly-owned subsidiary of Marsh & McLennan Companies, Inc., is a leading global provider of consulting, outsourcing and investment services, with more than 25,000 clients worldwide and approximately 10,000 in the United States. Mercer consultants help clients maximize the effectiveness of their compensation and benefit programs and optimize workforce performance by providing human resources and related financial advice, products, and services, including compensation consulting services to corporations, boards of directors, and board compensation committees concerning the compensation of executives and directors. Mercer provides executive compensation consulting services to companies around the globe. We have extensive experience designing and implementing incentive programs within the financial services industry.

Our comments primarily relate to the proposal to require mandatory deferrals of annual incentive-based compensation paid to executive officers at larger financial institutions. We also comment on:

- Hedging
- The role of risk management professionals
- Consistency with global standards

We agree that a deferral requirement with potential for adjustments to reflect losses or other measures is appropriate, particularly for businesses where the profitability of transactions takes longer than one year to be fully realized. However, we believe the proposal is too focused on the historical investment banking compensation model and does not take into account the variety of long-term incentives currently used by many financial service companies to compensate their executives. We also believe the potential for adjustments of deferrals should recognize gains as well as losses.

Mandatory Deferrals

For covered financial institutions with $50 billion or more of total consolidated assets, the proposed rules would require that “at least 50 percent of the annual incentive-based compensation of the executive officer be deferred over a period of no less than three years.” The deferred amounts would be adjusted “to reflect actual losses or other measures or aspects of performance that are realized or become better known during the deferral period.”

Defining “Annual Incentive-Based Compensation”

A key consideration in reviewing the mandatory deferral language is the term “annual.” It is unclear whether the Agencies’ intention is for this to apply solely to incentives that are earned over a single year, such as the typical annual bonus/incentive plan, or whether it refers to all incentives granted in a single year, including long-term performance plans, stock options and other awards that vest or are earned over more than one year.

We recommend that the Agencies clarify that annual incentive-based compensation includes all incentives granted in a single year. However, we believe this would only be appropriate if the rules reflect the fact that many financial institutions already pay a majority of executive officer compensation in the form of long-term incentives that vest over three or more years.

It should be noted that not all financial services companies use the same pay mix to compensate their executive officers. For example, the historical investment banking compensation model includes nominal base salaries and a significant discretionary cash bonus typically funded by annual profits. Most investment banks have also required deferral of a portion of the cash bonus typically for a period of three years often in the form of restricted stock or units whose ultimate value depends on the share price. Commercial or universal banks have used forward-looking long-term incentives to deliver the majority of executive compensation opportunities. Forward-looking long-term incentives are rewards linked with achievement of multi-year objectives, driving future behavior and performance. The objectives usually relate to the company's business / strategic plan and are aligned with creating value for the shareholders. Therefore, long-term incentives are about keeping the executives focused on executing the company's strategic plan going forward and sharing in the company's future success.

For example, the typical target pay mix for the CEO of a large commercial bank is 15% base salary, 25% target annual incentive and 60% target long-term incentives. Thus, 60% of the CEO's pay is already subject to long-term performance; requiring a deferral of 50% of his or her annual incentive would increase the deferred amount to 72.5% of the CEO's total pay.

> *Example:* Consider an executive officer whose compensation consists of salary, an annual incentive payment of $250,000 and a performance share award that vests over three years with a grant date value of $600,000. Incentive-based compensation would total $850,000, of which 70% ($600,000) meets the deferral requirement. No additional deferrals would be required.
>
> Alternatively, if the company were required to defer $125,000 of the annual incentive payment without taking into account the executive's entire compensation package, companies might be motivated to reduce or eliminate effective, well-designed long-term incentive plans to avoid placing excessive emphasis on long-term compensation.

Another possible way of clarifying this rule would be to require that at least of 50% of variable pay would need to have a performance period / measurement period of three years or longer.

Adjustments to Deferred Amounts

We believe that any adjustments to deferred amounts should consider performance over the deferral period and that potential adjustments should not be limited to reductions of the deferred amounts. The proposed rules clearly indicate downward adjustments for actual losses. We believe that actual gains that are realized or become better known during the deferral period likewise should be considered in determining appropriate adjustments to deferred amounts.

Hedging

We agree that the use of hedging instruments removes or weakens executives' alignment with shareholders and should not be permitted. Equity-based compensation is commonly used to align the economic interests of employees with those of shareholders, provide competitive compensation opportunities and enhance retention. For executives, alignment of interests with shareholders is frequently further reinforced through share ownership or retention guidelines. Such guidelines typically allow participants to diversify their personal investment portfolio once they obtain a significant equity stake. We believe these policies negate any perceived need for hedging and that companies should have an anti-hedging policy as well.

Risk Management Oversight

We agree that risk management plays an important role in ensuring that incentives do not encourage inappropriate risk-taking and should be included as part of a cross-functional team to develop and review incentive plans. Risk management expertise provides a valuable perspective in the incentive plan design and review process, particularly with regard to performance metrics and tail risks. Human Resources should "own" the design process given their knowledge of human capital and incentive plan design expertise, leading a team that include professionals from finance, legal and compliance, along with risk management, as well as operating executives, as appropriate.

MERCER

Consistency with International Standards

We believe that regulators should apply consistent principles in setting pay requirements for large, global financial services organizations. As a global organization, we work with many large financial services companies that face the challenge of complying with different jurisdictions' regulations on compensation. The proposed rules note that "requiring deferral for executive officers is consistent with international standards…" We agree that requiring some form of deferral is emerging as a regulatory standard in Europe and the UK. We believe that consistency in compensation regulations as relates to deferrals would help to make it clear to global financial institutions how they should proceed.

We thank you for the opportunity to comment on your rulemaking initiatives. We would be happy to discuss our comments or to answer any questions about our comments. I can be reached at +1 (213) 346-2240.

Sincerely,

William H Ferguson

William H. Ferguson
Senior Partner
Global Segment Leader for Rewards