ICBA
INDEPENDENT COMMUNITY
BANKERS of AMERICA

November 25, 2009

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

Re: Proposed Guidance on Sound Incentive Compensation Policies (Docket No. OP-1374)

Dear Ms. Johnson:

The Independent Community Bankers of America (ICBA) welcomes the opportunity to comment on the proposed guidance issued by the Federal Reserve concerning incentive compensation policies at banking organizations (Proposed Guidance). The purpose of the guidance is to help ensure that incentive compensation policies at banking organizations do not encourage excessive risk-taking and are consistent with the safety and soundness of an organization.

ICBA's Position

ICBA agrees with the Federal Reserve's premise to its Proposed Guidance that incentive compensation practices in the financial services industry were one of many factors contributing to the financial crisis that began in 2007. Banking organizations, particularly some of the large financial institutions, too often rewarded employees for increasing the firm's short term revenue without adequate recognition of the risks the employees' activities posed for the firm. For instance, the way that certain large banking organizations paid their mortgage originators certainly exposed those financial institutions to a great deal of risk and contributed to the credit problems associated with subprime mortgage lending.

However, it is important to note that these risky incentive compensation practices were confined to large banks. Few, if any, community banks had incentive compensation practices that had anything to do with the current crisis. Community banks were the common sense lenders during the crisis. Unfortunately, even though they did not contribute to the economic crisis, community banks are suffering the effects of it from a shrinking asset base, heavier FDIC assessments, and a tough examination environment.

It is important therefore, that the Federal Reserve's Proposed Guidance focus on those large, complex institutions with incentive compensation arrangements that did contribute to the financial crisis and not impose any additional regulatory burden on community banks. **We agree that there should be a horizontal review of large complex banking organizations (LCBOs) to ensure that those organizations do not establish incentive compensation arrangements that encourage excessive risk-taking.** These organizations are significant users of incentive compensation arrangements. Furthermore, the adverse effects of flawed approaches at these large institutions are more likely to have adverse effects on the broader financial system.

However, for other banking organizations that are not LCBOs, supervisory review of compensation arrangements should be confined to only those organizations that have incentive compensation arrangements that could possibly pose a material risk to the safety and soundness of that institution. Community banks that have only a few incentive compensation arrangements with senior officers should be exempt from supervisory review. The Proposed Guidance should be amended to clarify that only those non-LCBOs that have incentive compensation arrangements that could pose a material risk to the safety and soundness of the institution will be examined under the guidance and the results of the supervisory findings incorporated into the organization's supervisory ratings.

Furthermore, the Proposed Guidance should also make clear that many firm-wide, profit sharing plans of community banks will not be considered "incentive compensation arrangements" subject to the guidance. A community bank, for instance, should not be required to adopt a policy concerning incentive compensation or be subject to examination under the Proposed Guidance simply because it has a modest bank-wide profit sharing plan tied to the overall performance of the organization. **In the case of financial institutions that are not LCBOs, the Proposed Guidance should clarify that bank-wide, profit sharing plans tied to the overall performance of the bank or that do not result in compensation that exceeds more than a certain percentage of an employee's salary, are exempt from the guidance and not subject to supervisory review.** Similarly, the Proposed Guidance should clarify that for non-LCBOs, certain types of equity-based compensation arrangements also will be considered exempt.

While establishing separate compensation committees may be good corporate governance for large financial institutions, for community banks, it is costly and difficult with few benefits for management or shareholders. Family-owned community banks located in smaller towns and communities, for instance, would find it very challenging to establish separate compensation committees made up of outside directors who are competent on compensation issues. The Proposed Guidance should clarify that only LCBOs and large regional banks will be expected to consider establishing separate compensation committees.

ICBA urges the Federal Reserve not to adopt formulaic limits on incentive compensation for community banks, such as requiring at least 50 percent of incentive compensation for senior executives be paid in the form of stock options or other equity-linked instruments or requiring that a certain percentage of bonuses for senior executives be deferred. These limits would not necessarily promote the long-term safety and soundness of banking organizations and would severely limit the ability of community banks to fashion appropriate compensation packages for senior executives. Similarly, the Proposed Guidance should not presume that golden parachute arrangements are too risky for a banking organization. Many community banks find golden parachute arrangements very useful for retaining their senior executives, and such arrangements pose few, if any, material risks to the safety and soundness of the organization.

Finally, while the Proposed Guidance does incorporate a risk-based focus when it states that "regional and community banking organizations should develop and implement appropriate polices, procedures and systems…tailored to the size and complexity of the organization's activities," the Proposed Guidance does not say that community banking organizations that don't have incentive compensation arrangements or that have arrangements that don't pose a material risk to the safety and soundness of that institution will not be expected to have such policies and procedures in place. Without this clarification, ICBA is concerned that many community banks that don't have material incentive compensation arrangements will needlessly draft and adopt policies and procedures with the help of outside compensation consultants just to comply with the Proposed Guidance. **While we commend the Federal Reserve for adopting a risk-based focus to its guidance, we still believe it would be important to clarify that most community banks are not expected to adopt policies and procedures concerning incentive compensation arrangements.**

Conclusion

While ICBA generally agrees that the supervisors should conduct a horizontal review of large complex banking organizations (LCBOs) to ensure that those organizations do not establish incentive compensation arrangements that encourage excessive risk-taking, the Proposed Guidance should be amended to clarify that only those non-LCBOs that have incentive compensation arrangements that could pose a material risk to the safety and soundness of the institution will be examined in accordance with the guidance. Community banks that have only a few incentive compensation arrangements with senior officers should be exempt.

Furthermore, the Proposed Guidance should also make clear that many firm-wide, profit-sharing plans of community banks will not be considered "incentive compensation arrangements" subject to the guidance. The Proposed Guidance should spell out, for instance, that bank-wide profit sharing plans of non-LCBOs tied to the overall performance of the bank or that do not result in compensation that exceeds more than a certain percentage of an officer's salary will be considered exempt and not subject to supervisory review. The Proposed Guidance should also clarify that only LCBOs and large regional banks will be expected to establish separate compensation committees.

ICBA urges the Federal Reserve not to adopt formulaic limits on incentive compensation for community banks, such as requiring at least 50 percent of incentive compensation for senior executives be paid in the form of stock, options or other equity-linked instruments or that a certain percentage of bonuses for senior executives be deferred. These limits would not necessarily promote the long-term safety and soundness of banking organizations and would severely limit the use of executive compensation plans by community banks. Also, many community banks find golden parachute arrangements very useful for retaining their senior executives, and the Proposed Guidance should not presume that golden parachute arrangements pose significant risks for most banking organizations.

Finally, although the Proposed Guidance incorporates a risk-based focus with respect to the adoption of compensation policies and procedures, it does not state that community banking organizations that do not have incentive compensation arrangements or that have arrangements that do not pose a material risk to the safety and soundness of that institution are not required to have policies and procedures in place. Without this clarification, ICBA is concerned that many community banks will needlessly draft and adopt policies and procedures with the help of compensation experts just to comply with the Proposed Guidance.

ICBA appreciates the opportunity to comment on the Federal Reserve's proposed guidance on sound incentive compensation policies. If you have any questions or need additional information, please do not hesitate to contact me at my email address (Chris.Cole@icba.org) or at 202-659-8111.

Sincerely,
/s/ Christopher Cole

Christopher Cole
Vice President and Senior Regulatory Counsel