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Re: Notice of Proposed Rulemaking on Incentive-Based Compensation Arrangements (Federal Reserve Docket Nos. 1536, RIN No. 7100 AE-50; Docket ID OCC-2011-0001; SEC File No. S7–07–16)

Ladies and Gentlemen:

Teachers Insurance and Annuity Association of America ("TIAA" or the "Company") appreciates the opportunity to comment on the notice of proposed rulemaking on incentive compensation arrangements (the "Proposed Rule") jointly issued on May 16, 2016 by the Office of the Comptroller of the Currency (the "OCC"), the Board of Governors of the Federal Reserve System (the "Board"), the Federal Deposit Insurance Corporation (the "FDIC"), the Federal Housing Finance Agency, the National Credit Union Administration, and the U.S. Securities and Exchange Commission (the "SEC") (together, the "Agencies").

Founded by Andrew Carnegie in 1918 to offer retirement security for teachers and other persons employed by educational and other nonprofit institutions, TIAA is the leading provider of retirement services to the academic, research, medical, and cultural fields. Over our nearly century-long history, our mission has always been to aid and strengthen the institutions and participants we serve and to provide financial products that meet their needs. To carry out this unique mission, TIAA has evolved to offer a range of financial services, including asset management and retail services. Today, we manage over $861 billion in assets – including $272

billion in invested general account assets. Our investment model and long-term approach aim to benefit the five million participants we serve across more than 16,000 institutions.[1]

TIAA was incorporated as a stock life insurance company in the State of New York, and it is a licensed insurer in all states, the District of Columbia, and Puerto Rico. TIAA is a privately held, wholly owned subsidiary of the TIAA Board of Overseers, a special purpose New York not-for-profit corporation established to promote the welfare of the teaching profession by holding and administering all of the issued and outstanding stock of TIAA.[2] Our corporate charter requires TIAA to function as a nonprofit – such that we use operating earnings to fortify the overall organization. Consequently, TIAA's corporate interests are directly in line with those of our participants.

TIAA believes that incentive compensation arrangements are an effective tool of corporate governance and risk management, and TIAA uses incentive compensation arrangements to reward employees for serving the Company's mission of advancing our participants' interests. Properly designed, such arrangements align the interests of employees with the interests of the institutions where they are employed. Incentive compensation can encourage employees to work to maximize value for participants and allow institutions to acquire and retain an experienced and highly qualified workforce. Observers have long noted the important role that sound incentive compensation arrangements can play in aligning employee incentives with corporate goals. For example, a comprehensive review of compensation plans has demonstrated that financial incentives increase productivity and can lead to a more dedicated workforce, and researchers have shown that a well-implemented incentive compensation system can improve the work performed by employees.[3] Indeed, the Agencies themselves recognize in the Preamble to the Proposed Rule that "[i]ncentive-based compensation arrangements are critical tools in the management of financial institutions" that serve "important objectives," such as "attracting and retaining skilled staff and promoting better performance of the institution and individual employees," and that such arrangements can "promote the health of a financial institution by aligning the interests of executives and employees with . . . stakeholders."[4]

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1 Asset amounts provided are as of March 31, 2016.

2 Both the Company and the TIAA Board of Overseers are registered as Savings and Loan Holding Companies under the Home Owners' Loan Act.

3 Sara Rynes, Barry Gerhart, and Kathleen Minette, *The Importance of Pay in Employee Motivation*, 43 HUM. RES. MGMT. 381 (2004); *see also* Daniel Han Ming Chng et al., *When Does Incentive Compensation Motivate Managerial Behaviors?*, 33 STRAT. MGMT. J. 1343 (2012); Edward P. Lazear, *Performance Pay and Productivity*, 90 AM. ECON. REV. 1346 (2000).

4 81 Fed. Reg. 37,673-74 (Jun. 10, 2016); *accord* 75 Fed. Reg. 36,406 (Jun. 25, 2010) ("The Agencies recognize that incentive compensation arrangements often seek to serve several important and worthy objectives. For example, incentive compensation arrangements may be used to help attract skilled staff, induce better organization-wide and employee performance, promote employee retention, provide retirement security to employees, or allow compensation expenses to vary with revenue on an organization-wide basis."); Federal Reserve Bank of Philadelphia, *Incentive Compensation: Proposed Guidance to Help Equalize the Risks and Rewards* (2011) ("[I]ncentive compensation programs have been tools for the effective management of a financial institution. They provide easy avenues for attracting skillful staff, promoting performance, offering a security cushion for employees at retirement, and giving institutions the ability to better manage personnel costs.").

TIAA shares the Agencies' goal of minimizing risk to institutions from compensation arrangements that may encourage inappropriate risk-taking behavior. The Company has a long tradition of considered and thoughtful stewardship over the public equities in which our various funds and accounts are invested. Our Stewardship & Corporate Governance team, for example, votes on executive compensation-related items at annual meetings of over 9,000 companies around the globe in which we hold an ownership interest. When reviewing compensation programs and policies, we expect these companies – and independent compensation committees – to demonstrate an alignment between pay and long-term performance. We also hold companies, and boards of directors, accountable for the executive compensation decisions they make, including with respect to risk considerations.

Moreover, while TIAA is not a public company subject to SEC compensation disclosure rules, we have, where practicable, instituted the same principles and practices we promote for the public companies in which TIAA invests. For instance, the Human Resources Committee of the TIAA Board of Trustees voluntarily publishes a disclosure of compensation decisions for the Company's Chief Executive Officer, Chief Financial Officer, and next three most highly compensated policy makers. In addition, in 2007, the Company became one of the first U.S. companies to voluntarily adopt and implement an advisory vote on executive compensation policy, which annually gives TIAA policyholders an advisory vote on executive compensation policies and related disclosures. Finally, we maintain a robust enterprise-wide compliance program to ensure that incentive compensation arrangements are reasonable and appropriately balance risk and reward.

In crafting the final rule, TIAA urges that, rather than attempt to broadly and prescriptively regulate incentive compensation arrangements, the Agencies instead adopt a principles-based approach. Such an approach would be more effective at managing compensation practices in the long run and can be better tailored to the conditions of each institution so as to promote the goals of Section 956 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act"). Indeed, as the 2010 Guidance on Sound Incentive Compensation Policies – which was adopted by the Board, the OCC, the FDIC, and the Office of Thrift Supervision, Treasury – recognizes, a "principles-based framework . . . is the most effective way to address incentive compensation practices, given the differences in the size and complexity of banking organizations covered by the guidance and the complexity, diversity, and range of use of incentive compensation arrangements by those organizations."[5] In TIAA's view, the existing principles-based guidelines have been effective in regulating and improving incentive compensation practices so as to minimize risk. Refining these guidelines using a principles-based framework can enable the Agencies to tailor rules based on an individual institution's risk profile. Furthermore, a principles-based approach reduces the specter that talent will be driven towards financial institutions (or other sectors) that, for one reason or another, are not subject to the same prescriptive requirements under the Proposed Rule. We respectfully submit that the Agencies have not presented evidence that another approach is now more appropriate or necessary.

[5] Guidance on Sound Incentive Compensation Policies, 75 Fed. Reg. 36,399 (Jun. 25, 2010).

Along these lines, we offer below these specific comments on the Proposed Rule:

(1) The Proposed Rule should apply a principles-based approach that accounts for the lower risks associated with assets held in a life insurance company general account.

(2) In making consolidated assets the sole criterion for classification, the Proposed Rule's three-level tier structure is not adequately tailored to institutional risks and could create unintended competitive imbalances.

(3) Automatically regulating subsidiaries and affiliates at the same level as the corporate parent imposes burdens on subsidiaries that are not commensurate with potential risks.

(4) The definitions of "covered person" and "significant risk-taker" sweep too broadly and include large numbers of employees who are unlikely to expose financial institutions to risk.

(5) The deferral, forfeiture, and clawback requirements for Level 1 and Level 2 covered institutions are unnecessary to mitigate risk and may undermine the benefit of effective incentive compensation arrangements.

The Proposed Rule should apply a principles-based approach that accounts for the lower risks associated with assets held in a life insurance company general account.

Our foremost concern is that the Proposed Rule uses the amount of an institution's assets as the *sole* basis for applying more stringent incentive compensation restrictions. In our view, such an approach does not sufficiently account for the individual investment and risk characteristics of particular types of businesses. In particular, we encourage the Agencies to adopt a principles-based approach in the final rule that accounts for the lower risk profile of covered institutions that are insurance companies. *See* Question 2.12. If the final rule is not so tailored, and instead adheres to a bright-line approach focused solely on consolidated assets, insurance companies will be negatively impacted and put at a competitive disadvantage in the market solely because of the general account assets they maintain under insurance regulatory requirements designed to mitigate risk. In essence, the Proposed Rule tells an insurance company like TIAA that merely by virtue of holding the very general account assets that mitigate risk and satisfy prudential insurance regulatory requirements, the insurance company will be treated as posing *greater* risk for incentive compensation purposes. There is no basis in logic for this disparate treatment.

To underscore this point, it bears briefly recalling certain fundamental aspects of life insurance companies' investment and risk profiles:

- First, insurance investments rarely entail the risk of mismatch of assets and liabilities often present in other financial institutions, such as at banks. Rather, life insurance products (including annuities) require policyholders to pay premiums in exchange for a legal promise that is often finally settled years in the future.

- Second, because the payment of benefits is tied to the occurrence of specified events (*e.g.*, annuities begin payment at a specified age or date; term life insurance is paid upon the death of the insured), insurance liabilities also tend to operate independent of the business cycle and an insurer's payout schedule is not a function of economic conditions.
- Third, unlike banks, insurers' stable liability profiles provide them far greater freedom to choose when to sell assets, and they are unlikely to be forced to liquidate assets to satisfy short-term obligations in times of economic difficulty or market disruption.[6]
- Finally, extensive regulation of the safety of insurance assets already protects against inappropriate risk-taking by insurers. For example, the National Association of Insurance Commissioners' Risk-Based Capital framework establishes a minimum level of necessary capital that allows regulators to determine when an insurance company may be at risk of insolvency. General account assets are also subject to restrictions on when and how they can be invested. As a New York-regulated insurer, for example, TIAA must attain regulatory approval before committing more than twenty percent of admitted assets to medium grade or lower investments. (In TIAA's case, our general account assets are primarily invested in conservative fixed income assets, which raise little possibility or opportunity for inappropriate risk-taking behavior.) So, too, is our use of derivatives is strictly controlled, with our state regulator requiring TIAA to submit a derivative use plan.[7]

In related contexts, the Board itself has recognized that insurance companies have a lower risk profile that must be considered. For example, Governor Daniel K. Tarullo recently noted that "the funding structures of traditional insurers are generally much more stable than the funding structures of commercial banks" and that because insurance "claims generally cannot be accelerated, companies engaged in traditional insurance activities are less vulnerable to runs and, accordingly, to short-term pressures to sell assets into declining markets."[8] This business

[6] As the International Association of Insurance Supervisors ("IAIS") has explained, insurance underwriting risks generally are "not correlated with the economic business cycle. The nature of insurance liabilities, and the fact that payments to policyholders generally require the occurrence of an insured event, makes it less likely for insurers engaged in traditional activities to suffer sudden cash runs that would drain liquidity." IAIS, *Global Systemically Important Insurers: Proposed Assessment Methodology* (May 31, 2012), at 9. In the same consultation document, the IAIS identified several differences between insurance and banking including: (i) insurers use a predominantly liability-driven investment approach; (ii) insurance rests on the pooling of risks and probability theory; and (iii) the nature of insurance claims result in cash outflows that are likely to occur over an extended period. *Id.* at 8.

[7] N.Y. Ins. Dep't Reg. 163, § 178.3(a)(1) ("The insurer shall submit a derivative use plan, or amendment thereto, to the superintendent for prior approval."). Similarly, the National Association of Insurance Commissioners' Derivative Instruments Model Regulation sets standards for the prudent use of derivative instruments by insurance companies, requiring insurance companies to establish written guidelines for transacting in derivative instruments and internal control procedures describing elements including monitoring of derivative positions and the credit risk management process. NAIC Model Reporting Service, Vol. III at 282-1 (2009).

[8] Governor Daniel K. Tarullo, *Insurance Companies and the Role of the Federal Reserve* (May 20, 2016), *available at* http://www.federalreserve.gov/newsevents/speech/tarullo20160520a.htm.

structure insulates insurers from short-term market swings and leaves them less vulnerable than banks to the latent risks that inappropriate incentive compensation arrangements may foster.[9]

Consequently, TIAA believes the definition of total consolidated assets should exclude insurer general account assets *entirely*. Much like an investment adviser's non-proprietary assets under management – which the Proposed Rule excludes from the definition – an insurance company's general account assets are ultimately held for the benefit of its customers and are managed in accordance with the obligations the company owes to those customers. These assets should not be treated as the equivalent of bank assets and should not trigger more stringent restrictions on incentive compensation.

If, however, insurer general account assets are included in computing total consolidated assets, the final rule should tailor its requirements to the specific risk profile of the assets and the institution. Under such an approach, the Agencies could apply requirements that more accurately reflect an insurer's lower risk profile, which could militate against the potential competitive disadvantage that insurers might otherwise face in the market for qualified employees. Indeed, the Board recently suggested a similar approach in its advance notice of proposed rulemaking related to capital requirements for insurance entities. In that proposal, the Board suggested using weights and risk factors to account for the nature of insurance liabilities and assets.[10] More tailored principles-based guidelines here would provide flexibility for the Agencies to modify the level of restriction based on the assets and actual activities of the specific institution through the ongoing supervisory process, enabling the Agencies to impose more stringent restrictions on institutions engaging in activities that create a greater risk of material losses or systemic risk (through affiliates or otherwise), while not imposing similar restrictions on institutions where such restrictions are not warranted based on their risk profile.[11]

The Proposed Rule's three-level structure is not adequately tailored to institutional risks and could create unintended competitive imbalances – particularly for covered institutions organized as insurance companies.

The Proposed Rule separates covered institutions into three tiers based on an institution's "average total consolidated assets." The Preamble to the Proposed Rule explains that the tiered approach is based on the premise that "larger financial institutions have more complex structures and operations . . . [that] make controlling risk-taking more difficult." 81 Fed. Reg. at 37,687. The Agencies invite comment on whether this is a "workable approach for categorizing covered institutions by asset size," and "whether the asset thresholds used in these definitions would

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9 Similarly, most insurers authorized to do business in the United States prepare statutory financial statements in accordance with statutory accounting principles (SAP) – which are developed in accordance with the concepts of consistency, recognition and conservatism, and stresses measurement of the ability to pay claims of insurers in the future – rather than Generally Accepted Accounting Principles (GAAP). *See* 12 U.S.C. § 5371(c)(3)(A) (prohibiting requirements that an insurer prepare financial statements using GAAP).

10 *See* 81 Fed. Reg. 38,635–36 (June 14, 2016) ("As distinguished from the Board's consolidated capital requirements for bank holding companies, the [approach] would use risk weights and risk factors that are appropriate for the longer-term nature of most insurance liabilities.").

11 *See, e.g.*, 81 Fed. Reg. at 38,633 (stating that capital requirements should be tailored to the lower risk of insurance assets, while also taking into account "risks across the entire firm").

divide covered institutions into appropriate groups based on how they view the competitive marketplace." *Id.* at 37,690; *see* Questions 2.6, 2.7.

We are concerned this three-tier structure is too categorical and does not allow the level of regulation to appropriately reflect the risk profile of each institution. While size is surely *one* relevant factor in determining whether compensation practices at an institution may create inappropriate risk, it should not be the dispositive factor – and it should not be the *only* factor. In TIAA's view, asset size alone does not necessarily reflect the potential risks that may be posed by incentive compensation arrangements at institutions.[12] On the contrary, as discussed in the section above, the larger general account balances of insurance companies are generally an indicator of stability and reduce the potential that risky behavior by an individual employee could cause material loss to the institution. Rather than mere asset levels, we believe the nature and scope of an institution's proprietary assets (excluding general account assets for the reasons discussed above), investments, and trading activities are a more effective indicator of systematic risk.

Additionally, the three-tier approach would be both under- and over-inclusive. Large institutions with stable management and industry-leading risk controls, like TIAA and its subsidiaries, will be subject to extensive new prescriptive requirements on incentive compensation. Meanwhile, other institutions – which, in some cases, could present more risk to the financial system – may be largely exempt from compensation restrictions merely because of their corporate structure. For example, a covered institution with $49 billion in high-risk derivatives could present more risk to the U.S. financial system than an institution with $250 billion in large-cap equity securities or investment-grade debt securities. Indeed, there is no indication that Congress intended for the Agencies, in carrying out Section 956 of the Act, to impose a three-tier structure with comprehensive restrictions on only the largest institutions and relatively few restrictions on institutions with less than $50 billion in assets, regardless of actual risk.

The three-tier structure of the Proposed Rule also has the potential to destabilize the market for highly qualified financial-institution employees by imposing significant differences in regulatory burden based on differences in assets. Applying categorical and arbitrary asset thresholds at $50 billion and at $250 billion creates inflection points that could cause discrepancies in the regulatory burdens of similarly situated financial institutions. There is no practical difference between a $249 billion institution and a $251 billion institution, yet under the Proposed Rule the compensation structure of the latter would be subject to substantially more prescriptive regulation. This could have unintended consequences, leading key personnel to leave firms with large consolidated assets (including, for instance, insurance companies with large general accounts) for other firms with fewer controls on their incentive compensation structures, including some of the world's largest asset managers that – merely because they hold relatively small amounts of assets on their own balance sheets – would be subject to less onerous requirements, or entities that are subject to less overall regulation, like hedge funds. The SEC's Economic Analysis speculates that, even in the face of such restrictions, employees might value

[12] Furthermore, we do not believe that intangible assets (such as goodwill on a company's balance sheet) are the kinds of assets that incentivize risk-taking activities.

"non-pecuniary job benefits such as prestige, networking, and visibility." 81 Fed. Reg. at 37,785. As a practical matter, however, these non-pecuniary benefits often may not outweigh the uncertainty of having compensation subject to deferral, forfeiture, or clawback for more than a decade after the performance period.

This disparate treatment of institutions based on the sole proxy of consolidated assets is of significant concern to TIAA. In particular, such an approach could make it difficult for larger institutions like ours to recruit and retain key employees. Talented employees may opt to leave a Level 1 institution or its subsidiaries for a Level 2 or Level 3 institution where they can receive similar compensation without the delay or long-term uncertainty created by the Proposed Rule.[13] And, as the proposal recognizes, "the proposed rule may result in losses of managerial talent that may migrate from covered institutions to firms in different industries or abroad." 81 Fed. Reg. at 37,763. This is particularly true where employees have skill sets that translate across industries, such as information technology, cybersecurity, human resources, customer service, and general management. *See* Question 2.17.

The effect of losing these individuals will be to weaken financial institutions that face restrictions merely due to the size of their consolidated assets. Rather than protecting against acutely risky compensation practices, the rules may contribute to a deficit of managerial talent at large financial firms, potentially creating more risk to financial institutions. Alternately, qualified employees may demand a larger portion of their compensation in guaranteed salary, thereby making it harder to align the interests of employees and shareholders.

Several alternative approaches would fulfill the congressional directive to proscribe arrangements that encourage inappropriate risks, without altering the competitive balance among employers. The best approach would be to develop additional principles-based guidelines for compensation structures – an approach that is reflected in existing guidance issued by the Board. In fact, as the Preamble to the Proposed Rule notes, institutions have already taken significant steps to improve their compensation structures to minimize risk. The 2010 Guidance on Sound Incentive Compensation Policies and related supervisory activities have provided financial institutions with significant guidelines for designing compensation systems. Through evaluation factors and benchmarks, the relevant agencies have allowed financial institutions to structure incentive-based compensation in a flexible manner appropriate for the institution, its business plan, and its strategic focus. While the Agencies state in the Preamble that "there are even greater benefits possible under rule-based supervision," there is little in the Proposed Rule that explains the reasons *why* the Agencies have formed this conclusion. Rather than imposing a new set of regulatory requirements, the Agencies should build on the existing principles-based structure, which by all indications is working as designed.[14]

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[13] The impact may be particularly acute in asset management affiliates and subsidiaries of insurance companies. Many such affiliates may not manage any proprietary assets or assets affiliated with the insurance company at all. In addition, the asset management affiliates typically have incentive compensation plans intended to mimic the non-bank and non-insurance company asset managers with which they compete for portfolio management and other talent in the marketplace.

[14] TIAA, for example, has worked closely with the Board, its primary prudential regulator, during supervision to design and improve compensation arrangements.

To the extent the Agencies retain the tiered rules-based approach, it should be modified to allow for greater flexibility in application. This need for flexibility is already acknowledged in the Proposed Rule's provision allowing a Level 1 institution, based on its operations and level of complexity, to be treated as a Level 2 institution for the purpose of determining the percentage of employees deemed "significant risk takers." *See* 81 Fed. Reg. at 37,808, § 236.2(hh)(4). The Agencies should consider additional mechanisms by which a regulated entity can demonstrate that its risk profile warrants treatment as a lower-level entity. At a minimum, the Proposed Rule should be adjusted to reflect the relative lack of risk posed by insurance companies. For example, the Proposed Rule defines Federal Home Loan Banks as Level 2 covered institutions "because generally for the Federal Home Loan Banks, asset size is not a meaningful indicator of risk." 81 Fed. Reg. at 37,688. A similar consideration should apply for TIAA and other insurers with a lower risk profile. But as noted above, should the Agencies retain the tier structure in the final rule, the manner in which total consolidated assets are measured should account for differences in the types of assets maintained on a covered institution's balance sheet.[15]

Automatically regulating subsidiaries and affiliates at the same level as the corporate parent imposes burdens on subsidiaries that are not commensurate with their risks.

In general, the Proposed Rule imposes the regulatory requirements of the highest-level corporate entity on subsidiaries and affiliates, provided that the affiliate itself holds more than $1 billion in assets and therefore qualifies as a "covered institution." The Agencies requested comment on whether this is the best approach. *See* Questions 2.5, 2.8. Although the interconnected nature of many institutions has sometimes been a source of financial risk, automatically imputing the parent's status to all affiliates, without regard to the nature or scope of the affiliate's business activities, potentially subjects affiliates to requirements that may not be commensurate with their business or investment activities or risk profile.

The classification approach in the Proposed Rule is particularly problematic for affiliates and subsidiaries of insurance companies. As discussed above, insurance companies maintain large general accounts that have low risk profiles. But the Proposed Rule would disregard altogether this low risk profile and the fact that many affiliates do not manage any proprietary assets (or assets affiliated with the parent insurance company at all). Rather, the mere existence of an insurance general account would result in the insurance company being treated as a risky institution. And not only would the insurance parent be treated as such; so, too, would the insurance company's affiliates and subsidiaries, arbitrarily placing them into the highest risk category regardless of actual risks posed to the parent or its affiliates as a result of the affiliates' business or investment activities. Such an attribution of a parent institution's level to a subsidiary or affiliate is detrimental both to insurance companies and to entities that might consider affiliation with insurance companies.

In the case of TIAA, many of our affiliated adviser and broker-dealer entities are housed within our TIAA Global Asset Management ("TGAM") division. TGAM and its affiliated adviser and broker-dealer affiliates act as agents for their clients or customers under client-

[15] As a technical matter, we note that the Proposed Rule defines "average total consolidated assets" as "the average of a regulated institution's total consolidated assets . . . for the four most recent consecutive quarters." 81 Fed. Reg. at 37,807, § 236.2(b). But this definition is insufficiently clear for entities such as TIAA, which is not required to (and does not) report assets on the forms identified in the Proposed Rule.

approved and, in the case of registered funds, board-approved, investment mandates and guidelines. In addition, except with respect to initial seed capital for newly launched funds or operating subsidiaries, neither TGAM nor any of its affiliates trades securities or other instruments for the benefit of its own balance sheet. Any risk that TGAM or its affiliates might present to TIAA are mitigated by a wide range of current and proposed SEC rules on liquidity, risk, derivatives, and asset segregation along with the Board's anticipated stress testing rules. Consequently, we do not believe the TGAM and its affiliates present systemic risk for TIAA or the U.S. financial system.[16]

Nevertheless, under the imputed classification approach of the Proposed Rule, TGAM and its affiliates that qualify as covered institutions would be swept into TIAA's classification – which, under the Proposed Rule, would be Level 1 – thus subjecting these entities to the Proposed Rule's most rigorous requirements. Effectively, this designation could subject TGAM and its affiliates to a higher level of regulation than many of TGAM's competitors, but without *any* assessment or consideration of potential risks of TGAM's actual business activities.

We question whether this is a sound public policy objective, particularly given that smaller financial institutions may achieve considerable business and regulatory efficiencies through merger or affiliation with larger institutions. Moreover, larger institutions like TIAA are able to better diversify risks and activities through the ownership and acquisition of affiliates. These affiliations may also be beneficial to our participants. For example, in addition to insurance products, TIAA provides related financial services to our participants, who benefit from being able to bank, invest, and save for retirement through a related group of companies. The Proposed Rule could significantly deter such relationships to the detriment of both covered institutions and their customers.

Accordingly, with regard to subsidiaries and affiliates, we urge the Agencies also to adopt a more flexible, principles-based approach that enables each Agency to determine when a subsidiary or affiliate relationship poses risks to the larger organization and how best to mitigate those risks. Rather than a *per se* rule, such a principles-based approach would consider individual characteristics of a subsidiary-parent relationship and the specific nature and characteristics of the affiliate's business or investment activity.

In particular, we support the approach to the "operational integration" test for subsidiaries and affiliates that is being proposed by the Investment Company Institute ("ICI") in its comment letter to the Agencies. ICI's proposed approach would treat certain affiliates, including registered investment advisers, and other asset management-related entities, as separate from their parent company for these purposes based on a balancing of certain factors that demonstrate whether and to what extent the affiliate actually operates independently from its parent. These factors would include, among others, (i) the extent to which there are overlapping officers and other personnel, (ii) whether investment voting decisions are made independently, and (iii) the extent to which the parent and affiliate maintain and implement effective information barrier and other procedures

[16] We note as well that asset management divisions within insurance companies and banks provide product and income diversification benefits to the larger organization through expanding the sources of revenue and decreasing institutional reliance on spread versus fee income. This fact tends to mitigate risk to the larger organization. Insurance-owned asset managers must be able to attract and retain top talent in order to achieve that diversification and do it well.

that are intended to ensure that they operate independently from each other and do not share confidential or sensitive investment-related data. In addition, we recommend additional factors including (i) whether a majority of the affiliate's directors overlap with the directors or executive officers of the parent company and (ii) whether proxy voting decisions are made independently.

Under this type of principles-based approach to evaluating subsidiaries and affiliates with a parent bank or insurance company, the relevant Agency will have a more thoughtful and accountable approach for evaluating the investment and business activities of the affiliate and determining whether (i) the affiliate creates financial or operational risk to the parent (*e.g.*, due to high-risk trading activity) and (ii) treating the affiliate separately would otherwise undermine the purposes of the rule or other relevant regulatory requirements. Indeed, this type of principles-based approach that balances multiple factors around control and independence is well grounded in prior SEC precedent that addresses similar issues in the context of aggregation of securities holdings for purposes of Schedule 13D and 13G filings.[17] Accordingly, the use of such an approach in the final rule will result in a more measured and tailored determination of whether, based on the totality of the circumstances, to apply or impute the level of the parent to its subsidiaries and affiliates.

The definitions of "covered person" and "significant risk-taker" are overbroad and include large numbers of employees who are unlikely to expose financial institutions to risk.

We also believe that the definitions of "covered person" and "significant risk-taker" are too broad, and we respectfully recommend these definitions should be narrowed in the final rule. The Proposed Rule defines "covered person" as any employee who receives any part of his or her compensation through incentives. This definition subjects nearly every TIAA employee to compensation controls. TIAA, like many other financial services companies, offers incentive compensation (such as annual cash bonuses) to many employees who cannot plausibly create risk for TIAA or the financial system more generally, such as employees in purely administrative or "back office" roles and very junior positions. There is no evidence that Congress intended for the Agencies to regulate compensation in such a broad, sweeping manner.

Although the most significant restrictions in the Proposed Rule do not apply to all covered persons, this overbroad definition exposes employees to the uncertainty of compensation regulations and may encourage many lower-level employees to seek similar employment in other industries, or at non-covered institutions. As previously noted, TIAA believes a principles-based approach is preferable and would largely eliminate this concern by focusing on arrangements that in fact "encourage[] inappropriate risk." 12 U.S.C. § 5641(b). But in any event, the term "covered person" should be defined to include only those individuals whose seniority and compensation structures may create a prospect of inappropriate risk-taking that could lead to a material financial loss to a financial institution.

Besides soliciting feedback on the definition of "covered person", the Agencies also solicited feedback on the definition of "significant risk-taker" and whether that definition is appropriate. *E.g.*, Question 2.33. We also believe that the definition of "significant risk-taker" in the Proposed Rule is overbroad and recommend that it be narrowed. In particular, the use of

[17] SEC Rel. No. 34-39538 (Jan. 12, 1998).

the relative compensation test subjects compensation plans to additional regulation without regard to whether those plans actually encourage inappropriate risks. The relative amount of employee compensation is a poor proxy for the ability to expose an institution to risk. TIAA has several hundred employees who are compensated in the top five percent of all employees, but whose activities pose little risk to the institution. These include non-executive employees and those in back office or support positions. Many of these employees could obtain employment for similar compensation at other financial or non-financial entities without being subject to deferral, forfeiture, or clawback requirements. The broad "significant risk-taker" definition could make it substantially more difficult for TIAA to recruit and retain these high-quality employees, many of whom are critically important to internal operations, support, and control functions.

Additionally, while the exposure test in § 236.2(hh)(1)(iii) is more closely related to an employee's ability to put assets at risk, TIAA believes the test will be too difficult to implement and manage to be a workable standard. The Proposed Rule does not adequately define "capital," as the Preamble to the Proposed Rule contemplates that the Board may define that term on a case-by-case basis for certain institutions. 81 Fed. Reg. at 37,692, n. 83. The Proposed Rule's calculation of the 0.5 percent threshold is also not tailored to mitigating risk – and may, in fact, increase risk. For example, the cumulative authorization methodology treats an employee who is authorized to expose a small amount of capital each day the same as another employee who is authorized to expose a substantial amount of capital on a one-time basis, despite the very different risk profiles generated by these activities.

The best way the Agencies could mitigate or eliminate these concerns would be to retain the current principles-based approach that focuses on the types of activities in which employees are engaged, rather than adopt prescriptive definitions or thresholds.[18] Alternatively, the Agencies could utilize the approach adopted in § 236.2(hh)(2) of the Proposed Rule, by which the appropriate Agency or the covered institution could designate an employee as a "significant risk-taker." This option provides more flexibility to ensure that the enhanced restrictions on incentive-based compensation target only those employees whose activities give rise to institutional risk.

The deferral, forfeiture, and clawback requirements for Level 1 and Level 2 covered institutions are not necessary to mitigate risk and may undermine the benefits of effective incentive compensation arrangements.

TIAA supports the Agencies' efforts to align employee incentives with the long-term interests of institutions. And we agree that aligning those interests will improve the performance of institutions and could improve the health of the financial system. We do not believe, however, that the mandatory deferral, forfeiture, and clawback mechanisms in the Proposed Rule are necessary to deter inappropriate risk-taking. *See* Questions 7.4, 7.5.

Using such mechanisms may be at times justified as part of a compensation plan; in fact, TIAA uses similar mechanisms in the compensation of some employees. For example, at least half of the Executive Management Team's incentive compensation award is deferred for three years under the TIAA Long Term Performance Plan ("LTPP"), while the percentage of such

[18] *See* 75 Fed. Reg. at 36,407.

awards deferred for other employees progressively increases as total compensation increases. But the categorical nature of the Proposed Rule does not consider scenarios where such measures are not necessary, appropriate, or effective.

The specific deferral, forfeiture, and clawback requirements in the Proposed Rule are not justified by any meaningful determination or fact-finding that the restrictions are necessary to prevent inappropriate risk-taking. As the Agencies acknowledge, "the existing academic literature does not provide conclusive evidence about a specific type of incentive-based compensation arrangement that leads to inappropriate risk-taking without taking into account other considerations." 81 Fed. Reg. at 37,763. Given this general uncertainty, it is unclear how the Agencies concluded that long deferral, forfeiture, and clawback periods are necessary to prevent inappropriate risk-taking. Further, because they are unsupported by specific evidence or fact-finding, the time periods and deferral percentages in the Proposed Rule are arbitrary. For example, the Agencies do not explain why an incentive compensation arrangement at a Level 1 institution that does not defer at least sixty percent of senior executive compensation for at least four years encourages inappropriate risk-taking, while the same arrangement at a Level 2 institution does not.

Under the Proposed Rule, an executive at a Level 1 entity would face uncertainty about his or her compensation for up to *eleven* years after the end of the relevant performance period. Rather than acquiesce to such substantial uncertainty regarding their earned compensation, highly qualified managers and other personnel with translatable skills may migrate to lower-level institutions or leave the financial industry altogether. Imposing such long time periods for these adjustments fails to take account of the reality that that many years down the road, the risk to a financial institution is far more likely to be caused by market, economic and other forces (*e.g.*, recessions, inflation, or geopolitical disruptions) that are beyond the control of covered persons and significant risk takers at financial institutions. If these incentive compensation adjustment mechanisms are ultimately retained in the final rule, we believe that they should be much closer in time (*e.g.*, 12-18 months) to the end of the performance period.

The deferral, forfeiture, and clawback restrictions in the Proposed Rule also expose financial institutions to the prospect of regulatory action based on loosely defined standards. *See* Question 7.26. The rules mandate that institutions "must consider forfeiture and downward adjustment" due to certain adverse outcomes without adequately defining those outcomes. For example, a financial institution would violate the Proposed Rule if it failed to consider downward departure based on "poor financial performance attributable to a significant deviation from the risk parameters set forth in a covered institution's policies and procedures." But the rule does not define "poor financial performance" or "significant deviation." 81 Fed. Reg. at 37,810, § 236.7(b)(2)(i). This uncertainty is of particular concern for entities like TIAA, which are regulated by several Agencies and that may be subject to varying applications of the rule. This regulatory overlap will almost certainly lead to instances where employees of the same institution, or even the same incentive compensation arrangements, are treated differently across regulators. Without additional guidance, many institutions may seek to avoid the regulatory uncertainty of these requirements by simply abandoning incentive compensation arrangements altogether.

Well-designed compensation plans provide meaningful incentives for employees to act in the interests of their institution, and we have serious concerns about the Proposed Rule's effect on such incentives used by TIAA. Because TIAA is a private company that does not have publicly-traded stock, our long-term compensation does not use equity awards (*e.g.*, issuance of restricted stock or stock options) or other incentive vehicles tied to the value of TIAA. Instead, we have developed the LTPP to align a portion of the compensation of senior employees to the experience of our participants. To this end, we grant deferred cash awards for which the ultimate value is based on the results of a multifactor composite "scorecard" that is designed to measure how efficiently we operate our business and deliver results for our participants. The scorecard incorporates a range of business objectives, including participant satisfaction, assets under management, relative investment performance, and results of operations.

But because it prohibits the increase in the value of deferred compensation during the mandatory deferral period (other than "an increase in value solely attributable to a change in share value, a change in interest rates, or the payment of interest according to terms set out at the time of the award"), the Proposed Rule would appear to prohibit TIAA from maintaining the LTPP as a vehicle for the mandatory deferrals required under the Proposed Rule. 81 Fed. Reg. at 37,804. This would put TIAA (and non-public institutions with similar compensation programs) at a competitive disadvantage to public companies or other entities that use equity-based awards, which can continue to provide an opportunity for performance-based upside during the mandatory deferral period. This is especially harsh for TIAA given the nature of our business (as a not-for-profit created to provide retirement services to the academic, research, medical, and cultural fields) and the steps we have taken to ensure that compensation is aligned with the results experienced by our participants.

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TIAA appreciates the opportunity to comment on the Proposed Rule. As a leading provider of retirement and financial services, and as leading advocate for appropriate corporate governance over incentive compensation arrangements, TIAA strongly agrees that financial institutions should structure their compensation arrangements in such a way as to avoid inappropriate risk. We support the Agencies' goal in this effort. But as we have noted, elements of the Proposed Rule could harm efforts to align employee incentives with the long-term interests of an institution like TIAA. We hope that our comments are given careful consideration and will serve to improve the final rule.

Sincerely yours,

Jonathan E. Feigelson