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May 31, 2011

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

Re: Docket No. R-1410; RIN No. 7100-AD69

Dear Ms. Johnson,

Pearl Meyer & Partners ("PM&P") is pleased to submit comments on the proposed release containing guidance to implement Section 956, the provision of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act") with respect to regulation of Incentive-Based Compensation Arrangements at certain financial institutions (the "Proposed Rules").

By way of background, Pearl Meyer & Partners is one of the nation's leading independent compensation consulting firms, serving Board Compensation Committees as advisors and assisting companies in the creation and implementation of innovative, performance-oriented compensation programs to attract, retain, motivate and appropriately reward executives, employees and Board Directors. We help Boards and Committees establish and maintain sound governance practices, particularly as this relates to executive and director pay decision-making. Since its founding in 1989, PM&P's compensation professionals have advised hundreds of organizations in virtually every industry, ranging from Fortune 500 companies to smaller private firms and not-for-profit organizations. In addition, we focus on serving the banking industry and have worked with hundreds of financial institutions.

Background – The Dodd-Frank Act

Section 956 of the Act requires the SEC, the OCC, Board of Governors of the Federal Reserve System ("Board"), FDIC, OTS, NCUA, and FHFA (collectively, "the Agencies") to jointly prescribe guidance with respect to incentive-based compensation practices ("ICAs") at covered financial institutions ("CFIs"). Section 956 specifically requires that the Agencies prohibit ICAs, or any feature of any such arrangement, at a CFI that the Agencies determine encourages inappropriate risks by providing excessive compensation, or that could lead to material financial loss. A CFI must also disclose to its appropriate Federal regulator the structure of its ICAs sufficient to determine whether the structure provides excessive compensation or could lead to material financial loss to the institution.

Specific Comments on the Proposed Rules

Definition of Executive Officer

The Proposed Rules define an "Executive Officer" as a person who holds the title or performs the function (regardless of title, salary or compensation) of one or more of the following positions: president, chief executive officer, executive chairman, chief operating officer, chief financial officer, chief investment officer, chief legal officer, chief lending officer, chief risk officer, or "head of a major business line." In our experience, the term "head of a major business line" is often difficult to define and may cover many individuals in sizeable organizations.

The final rules should contain more specific parameters as to how deep into an organization this position should go and exactly which types of business lines are intended to be covered (i.e., some organizations may categorize the head of human resources as head of a major business line, although we doubt the Proposed Rules are aimed at such positions).

The final rules should also explain whether the term "Executive Officer" includes individuals working in each subsidiary or division maintained by a parent. For example, a non-U.S. bank might do business in the U.S. through several subsidiary entities, each of which has a chief executive officer, chief financial officer, etc. As indicated below, if this is the case, we submit that the parent organization have the flexibility to determine that only the Executive Officers of the parent need be covered by this definition.

Definition of Covered Financial Institution

At an extreme, the term "CFI" in the Proposed Rules can apply too broadly. On this note, we believe that parent CFIs should be permitted to comply on their own behalf and on behalf of any subsidiary that is also a CFI by adopting procedures and by making reports to the parent CFI's primary regulator that cover both the parent CFI and any subsidiary CFIs.

Definition of ICAs

The Proposed Rules define ICA to mean any variable compensation that serves as an incentive for performance, with specific exclusions for salary, payments for achieving or maintaining professional certification or a higher level of educational achievement, company 401(k) contributions, and stock or other equity instruments that are owned outright by a "Covered Person" and not subject to any vesting or deferral arrangement, along with any dividends paid and appreciation realized thereon.

The Proposed Rules seek comment as to whether additional exclusions would be appropriate. We submit that an exception also be made for partnership and LLC interests – when such interests are not subject to any vesting or deferral arrangement – together with distributions and appreciation on such interests. In addition, we submit that the final rules clarify that options are excluded once they become vested, in the same manner restricted stock is excluded from the definition of ICA once it vests.

Finally, we note that the definition of ICA does not specifically address the type and form of compensation typically paid to Directors, who are covered by Section 956. For example, the current definition contains a specific exclusion for "salary" but not for "fees." We submit that fixed annual Director fees be specifically excluded from the definition of ICA.

Valuation of ICAs

We believe that in addition to defining ICAs, the Proposed Rules must provide a valuation methodology for consideration of ICAs (particularly with respect to calculating the mandatory deferral requirement, discussed below). Equity should be valued for ICA purposes at the time of grant, and dividends and appreciation of such equity between grant and vesting would be excluded, as it is the grant-date value that is considered when compensation decisions are made.

Mandatory Deferral Rules for Larger CFIs

The Proposed Rules require that for larger CFIs, at least 50% of the ICAs for Executive Officers must be deferred over at least three years. Consistent with the literal reading of the rules, we presume, and seek confirmation that grants of equity with multi-year vesting periods would already be considered "deferred" for purposes of the mandatory deferral rules. This would include, but not be limited to, grants of stock options, stock appreciation rights, and stock with time or performance conditions that vest over three years.

We are also concerned that application of this rule only to Executive Officers does not target risk mitigation at the correct population for numerous CFIs. Deferrals are most effective at mitigating excessive risk at levels where ICAs are highly leveraged and are many multiples of fixed pay. At most organizations, the most concentrated risk in the organization is taken by individuals other than Executive Officers (e.g., traders), and requiring deferral at that level of the organization may be more effective at controlling unwarranted, short-term risk than at the Executive Officer level (which, in public companies, is already highly regulated). While we appreciate that Covered Persons are subject to special review and approval, we are not convinced that this will produce the same risk-mitigating results as the mandatory deferral rule.

Determination of Total Consolidated Assets

The Proposed Rules apply to CFIs that have total consolidated assets of $1 billion or more, with further rules applicable to CFIs that have total consolidated assets of $50 billion or more. Determination of asset size is generally assessed by the institution's year-end financial statements or balance sheets. We believe that several clarifications are needed on this point:

- More specificity should be provided with respect to whether off-balance sheet activity should be included;
- More specificity should be provided with respect to whether asset size should include deferred compensation. Inclusion of deferred compensation would likely overstate the firm's true assets, and may in any case serve as a disincentive for firms under the mandatory deferral threshold to require deferrals; and
- Asset size should be indexed for inflation going forward so that smaller institutions that were never intended to be covered by these rules continue to be exempt.

Definition of "Excessive Compensation"

In describing factors that will be considered in determination of "excessive compensation," the Proposed Rules direct the regulators to consider, among other things, comparable pay practices at comparable CFIs. We are concerned that information regarding comparable pay practices will be difficult to obtain for non-pubic CFIs, and may in fact only be accessible by the regulator. As a result, private CFIs will be at a disadvantage in trying to understand comparable pay practices considered by the regulator when they are setting their pay. We also believe that the regulators should consider that pay practices at one organization may not be comparable to a similar CFI, because differing arrangements may be deemed necessary to attract and retain the best talent in a competitive environment at a given point in time. Accordingly, competition for talent and alignment with compensation philosophy and strategic goals should be considered in assessing "comparable pay practices."

Reporting Requirements

The Proposed Rules require CFIs to submit an annual report to their respective regulator(s) in a format specified that regulator. Such report would be required to describe the structure of the covered financial institution's incentive-based compensation arrangements for Covered Persons. We request that the final rules clarify that these reporting requirements are only to be applied prospectively, and not retroactively to compensation that has been previously awarded but not paid, or to compensation subject to existing employment agreements.

Timing of Annual Reports

With respect to the timing of reports, we are concerned that the requirement that total consolidated assets be determined based on a single date snapshot may inadvertently capture firms that only meet the $1 billion threshold on that particular date. In order to avoid inadvertently covering firms that would ordinarily fall below the $1 billion or $50 billion threshold, financial institutions should be permitted, where appropriate, to elect to measure assets by reference to a date that uses a median or average of a period of months or consecutive reporting periods (provided that the methodology used to select the reference date is applied consistently over time). This would also permit firms to select a reference date that coincides with their annual compensation review.

Form of Report for Multiple Agency Reporting

With seven different Agencies administering Section 956, we are concerned as to how consistently the Proposed Rules will be applied with respect to reporting and report formats. The general standards of Proposed Rule are very broad and we are concerned that there will be conflicting interpretations.

In addition, the Proposed Rules direct CFIs to submit their reports to their "primary regulators." Many financial institutions have multiple regulators and we are concerned such CFIs may have to develop multiple and potentially different reports for each, creating undue hardship particularly on smaller firms. We propose some basic guidelines be developed and shared across regulators such that one format for reporting can be used by a company to report to multiple regulators as required. In addition, we are hopeful that if a CFI reacts to comments from one regulator by changing its compensation arrangement(s), other regulators provide a consistent review of the new arrangement(s).

Closing Comments

We believe that the Proposed Rules, which will apply to thousands of very different institutions governed by seven different Agencies, apply a one-size-fits-all approach to compensation. Each of these organizations operates in a different way with different players, business models and risk factors. However, certain risk assessments and risk-mitigators would apply equally to all CFIs under the Proposed Rules. We believe that more general rules, such as those contained in the Guidance on Sound Incentive Compensation issued by the Board in 2010, use broader principles-based parameters that would be more appropriately applied to all CFIs. A one-size-fits-all approach with pre-set caps or limits is a poor construct for any compensation program. In order to promote the long-term success (as well as the safety and soundness) of institutions, compensation programs should always be specifically tailored to the organization's goals as well as the particular individual filling the role. No two organizations or executives are the same. Trying to homogenize compensation across or among organizations will jeopardize attraction, motivation and retention of talent, as well as impede organizational growth and innovation.

Moreover, it goes without saying that pushing organizations toward compensation programs with zero risk (i.e., 100% base salary and/or firm-wide profit-sharing programs) runs counter to the pay-for-performance linkage that investors and other stakeholders seek. Thus, some level of risk tied to performance is quite appropriate for compensation programs and, in a balanced program, encourages innovation, opportunity and growth. We are concerned that some of the rules will incentivize CFIs to base more of the total compensation program on fixed, rather than incentive compensation. As such, we are hopeful that in its review of ICAs, the Agencies will strike a careful balance between minimizing risk and preserving pay-for-performance principles.

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We appreciate the opportunity to comment and share our views. We note that PM&P is submitting this commentary on its own behalf, and not on behalf of any specific client. Please contact us at 212-407-9517 if you have any questions.

Sincerely,

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