



JOHANNES GUTENBERG
UNIVERSITÄT MAINZ



Johannes Gutenberg University of Mainz (JGU), 55099 Mainz, Germany
Chair of Banking

Faculty of Law and Economics

Chair of Banking

Professor Dietmar Leisen

Tel. +49 6131 39-25542

Fax +49 6131 39-29905

leisen@uni-mainz.de

www.finserv.bwl.uni-mainz.de

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Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

— **Proposed Rulemaking on Incentive-based Compensation Arrangements**

Dear Chairman Bernanke,

I am submitting this comment letter in response to the Notice of Proposed Rulemaking on Incentive-based Compensation. My comments focus on deferral arrangements.

— Professors Jennifer Carpenter and Professor Stephen Ross studied in two Journal of Finance articles how bonus schemes affect risk taking and showed that the size and sensitivity of the payments are important parameters to consider. Based on these I recently carried out a stylized analysis of bonus deferral arrangements entitled "Bonus Deferral does not Choke Excessive Risk-Taking," available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1662555

My paper cautions against the common thinking that deferral reduces risk taking. In fact, deferring payments will increase future payments further in those situations when a financial institution is already doing well; thus risk taking incentives may be strengthened instead of weakened. In addition to this size effect, deferral changes the sensitivity of incentive payments to the company performance.

I recommend regulating how deferred compensation is reduced at future payment dates. My analysis shows that the deferral ratio should not exceed the ratio of that sensitivity and the pay-for-performance sensitivity. For your proposed deferral ratio of 50% this means: when an executive's bonus increases by x dollars for each dollar of company performance, then her reduction in deferred compensation must be *at least* x/2 dollars for each dollar of shortfall.

Yours sincerely,

Dietmar Leisen, Professor of Banking