Date: November 26, 2009

To: Chairman Bernanke
Vice Chairman Kohn
Board Members Duke, Tarullo and Warsh
Staff

From: Integrated Governance Solutions, LLC (IGS)

Subject: Comments Regarding Proposed Guidance on Sound Incentive Compensation Policies Docket No. OP-1374

Introduction

IGS is submitting comments regarding three portions of the proposed guidance:

A. Risk management experience and expertise on an institution's board.
B. An independent monitor to provide information and analysis to an institution's board.
C. Disclosure to shareholders regarding the institution's incentive compensation arrangements and related risk management, control, and governance processes.

These topics align well with three of IGS' key corporate governance principles:

1. Accountability: an institution's board of directors must possess appropriate risk expertise.
2. Integrity: each institution must have a risk monitor reporting to its board of directors.
3. Transparency: each institution must disclose to its owners its governance and risk management structures and practices.

Appendix A contains some background information regarding IGS and supporting authorities for IGS' recommendations and comments.

Detailed Comments Regarding Proposed Guidance

While IGS does not directly practice in the executive compensation space, it strongly believes that a direct connection exists among compensation, results and risk. Another colloquial expression to describe this connection is, "you get what you pay for." The crisis the markets experienced resulted from the adoption of short-term incentives and the pursuit of short-term value at the expense of long-term value creation. To compound the problem, the relationship between the reward and the consequence is asymmetric; to the extreme of another colloquial expression, "heads I win, tails I still win." An appropriate portion of an executive's compensation should be aligned with long-term value creation and adverse consequences should attach to the performance results, as well as rewards. The prevalence in the regulated institutions of the model of the roles of the CEO and board chair combined in one person can exacerbate the potential risk addressed by the proposed guidance. Consequently, IGS' comments recommend enhancing the proposed guidance in three areas to help mitigate that risk.

A. Risk Management Experience and Expertise on the Board

Corporate governance practices have not maintained pace with business models that have rapidly and dramatically changed over the past 20 years. Consequently, the bench strength of many boards is very shallow in certain disciplines, most notably, risk expertise. It's one thing to claim a skill. It's quite another to possess a demonstrated competency or expertise. This topic is a cornerstone of IGS' trio of corporate governance key principles that will help institutions achieve next generation governance - *accountability*. IGS believes that the proposed guidance provides value to institutions regarding the subject of risk expertise; however, IGS recommends strengthening the requirement for the presence of risk expertise on the board to support the execution of its duties.

IGS Corporate Governance Key Principle #1
Risk Expertise on Board of Directors - Accountability.

IGS Recommendation:

> Each regulated institution shall establish specialized risk management and risk oversight competencies (comprised entirely of independent voting directors, supplemented by periodic use of advisory expert resources applicable to the institution's industry and situation) on its board of directors, which shall assist the board of directors in adequately executing its responsibility for the oversight and evaluation of the risk management policies and practices of the institution.

Current U.S. law requires a "financial expert" for all public boards/audit committees. By analogy, it would be appropriate to require the board of each institution to include a member with expertise in risk management.

B. Independent Monitor to Provide Information and Analysis to Board

A concept that is not directly addressed in the proposed guidance and has received very little attention in the popular and professional trade press represents the second cornerstone of IGS' trio of corporate governance key principles that will help institutions achieve next generation governance - *integrity*. A robust monitoring system within an institution that reports directly to its board of directors supports a healthy system of checks and balances by providing the board with an integrated view of material risk to the institution, empowering the board to fulfill its fiduciary duties. Since the emergence of the current economic crisis, directors have been quoted in the media to the effect that they were not aware of the risks assumed by the institutions that contributed to the crisis. Monitoring systems in those institutions either did not exist or were compromised to preclude the boards from fulfilling their fiduciary duties. Consequently, the proposed guidance should require each regulated institution to implement a monitoring officer as described below.

IGS Corporate Governance Key Principle # 2
Monitoring Officer - Integrity.

IGS Recommendation:

> The board of directors of each regulated institution shall designate a qualified employee of the institution (other than the chief executive officer, president, chief operating officer, chief financial officer, treasurer, controller, secretary or general counsel) who shall:
>
> A. be responsible for the establishment and performance of the institution's system that objectively monitors and communicates findings regarding key aspects of the institution's business, including, but not limited to, ethics, risk, compliance and social responsibility,
>
> B. serve as an officer (e.g., a chief monitoring, chief risk or functionally equivalent position) of the institution,
>
> C. report directly and solely to the institution's chairman of the board or appropriate committee of the board; and
>
> D. not directly or indirectly perform or be responsible for the performance of any activities of the institution which interfere or conflict with such employee's foregoing duty to monitor and communicate findings regarding the key aspects of the institution's business in an objective and non-filtered manner to all appropriate parties.

C. Disclosure About Institution's Risk Management Process

The last cornerstone of IGS' trio of corporate governance key principles that will help institutions achieve next generation governance is *transparency*. This concept represents the heart of the proposed guidance. IGS believes added value will be realized from the disclosure of the rationale for and operation of an institution's governance and risk management structures and practices that are responsive to key stakeholders as well as shareowners and employees. Proxy advisor firms provide analyses to their clients based primarily on publicly available information. Lacking quality information regarding an institution's rationale for and operation of its governance and risk management structures and practices handicaps the accurate analysis by an owner or prospective investor of the institution's exposure to material risk and the institution's internal capability to identify and manage its risk effectively.

IGS Corporate Governance Key Principle # 3
Public Disclosure of Governance and Risk Management Structures and Practices - Transparency.

IGS Recommendation:

> Each regulated institution must disclose in appropriate public filings, detailed information that explains the rationale for and the operation of its governance and risk management structures and practices, responsive to the governance and risk management needs of the institution and expectations of its key stakeholders.

Appendix A

Background regarding IGS

Based on 25 years in the corporate governance space, including experience as a governance executive with a Fortune 25 company, the founder of IGS established it with a vision to transform and revolutionize how present and future organizations are governed, boldly setting a new standard for trusted governance. Its mission is to help create, restore, and sustain trust through next generation board oversight and integrated risk management. It devoted the past two years to the development of next generation governance solutions for board oversight, business monitoring, and risk management. You may read more about IGS by visiting www.integratedgovernance.com. IGS believes strongly that it offers an important part of the answer our country is seeking. There are many others who appear to concur with IGS' approach.

IGs has reviewed its solutions with the following stakeholders, who have all been very interested and intrigued with how they can help the country in moving toward next generation governance and restoring trust in the market:

- Over 200 board members and senior executives
- The Council of Institutional Investors
- Proxy advisor firms
- The Corporate Executive Board (a major best practices and benchmarking organization)
- U.S. House Financial Services Committee members and staff (Democrat and Republican)
- A member of the Congressional Oversight Panel (COP)
- An SEC commissioner
- A representative from the FDIC
- SIGTARP senior leadership team
- Major academic institutions – nationally recognized business and law schools
- Other key stakeholders, including the AICPA, IMA, CFA, FEI, ECOA

Supporting Authorities - Excerpts

A. Risk Management Experience and Expertise on the Board

Policy Briefing No. 4 Chairing the Board
The Case for Independent Leadership in Corporate North America, March 30, 2009
The Millstein Center for Corporate Governance and Performance, Yale University School of Management in support of The Chairmen's Forum

- The board's apparent failure to perform its risk management function is considered by many to be a key contributing factor to the current financial crisis.
- This crisis has exposed a board failure in fulfilling its duties and ensuring the existence of an adequate risk management system.

Financial Reform, A Framework for Financial Stability by The Group of 30
January 2009

> Regulatory Standards for Governance and Risk Management
> Recommendation 9:
> Regulatory standards for governance and risk management should be raised, with particular emphasis on:
> > a. Strengthening boards of directors with greater engagement of independent members having financial industry and risk management expertise.

A review of corporate governance in UK banks and other financial industry entities 16 July 2009

Recommendation 13
The evaluation statement should include such meaningful, high-level information as the board considers necessary to assist shareholders understanding of the main features of the evaluation process. The board should disclose that there is an ongoing process for identifying the skills and experience required to address and challenge adequately the key risks and decisions that confront the board, and for evaluating the contributions and commitment of individual directors. The statement should also provide an indication of the nature and extent of communication by the chairman with major shareholders.

Recommendation 23
The board of a bank or other financial institution should establish a board risk committee separately from the audit committee with responsibility for oversight and advice to the board on the current risk exposures of the entity and future risk strategy.

B. Supporting Authorities for Independent Monitor to Provide Information and Analysis to Board

Policy Briefing No. 5, Pay, Risk and Stewardship
Private Sector Architecture for Future Capital Markets, June 2009
The Millstein Center for Corporate Governance and Performance, Yale University School of Management

Recommendation a.6:
Risk management units should have sufficient clout, independence and access to resources. Risk officers should not report to business lines, given the potential for conflicts of interest. Direct reporting obligations to the board independently of management are especially valuable in ensuring the clout and independence of the chief risk officer.

Financial Reform, A Framework for Financial Stability by the Group of 30, January 2009

Regulatory Standards for Governance and Risk Management
Recommendation 9:
Regulatory standards for governance and risk management should be raised, with particular emphasis on:
d. Ensuring the risk management and auditing functions are fully independent and adequately resourced areas of the firm.

Section 8B2.1(b)(2)(C) of the Federal Sentencing Guidelines, the U.S. Sentencing Commission

For an organization to have an effective compliance and ethics program, specific "individuals shall be given direct access to the governing authority or an appropriate subgroup of the governing authority".

A review of corporate governance in UK banks and other financial industry entities 16 July 2009

Recommendation 24
In support of board-level risk governance, a bank or other financial institution board should be served by a chief risk officer (CRO) who should participate in the risk management and oversight process at the highest level on an enterprise-wide basis and have a status of total independence from individual business units. Alongside an internal reporting line to the CEO or financial director, the CRO should report to the board risk committee, with direct access to the chairman of the committee in the event of need. The tenure and independence of the CRO should be underpinned by a provision that removal from office would require the prior agreement of the board. The remuneration of the CRO should be subject to approval by the chairman or chairman of the board remuneration committee.

C. **Supporting Authorities for Disclosure about Institution's Risk Management Process, including Compensation Structures**

A review of corporate governance in UK banks and other financial industry entities 16 July 2009

Recommendation 27

The board risk committee (or board) risk report should be included as a separate report within the annual report and accounts. The report should describe the strategy of the entity in a risk management context, including information on the key exposures inherent in the strategy and the associated risk tolerance of the entity and should provide at least high level information on the scope and outcome of the stress-testing programme. An indication should be given of the membership of the committee, of the frequency of its meetings, whether external advice was taken and, if so, its source.

The Aspen Principles - Long-Term Value Creation: Guiding Principles for Corporations and Investors
The Aspen Institute - Business &Society Program, June 2007

1. Define metrics of long-term value creation
2. Focus corporate investor communication around long-term metrics
3. Align company and investor compensation policies with long-term metrics

Policy Briefing No. 5, Pay, Risk and Stewardship
Private Sector Architecture for Future Capital Markets, June 2009
The Millstein Center for Corporate Governance and Performance, Yale University School of Management

Recommendation b.2:
The goal of executive pay should be to compensate and incentivize executives for their contribution to long-term value creation. The existing focus on short-term stock price movement as the relevant metric for compensation decisions is misplaced.

Recommendation b.4:
Boards should approach pay decisions as an element of risk to the organization. The structure of certain compensation packages may induce executives to reach performance targets through inefficient, artificial or even illegal means, at a huge risk to the organization's long-term interest.

Financial Stability Forum Principles for Sound Compensation Practices 2 April 2009

4. Compensation must be adjusted for all types of risk.

5. Compensation outcomes must be symmetric with risk outcomes.

6. Compensation payout schedules must be sensitive to the time horizon of risks.

7. The mix of cash, equity and other forms of compensation must be consistent with risk alignment.

8. Supervisory review of compensation practices must be rigorous and sustained, and deficiencies must be addressed promptly with supervisory action. Compensation practices should be included in risk assessment of firms.

9. Firms must disclose clear, comprehensive and timely information about their compensation practices to facilitate constructive engagement by all stakeholders.

A review of corporate governance in UK banks and other financial industry entities 16 July 2009

Recommendation 28
The remit of the remuneration committee should be extended where necessary to cover all aspects of remuneration policy on a firm-wide basis with particular emphasis on the risk dimension.

Recommendation 33
Deferral of incentive payments should provide the primary risk adjustment mechanism to align rewards with sustainable performance for executive board members and executives whose remuneration exceeds the median for executive board members. Incentives should be balanced so that at least one-half of variable remuneration offered in respect of a financial year is in the form of a long-term incentive scheme with vesting subject to a performance condition with half of the award vesting after not less than three years and of the remainder after five years. Short-term bonus awards should be paid over a three year period with not more than one-third in the first year. Clawback should be used as the means to reclaim amounts in limited circumstances of misstatement and misconduct.

Recommendation 35
The remuneration committee should seek advice from the board risk committee on an arm's-length basis on specific risk adjustments to be applied to performance objectives set in the context of incentive packages; in the event of any difference of view, appropriate risk adjustments should be decided by the chairman and non-executive directors on the board.

Recommendation 37
The remuneration committee report should state whether any executive board member or senior executive has the right or opportunity to receive enhanced pension benefits beyond those already disclosed and whether the committee has exercised its discretion during the year to enhance pension benefits either generally or for any member of this group.

Policy Statement 09/15 Financial Services Authority 11 August 2009
Reforming remuneration practices in financial services
Amendments to the FSA Handbook for Senior Management Arrangements, Systems and Controls (Remuneration Code) Instrument 2009

19.2 Remuneration Code: General requirement

Remuneration policies must be consistent with effective risk management

19.2.1 R A *firm* must establish, implement and maintain *remuneration policies*, procedures and practices that are consistent with and promote effective risk management.

19.2.2 G (1) If a *firm's remuneration policy* is not aligned with effective risk management it is likely that *employees* will have incentives to act in ways that might undermine effective risk management.

(2) The aim of the *Remuneration Code* is to ensure that *firms* have risk-focused *remuneration policies*, which are consistent with and promote effective risk management and do not expose them to excessive risk.

(5) The principles in the *Remuneration Code* will be used by the *FSA* to assess the quality of a *firm's remuneration policies* and whether they encourage excessive risk-taking by a *firm's employees*.

(6) The *FSA* may also ask *remuneration committees* to provide the *FSA* with evidence of how well the *firm's remuneration policies* meet the *Remuneration Code's* principles, together with plans for improvement where there is a shortfall. The *FSA* will also expect relevant *firms* to use the principles in assessing their exposure to risks arising from their *remuneration policies* as part of the *internal capital adequacy assessment process* (*ICAAP*).

19.3 Remuneration Code: Remuneration principles

19.3.2 G (1) *Remuneration* is usually the largest cost incurred by *firms* after funding costs. The risks arising from the way *employees* are recruited and managed, including the risks posed by *remuneration policies*, constitute some of the most important risks faced by *firms*. *Remuneration committees* should pay specific attention to these risks.

(3) *Remuneration committees* should have a majority of *non-executive directors*, one or more of whom should have practical skills and experience of risk management, for example through being a member of a *firm's* risk committee or audit committee. *Remuneration committees* should receive regular reports directly from the *firm's* risk management function on the implications of the *remuneration policy* for risk and risk management.

(4) The *FSA* may ask a *remuneration committee* to prepare a statement on the *firm's remuneration policy*, including the implications of the policy for the *firm*. The *FSA* will expect the statement to include an assessment of the impact of the *firm's* policies on its risk profile and *employee* behaviour.

(5) It is good practice for a *firm's governing body* or the *remuneration committee* to issue a separate public document to inform its shareholders and other stakeholders about its *remuneration policy* and its implications for the *firm's* risk profile and for *employee* behaviour.

19.3.4 G (2) It is good practice for a *remuneration committee* to ask the risk management function to validate and assess risk adjustment data, and to attend a meeting of the *remuneration committee* for this purpose.

Remuneration Principle 5: Long-term performance measurement

19.3.9 E (1) Where the performance-related component of an *employee's remuneration* is a significant part of his total *remuneration*, the assessment process should be designed to ensure assessment is based on longer-term performance.

19.3.10 G (2) Performance assessment on a moving average of results can be a good way of meeting Remuneration Principle 5. However, other techniques such as good quality risk adjustment and deferment of a sufficiently large proportion of *remuneration* may also be useful.

19.3.11 E (2) Non-financial performance metrics should include adherence to effective risk management and compliance with the *regulatory system* and with relevant overseas regulatory requirements.

19.3.12 G (1) Poor performance in non-financial metrics such as poor risk management or other behaviours contrary to *firm* values can pose significant risks for a *firm* and should, as appropriate, override metrics of financial performance.

Remuneration Principle 7: Measurement of performance for long-term incentive plans

19.3.13 E (1) The measurement of performance for long-term incentive plans, including those based on the performance of *shares*, should take account of future risks.