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November 25, 2009

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

Re: Proposed Guidance on Sound Incentive Compensation Policies, Docket No. OP-1374, 74 Federal Register 55227 (October 27, 2009).

Dear Ms. Johnson:

The American Bankers Association¹ (ABA) appreciates the opportunity to offer comments on the proposed incentive compensation guidance recently issued by the Board of Governors of the Federal Reserve System (FRB). The ABA supports the principal goal of the guidance to ensure that incentive compensation arrangements at financial institutions do not encourage undue risk taking that could materially threaten the safety and soundness of the firm. As the Board recognizes, effective controls and risk management, coupled with strong corporate governance, including active oversight by the firm's board of directors, are a firm's best defense in ensuring that no individual or group of employees can create a material risk to the firm.

We do, however, have several concerns that we wish to highlight in this letter. First, the FRB should strongly emphasize, through examiner guidance and training, that there is no single correct method of structuring an appropriate incentive compensation plan and that any FRB identified "best practices" may not be appropriate for a particular banking organization. Rather, it is up to each organization to determine how best to structure a balanced incentive compensation arrangement and to manage the risks, if any, associated with that arrangement.

Second, the FRB should make clear that not all incentive compensation arrangements need be subject to heightened scrutiny under the FRB's guidance. Rather, banking organizations should be able to determine which incentive

¹ The ABA brings together banks of all sizes and charters into one association. ABA works to enhance the competitiveness of the nation's banking industry and strengthen America's economy and communities. Its members—the majority of which are banks with less than \$125 million in assets—represent over 95 percent of the industry's \$13.3 trillion in assets and employ over 2 million men and women.

compensation plans potentially pose risks to the safety and soundness of the organization and should be subject to the firm's risk management, control and corporate governance processes.

Finally, implementing the FRB's guidance should not impair a banking organizations' ability to retain and attract talented employees or adversely affect the privacy rights of those employees. Moreover, because many banking organizations operate globally, coordination and consultation with other regulatory authorities is essential.

DISCUSSION

The proposed guidance appropriately places the determination of how best to structure incentive compensation arrangements for each banking organization squarely on the shoulders of bank management and its board of directors. Specifically, banking organizations are expected to evaluate their incentive compensation arrangements for executive and non-executive employees who, either individually or as part of a group, have the ability to expose the firm to material amounts of risk. Banking organizations are also expected to review their risk management, control and corporate governance processes related to these arrangements and address any deficiencies in these arrangements or processes that are inconsistent with safety and soundness.

As the guidance notes, the prevalence and scope of incentive compensation arrangements will vary, generally with the scope and complexity of the organization's activities. Similarly, risk management and controls will vary across banking organizations according to the business model, risk tolerance, size and complexity of each firm.

No One-Size-Fits-All Approach

Consistent with this approach, the guidance does not mandate the use of a single formulaic approach to setting incentive compensation, partly in recognition that such singular approaches could provide certain employees with incentives to take on excessive risks. Moreover, while some banking organizations may find it helpful to defer a certain percentage of incentive compensation awarded to senior executives or to award a certain percentage of that deferred amount in the form of equity or equity-linked instruments, these approaches are just several of many measures that may be employed as part of balanced incentive compensation arrangements. As the guidance recognizes, other methods could include longer deferral periods and reducing the award rate as successive performance targets are met. Finally, by definition, a formulaic approach cannot embrace the diversity in terms of charter type, size, geography and business model of this nation's 7,000 plus banking institutions.

In this connection, we note that the guidance contemplates that through the special horizontal review of incentive compensation practices at large complex

banking organizations (LCBOs), as well as through the risk-focused examination process for all other banking organizations, the FRB will be able to identify emerging “best practices” in connection with incentive compensation arrangements. While ABA agrees that the future development and refinement of effective and balanced incentive compensation arrangements is to be encouraged, we are concerned that the FRB’s efforts to identify “best practices,”² through the use of multidisciplinary resource teams for supervisory staff and its planned 2011 report on trends and developments in incentive compensation arrangements, could have the unintended effect of dictating one-size-fits-all incentive compensation arrangements for banking organizations. To avoid this result, we strongly encourage the FRB, through examiner guidance and training, to educate its supervisory staff that the responsibility for structuring balanced incentive compensation arrangements appropriate for each particular banking organization rests not with the regulators but with bank management and its board of directors.

Minimizing Undue Burdens

The guidance recognizes that designing and implementing compensation arrangements that properly incent employees to pursue the organization’s long-term well being and that do not encourage excessive risk-taking is a complex task that requires the commitment of extensive resources. As an example, many public banking organizations have historically focused much of their scrutiny on their top five senior executive incentive compensation plans. Under the guidance, this scrutiny will now be expanded to cover:

- All senior executives and others who are responsible for oversight of the organization’s firm-wide activities or material business lines;
- Individual employees whose activities may expose the firm to material amounts of risk (e.g., traders); and
- Groups of employees who, in the aggregate, may expose the firm to material amounts of risk (e.g., loan officers).

While it is appropriate to focus beyond the incentive compensation structures of the top five senior executive officers, regulatory examination and supervision should, nevertheless, be narrowly focused on the incentive compensation plans of those employees or groups of employees that truly can affect the safety and soundness of the firm. In this vein, the guidance appropriately recognizes that certain job families pose little risk to the safety and soundness of the banking organization and, thus, are outside of the guidance.³ We strongly believe that

² Moreover, there is no reason to believe that “best practices” developed by proxy advisory firms and other similar market participants are superior to those handcrafted by a banking organization’s board of directors exercising its best business judgment. Unlike proxy advisory firms, bank compensation committee members generally share a deep and intimate knowledge of the organization, its risk appetite, and its risk management and controls.

³ The guidance specifically identifies tellers, bookkeepers, couriers, and data processing personnel as job families that are outside of the guidance.

risk management and control processes are the heart of safety and soundness, and, accordingly, the FRB should explicitly acknowledge in the guidance that banks can consider the effectiveness of these processes in determining which employees are “covered” by the guidance.

Similarly, banking organizations should also be able to demonstrate through their processes and controls that certain types of incentive compensation plans do not pose sufficient risk to the safety and soundness of the institution to come within the guidance’s coverage. For example, referral programs that reward employee’s small sums of money for sending a customer to an investment counselor pose little risk to the institution, especially as the referring employee has no control over whether the customer purchases an investment product. Employees, such as these, are less likely to engage in excessive risk taking when their incentive compensation is a small portion of their overall compensation. Profit sharing plans should also be excluded from the guidance’s coverage as they, too, poses little, if any, incentives for excessive risk taking.⁴

Retaining Talented Staff

The ABA strongly endorses the fact that the proposed guidance is consistent with the Principles for Sound Compensation Practices adopted by the Financial Stability Board (FSB) in April 2009, as well as the Implementation Standards for those principles issued by the FSB in September 2009. As the guidance recognizes, incentive compensation arrangements serve several important and worthy objectives, including helping to attract and to retain skilled staff and promoting better firm and employee performance. Given the global nature of financial services, coordination, as appropriate, with international and other domestic supervisors on compensation issues is central to the banking industry’s continued ability to retain and attract talented employees.

In this connection, we understand the need for the regulators to have access to confidential information concerning incentive compensation awards made. We are, however, concerned that, the guidance’s focus on increased disclosures could have the unintended consequences of undermining the banking organization’s ability to retain and attract talent, as well as violating individuals’ privacy. For example, the guidance emphasizes the need for banking organizations to provide sufficient information concerning its incentive compensation arrangements and related risk management, control and governance processes in order to allow shareholders to monitor and take action where appropriate. The FRB has stated its intention to work with the Securities and Exchange Commission to improve public banking organization incentive compensation disclosures in ways that

⁴ The FRB should make clear that language in the guidance suggesting that risk officers should receive incentive compensation based primarily on the achievement of objectives related to their functions (e.g., risk-adjusted performance or adherence to internal controls) does not prohibit bank risk officers from participating in incentive pools that are derived from company-wide financial performance. Bank risk officers frequently participate in these incentive compensation programs and these programs pose little risk to the safety and soundness of the banking organization.

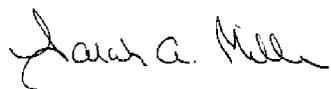
promote safety and soundness of the firms. The FRB has also suggested that its regulatory reporting forms may be amended to require certain information about incentive compensation awards and payments.

As the FRB is aware, recent public disclosures concerning certain firms' bonus payouts have caused those affected employees to be subject to unwarranted scrutiny and, in some cases, to fear for their personal safety. Even information disclosed at a summary level can be easily traceable to individual employees. We would encourage the FRB to tread carefully in this area and be mindful the impact these disclosures could have on banking organizations' ability to attract talent. In addition, information obtained through the examination process should be treated with the appropriate level of confidentiality that it deserves. For all these reasons, ABA does not support further public or regulatory reporting of incentive compensation arrangements, even if provided at a summary level.

CONCLUSION

In conclusion, the ABA appreciates the opportunity to offer comments on the FRB's incentive compensation guidance. The FRB should make clear that the guidance does not embrace a one-size-fits all model of compensation structures; that any "best practices" developed are suggestions at best; that only those job families and incentive compensation plans that pose risks to the safety and soundness of an organization should be subject to rigorous risk management, controls and corporate governance processes; and, finally, that care should be taken so that implementing the guidance does not impair a banking organization's ability to retain and attract talented employees.

Sincerely yours,

A handwritten signature in cursive script that reads "Sarah A. Miller".

Sarah A. Miller