SUNTRUST

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

Re: **Docket No. OP-1374 –**
Proposed Guidance on Sound Incentive Compensation Policies

Dear Ms. Johnson:

Thank you for the opportunity to comment upon the Proposed Guidance on Sound Incentive Compensation Policies (the Guidance) published by the Board of Governors of the Federal Reserve System (the Federal Reserve). We would like to comment on three areas: (1) the interplay of business risk and compensation risk, (2) financial institutions' need to be permitted to deliver competitive compensation, and (3) the expertise and resources available to financial institution boards of directors.

Interplay of Business Risk and Compensation Risk
Under Principle 1, "Balanced Risk Taking Incentives," the Guidance directs banking organizations to consider the full range of risks associated with an employee's activities, as well as the time horizon over which those risks may be realized, in assessing whether incentive compensation arrangements are balanced. The Guidance goes on to say that banking organizations can move an unbalanced arrangement towards balance by adding or modifying features that cause the amounts ultimately received by employees to appropriately reflect risk and risk outcomes. We agree with these points. However, the Guidance does not directly address the interplay between business risk and compensation risk.

We believe the Guidance can be improved by including a recognition that the appropriateness of an incentive depends upon the incentive and its risks, as well as the business, the type and size of risks inherent in the business, and the risk control environment and other factors mitigating the risks. The Guidance should also reflect that an unbalanced incentive can be moved toward balance by adjusting the risk environment.

Connecting the incentive to the business risk environment is important because the best way to address a risk may not necessarily be to change the terms of the incentive. Rather, safety and soundness might be better protected by changing the business environment by modifying or supplementing its risk controls. Depending on the situation, this could be done instead of, or in conjunction with, changes to incentives. The appropriateness of incentive structure would depend on the business risk involved, the compensation risk involved, and the existence of controls or mitigants to both sets of risks.

Analyzing both business risk (the risks accompanying a particular business activity) and compensation risk (the risk that a business pays or incentivizes its employees for actions that are not intended or desired) often allows one to identify multiple opportunities for risk reduction or compensating controls. For example, in certain business lines, it might be appropriate to provide incentive compensation based on risk-adjusted return or return on capital. It would seem redundant to further reduce or limit such incentives.

Additionally, an understanding of both the risk environment and the compensation risks might allow one to separate important risks from unimportant risks. For example, incentives with the highest potential payouts and the highest business risk should receive the most attention and should be accompanied by the greatest risk and compensation controls. Also, an incentive relating to a business activity, even a business activity that incurs substantial risk, appropriately may require no changes if the existing business risk controls are robust or are supplemented to become robust.

Competition Issues
Compensation risk should consider the competitive environment. Federal Reserve supervision of incentive compensation practices has the potential to affect the competitive environment in which financial institutions operate in ways in which the Federal Reserve does not intend. This is because the Guidance will affect financial institutions of varying size which operate in very different markets.

We support the Federal Reserve's principles-based approach and apparent intended flexibility rather than adopting one-size-fits-all rules. However, because financial institutions vary in size and in other important characteristics, it will be important that the Federal Reserve apply the Guidance flexibly as well.

In the context of Treasury Department regulations applicable to TARP recipients, we saw unintended results which derived from the varying size of financial institutions subject to such rules. For example, specific rules apply to the payment of certain forms of compensation to the senior executive officers and next twenty most highly-compensated employees. A key contributor at a large regional bank might be among the persons to which such rules limit permissible compensation. That person's current employer might reduce the amount of compensation paid to him or her in order to comply with TARP. However, a competitor which is a large money-center bank for example might be unrestricted in the amount or type of compensation it could pay this person, solely for the reason that this financial institution has more than twenty persons which are paid significantly more (and it is to only these relatively more highly compensated employees to which the TARP regulations apply). So while the rule applies to an equal number of employees, the varying size of the financial institutions to which it applies causes competitive concerns.

Similarly, in the context of the Federal Reserve's Guidance, it is important to recognize that it applies to employees of financial institutions with businesses far removed from traditional banking. These business units have competitors in the form of non-bank boutique investment firms, hedge funds, insurance companies, asset management firms, and others which are not subject to the Guidance. Ironically, the Federal Reserve could adversely affect the safety and soundness of its financial institutions if it applies the Guidance without regard to competitive market for key contributors, especially from unregulated entities. Therefore, we encourage the Federal Reserve to supplement the Guidance with an acknowledgement of the appropriateness of financial institutions to balance the business and compensation risks on the one hand with competitive concerns and the need to retain key contributors on the other hand.

Board Expertise and Resources
Finally, the Guidance discusses the role of the boards of directors of financial institutions. It states that one or more of the members of boards of directors of large complex banking organizations and large regional banking organizations should have a level of expertise and experience in risk management and compensation practices in the financial services industry that is appropriate for the nature, scope, and complexity of the organization's activities. While the Federal Reserve does not attempt to define in the Guidance the level of expertise and experience that is appropriate for such organizations, it appears to be creating a requirement of substantive qualification for one or more directors.

We agree that a board needs to have access to a wide variety of expertise, particularly with respect to rapidly changing areas such as compensation practices in the innovative financial services industry. However, we do not feel that it is good corporate governance to mandate that members of the board individually possess this experience. Rather, it is the responsibility of management to possess and develop this expertise, and for the board to supervise management. In addition, independent expertise is readily available to such financial institution boards.

In fact, under state corporation law, directors have a non-delegable duty to supervise management. Designating particular directors as the expert in this subject or that subject is not optimal for at least two reasons. First, it implies that the other directors have less responsibility or authority with respect to a given subject matter, which is not the case under the corporation law of most or all U.S. states. Second, it encroaches on the appropriate, respective roles of management and the board and wrongly suggests that boards have day-to-day, rather than supervisory, responsibility for these issues.

Additionally, we note that such a requirement may place an undue burden on financial institutions since there is a limited pool of persons suitable for service on boards who presently have this experience. In other words, there are few persons who have deep risk and financial services compensation experience presently available for service on a financial institution's board of directors, either as a result of their own employment, competitive sensitivities, issues related to interlocking directorates, and other reasons.

In the event the Federal Reserve does not alter this portion of its Guidance, the Federal Reserve should consider allowing financial institutions to educate existing board members about risk and compensation best practices. This is preferable to selecting new members to boards based on their *past* experience with compensation and risk management since these are ever-changing areas and such experience is likely to become stale quickly. The value and relevance of such experience erodes as business practices, market conditions, and regulatory requirements change, and all three of these areas have experienced rapid change recently. Therefore, the goal of having an informed board is best served by developing this expertise among management and allowing the board to supervise management.

If you have any questions or concerns, please do not hesitate to contact me.

Very truly yours,

Raymond Fortin

cc: Mimi Breeden
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