23 November 2016

Gillian M. Burgess
Counsel, Legal Division
Board of Governors of the Federal Reserve System
Washington D.C.
20551

**Re: Re-proposed Rule on Incentive-Based Compensation Arrangements**

Dear Ms. Burgess:

Thank you to you and all the other regulatory agencies for meeting the SIFMA Delegation on 2 November to discuss our comment letter on Section 956 of the Dodd Frank Act. We offered to provide supplementary information on some aspects of our comments.

**Covered Persons - Significant Risk-takers**

In SIFMA's comment letter[1] on the re-proposal we argued that the final rule under Section 956 should impact the design of incentive-based compensation for employees who have the ability, either individually or as part of a group, to expose their employers to material amounts of risk. We argued further that "significant risk-takers" should be a subset of that group of employees, identified generally based on a functional standard.

The re-proposal defines "significant risk-taker" in substantial part based on a compensation ranking, with the highest 5% (for Level 1 covered institutions) or 2% (for Level 2 covered institutions) designated generally as significant risk-takers.

At our meeting on November 2 you asked how the number of employees who would be designated as significant risk-takers based on our proposed functional approach would compare with the number of employees who would be designated as significant risk-takers based on the compensation ranking

[1] http://www.sifma.org/issues/item.aspx?id=8589961618

approach of the re-proposal. We replied that the answer would vary substantially from one financial institution to another, with a principal factor being the number of lower-paid employees (e.g., tellers or other retail bank employees) at the financial institution. For example, consider two Level 1 financial institutions, each with 2,500 risk-takers determined on a functional basis. Assume that one of the financial institutions has no retail banking business and 50,000 total employees while the second financial institution has a large retail banking business and 250,000 total employees. The first financial institution would have 2,500 "significant risk-takers" under either a functional or compensation ranking approach (although the identity of the significant risk-takers would differ, as discussed in the next paragraph, depending on which approach is used). The second financial institution would have 2,500 "significant risk-takers" under a functional approach and 12,500 "significant risk-takers" - five times as many as the first financial institution - under a compensation ranking approach. That difference does not advance any policy purpose of Section 956.

More generally, we noted that a compensation ranking approach does not advance the purposes of Section 956 because it would be over-inclusive at almost all financial institutions, covering employees who did not in fact have the ability, either individually or as part of a group, to expose their employers to material amounts of financial risk. In particularly, the ranking approach would likely result in the designation of senior technology, legal and human resources professionals, as well as other professionals in corporate functions that do not implicate the financial risks that are the focus of Section 956 (such as investor relations, facilities, tax, etc.), as significant risk-takers. The approach could also be under-inclusive by not always picking up all functional risk-takers. In fact, the number of functional risk-takers at any institution is unlikely to correspond to exactly 5% or 2% of its employees. For example, a Level 1 financial institution with 50,000 employees might have 2,000, or alternatively might have 3,000, functional risk-takers, depending on the nature of its business, its governance and other factors. Accordingly, the number of employees who would be designated as significant risk-takers based on our proposed functional approach could vary, either up or down, depending on the financial institution from the number of employees who would be designated as significant risk-takers based on the compensation ranking approach of the re-proposal.

As referenced in our comment letter, financial institutions that have been subject to the 2010 Federal Banking Agency Guidance on Sound Incentive Compensation Policies have already been required to agree with their regulators on an approach to identifying material risk-takers. The agencies therefore have substantial information concerning how an approach other than compensation ranking would work, and how many significant risk-takers would be designated at different types of financial institutions using such an approach. We believe that the agencies also have a substantial basis to conclude that a functional approach would produce results that are significantly better aligned with the purposes of Section 956, while a compensation ranking approach would produce anomalous results, for the reasons described above.

**Total Consolidated Assets**

In SIFMA's comment letter on the re-proposal we set out why we believe Average Total Consolidated Assets should not include assets that do not implicate risk concerns and we further elaborated on this theme at our recent meeting. Excluding certain items on these grounds would be consistent with several other regulations in both the United States and overseas. For example:

- FINRA leverage ratio guidelines compute that ratio "by *dividing total balance sheet assets, less U.S. Treasury and U.S. government agency inventory by total regulatory capital (the sum of stockholder's equity and subordinated debt*)."[2]
- The SEC's Net Capital Rule (15c3-1) has been interpreted as permitting financial institutions to exclude operating leases from their balance sheets.[3] The same rule also exempts government securities (including treasuries) from the discounts ('haircuts') that are applied to other asset classes in measuring firms' capital for compliance.
- The Financial Stability Oversight Council's Stage 1 thresholds to determine whether a nonbank financial company shall be supervised by the Board of Governors excludes separate account assets from total consolidated assets for the purposes of the 15:1 leverage ratio threold and the 10 per cent short-term debt ratio threshold.[4]
- The Bank of England's Financial Policy Committee recently announced that reserves held by banks at the Bank of England would be excluded from its application of the UK leverage ratio.[5]

2 http://www.finra.org/sites/default/files/NoticeDocument/p122146.pdf

3 https://www.sec.gov/divisions/marketreg/mr-noaction/2016/sifma-111016-15c3.pdf

4 https://www.treasury.gov/initiatives/fsoc/designations/Documents/FSOC%20Staff%20Guidance%20-%20Stage%201%20Thresholds.pdf

5 http://www.bankofengland.co.uk/publications/Pages/news/2016/062.aspx

**Fixed Versus Variable Accounting**

Under U.S. generally accepted accounting principles equity-based incentive compensation awards may be accounted for either under fixed accounting, under which the fair value of the award at the grant date is expensed over the life of the award, or under liability accounting, under which the award's value is re-measured at each reporting date and the increase (or decrease) from the prior measurement date is reflected in income. Variable accounting may be required if the terms of the award are not predetermined within the meaning of the accounting literature at the time of grant, and could arise from the downward adjustment and forfeiture provisions in section _.7(b)(4) of the re-proposed rule.

We request two steps in order to avoid uncertainty in the Section 956 rules:

*First,* Section _.7(b)(4) should be revised to clarify that, while each of the factors listed there must be taken into account in making forfeiture or adjustment determinations, covered institutions could elect to take the factors into account under any incentive compensation arrangement in a predetermined way.

*Second,* the regulators should expressly confirm, in the interest of clarifying the point for auditors who in the future are required to interpret the rules, that the downward adjustment and forfeiture factors are not intended to be applied in a way that requires variable (liability) accounting. This should be done before or at the time that the rule is finalized.

We hope this is helpful. SIFMA and its members stand ready to help in any subsequent way that the rule-writing agencies would find useful.

**Kenneth E. Bentsen, Jr.**
**President and CEO**

**Cc: Interagency Working Group**