American Bankers Association
Building Success. Together.

Hu Benton
Vice President of Bank Policy
202-663-5042
hbenton@aba.com

Robert deV. Frierson
Secretary
Board of Governors of the Federal Reserve System
20th Street & Constitution Avenue, N.W.
Washington, DC 20551
Docket No. R-1536
RIN No. 7100 AE-50

Legislative and Regulatory Activities Division
Office of the Comptroller of the Currency
400 7th Street, S.W.
Suite 3E-218
Mail Stop 9W-11
Washington, DC 20219
Docket No. OCC-2011-0001
RIN 1557–AD39

Robert E. Feldman
Executive Secretary
Attention: Comments, Federal Deposit Insurance Corporation
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, DC 20429
RIN 3064-AD86

Alfred M. Pollard
General Counsel
Attention: Comments/RIN 2590-AA42
Federal Housing Finance Agency
400 7th Street, S.W.
Washington, DC 20219
RIN 2590–AA42

Gerard S. Poliquin
Secretary of the Board
National Credit Union Association
1775 Duke Street
Alexandria, Virginia 22314-3428
RIN 3133-AE48

Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549
Release No. 34–77776; IA–4383; File No. S7–07–16
RIN 3235–AL06

Via Electronic Mail/Electronic Submission

July 22, 2016

Re: Notice of Proposed Rulemaking on Incentive-Based Compensation Arrangements (Docket Nos. OCC-2011-0001, 1536, RIN No. 7100 AE-50, RIN 3064-AD86, RIN 2590-AA42, RIN 3235–AL06)

Ladies and Gentlemen: The American Bankers Association[1] (ABA) appreciates the opportunity to comment on the notice of proposed rulemaking (NPR) from the Board of Governors of the Federal Reserve System (Federal Reserve), the Office of the Comptroller of the Currency

[1] The American Bankers Association is the voice of the nation's $16 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard $12 trillion in deposits and extend more than $8 trillion in loans.

(OCC), the Federal Deposit Insurance Corporation (FDIC), the Securities and Exchange Commission (SEC), the National Credit Union Administration (NCUA) and the Federal Housing Finance Administration (FHFA)[2] on "incentive-based compensation arrangements." Comments in this letter are drawn from discussions with representatives from ABA member banks of all sizes that would be subject to the NPR (covered banks).

Under Section 956(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (DFA), the Agencies are required to propose jointly "regulations or guidelines" for the respective institutions under their jurisdiction that "prohibit any types of incentive-based payment arrangement...[that] encourages inappropriate risks by covered financial institutions (1) by providing an executive officer, employee, director, or principal shareholder of the covered financial institution with excessive compensation, fees, or benefits; or (2) that could lead to material financial loss to the covered financial institution." Institutions having assets of less than $1 billion are exempt under Section 956(f). The NPR is a reproposal following an initial proposed rulemaking in April 2011.

ABA appreciates the significant effort the Agencies have made to address the many complexities inherent in managing compensation of bank officers, directors and employees.[3] A well-managed compensation scheme must attract and reward talented employees, promote appropriate behavior and incent highly productive work. It must promote a correct balance between risk-taking (which is the core of the banking business) and risk management to protect the safety and soundness of the institution and the interests of its customers, its owners and the public. Given the significant impact of an institution's compensation scheme on its ability to meet these diverse objectives, it is inevitable that banking organizations will take a highly individualized approach to managing compensation. This approach acknowledges the widely varying circumstances of individual banks' business models and risk profiles, their resulting different risk management frameworks and the different competitive environments in which they operate (including the different talent pools in which they recruit to meet the needs of their specific business models).

ABA members are concerned, however, that the NPR not only fails to take account of this complex balancing process, but would actually threaten banks' efforts to achieve these objectives, including inhibiting successful risk management. As described in detail below, the Agencies' attempt to prescribe such detailed uniform standards for such a wide swath of the financial services industry seems to be based on assumptions about how banking organizations measure and manage risk and define the authority of broad groups of employees, when actual practice is much more diverse and in many cases dramatically different from the Agencies' assumptions. For example, a compensation framework that appears to be based on management systems applicable to securities trading platforms fits poorly or not at all with the risk management and governance that ABA members apply to the wide variety of other functions within their organizations. To attract, keep and manage talented employees, bank management must provide appropriate incentive compensation to many areas of the organization that bear little or no functional resemblance to a trading desk. Furthermore, the Agencies' attempt to standardize compensation schemes across a wide swath of the financial services landscape far

[2] We refer to the proposing agencies collectively as the "Agencies."

[3] For simplicity, in this letter an institution's directors, officers and other employees are referred to as "employees," except where the context requires an explicit distinction.

exceeds the DFA requirement to limit two categories of incentive compensation plan features, those that provide excessive compensation or that could lead to material financial loss.

ABA appreciates the Agencies' recognition of the special position of depository institutions and holding companies organized in mutual form and the accommodations made for them in the NPR. Today, there are over 540 mutually chartered institutions with $264 billion in assets across the country, ranging in size from well under $100 million to over $1 billion. Mutual banks are not subject to the pressures of stockholders interested in maximizing shareholder value, and thus have both a different universe of stakeholders and in some respects a different governance framework compared to stock institutions. Besides the lack of a class of equity interests and thus an inability to comply with those aspects of the NPR that apply to other institutions, mutual institutions in particular may have difficulty identifying compensation practices at similar, non-publicly-traded financial firms, as the NPR recognizes. Mutual institutions take risk governance seriously, as do institutions in stock form. Discussions with ABA's mutual members reveal that their managers share the general concerns of the industry expressed in this letter.

Key Concerns

- The proposed definitions of "significant risk takers" do not reflect how most employees' responsibilities and authorities are delimited.
    - Because of market conditions and practices, certain classes of employees, e.g., those in sales, may receive high compensation relative to other employees without having authority to make final commitments on behalf of the institution and thus create risk exposure.
    - Also, the authorized limits for employees who can commit the firm and create exposure often are expressed in terms other than as a percentage of the firm's capital, and cannot be accurately translated into terms based on capital.
- The proposed rule would require inappropriate treatment of compensation for employees with widely differing levels of responsibility based simply on their job titles; the titles might be appropriately used in a subsidiary or business line without implying the ability to create material risk for the consolidated organization.
    - Definitions of "senior executive officer" by job title fail to take into account the responsibilities associated with those titles at subsidiaries of large organizations.
- The NPR raises numerous concerns in its treatment of consolidation of covered institutions that are holding companies. Resolution of compensation for risk takers and senior executive officers as noted above would, however, address or significantly mitigate many of the problematic aspects of the NPR's approach to consolidation.
- In addition to expanding the scope of employees to include those who do not significantly affect risk, the NPR's definitions of incentive-based compensation arrangements would unnecessarily include plans that do not incent risk-taking.

- Details of the proposed requirements for deferred equity may have unintended and adverse accounting consequences for covered institutions.

- The proposed restrictions on certain types of incentive compensation, e.g., brokerage fees for some types of employees, and on acceleration of payment in specified circumstances, will likely make banking organizations and other institutions subject to the rule uncompetitive with employers that are outside the Agencies' jurisdiction.

    - Several aspects of the NPR would introduce unnecessary complexity into banking organizations' compensation plans. For example, the proposed distinct treatment of long-term incentive compensation plans vs. other plans creates no advantages in managing risk and will significantly complicate both administering the plans and making them understandable to employees and potential employees.

- The final rule should broaden the Agencies' reservation of authority to provide a procedure to exempt institutions whose lack of complexity warrants exclusion from coverage under the rule, analogous to the proposed authority to impose the rule on additional institutions whose operations appear to present special degrees of risk.

These points are discussed in greater detail in the sections below. After providing these details, ABA offers a concluding recommendation for simplified approach that would meet the requirements of DFA Section 956 and serve the industry's objectives of talent recruitment and retention, incenting of employee success and appropriate risk governance.

DISCUSSON

I. *The proposed definition of "significant risk taker"* has inherent flaws of both over- and under-inclusion.

Both the "relative compensation test" and the "exposure test"[4] are likely to sweep under the rule many individuals at numerous covered institutions who do not, in practice, have the potential to expose their employers to material risk. In the case of the relative compensation test, highly-paid individuals such as sales people for insurance products are paid in line with market practice (specifically compensation practices at competitors who would not be subject to the Agencies' final rule), but who do not commit the firm to contractual relationships or other risk – either they do not have approval authority for the transactions they originate, or, in some cases, they act as agents for unaffiliated parties such as insurance carriers. Their functions correlate badly or not at all with the expansion or mitigation of the firm's risk. To place them under the proposed incentive compensation rules on the basis of their total compensation relative to other employees would therefore not advance the purposes of the rule.

We also refer the Agencies to the comment letter submitted by the American Bankers Insurance Association, dated July 21, 2016, and its discussion of the proposal's application to insurance agents/brokers.

[4] See NPR at 37,692.

The "exposure test" will be extremely problematic in a different way, in both theoretical and practical terms. This risk measure appears to reflect the way securities traders' risk limits are typically set in broker-dealers and other securities firms. For most bank personnel, risk limits are not set in reference to ability to commit a specific amount of the firm's capital. In fact, for most risk takers in banks, it is not possible to convert their authorities into a capital-based measure, at least not without making assumptions that are likely to prove unrealistic or inaccurate, leading to results in conflict with the Agencies' intent. Moreover, risk limits are not expressed in terms of the capital of specific legal entities, but with reference to overall risk limits within a line of business. In short, the proposed measure bears no real relation to the way risk management is applied in most institutions and in significant business lines.

Rather than the two proposed "significant risk taker" tests, ABA recommends that the final **regulation take a principles-based approach to identifying risk takers to be subject to the rule.** Because each covered institution has its own risk governance model, policies and procedures, the allocation of authority for business decisions is divided in ways that are unique to the institution.[5] Accordingly, identification of risk takers is an exercise unique to each covered institution, and the "one size fits all" approach of the NPR would mean both over-inclusion (because relatively highly paid individuals whose duties do not give them control of significant risks will probably be included) and under-inclusion (because individuals whose authorities are not easily translated into capital commitment measures are likely to be omitted). A principles-based approach tailored to each institution, similar to that currently employed,[6] would address both of these concerns. It would also offer two additional advantages: it would permit use of an existing governance process with which both institution management and supervisory staff are familiar, and it would meet the requirements of DFA Section 956, which specifically contemplates "guidelines" as acceptable to satisfy the statutory requirement.[7] The principles could appropriately include downward adjustments and similar features to avoid encouraging inappropriate risks, as is done under current guidance and as required by DFA Section 956. In each case the program and its administration would be transparent to the covered institution's examiners.

II. *The proposed definition of "senior executive officer" potentially includes too* **many employees who are not in a position to have a material effect on risk.**

The proposed definition apparently would capture not only the senior management officials having the listed job titles (chief executive officer, chief financial officer, head of internal audit, etc.) and responsibilities for the entire enterprise. As proposed, the language appears to extend to those having similar titles within subsidiaries (whether or not those subsidiaries are also "covered institutions" within the meaning of the proposed rule) and individual business lines and their related control functions.[8] Though the chief executive officer, for example, of a holding company subsidiary that is itself a covered institution (based on the character of that subsidiary's

[5] ABA notes that risk governance, policies and procedures have been a first priority of examiners' focus in the years since the financial crisis. Examiners' familiarity with the details of this information will be highly beneficial in implementing ABA's recommendations for identification of a covered institution's risk takers.
[6] See "Guidance on Sound Incentive Compensation Polices," 75 FR 36,395, referred to in this letter as the "2010 Guidance."
[7] See DFA Section 956(b).
[8] See, e.g., NPR at 37,802, 37,814.

business and the level of its consolidated assets) may appropriately be subject to restrictions on incentive-based compensation, the proposed definitions of "covered company," "covered person," "regulated institution" and "senior executive officer" in the Federal Reserve's version of the regulations, in particular, appears to capture subsidiaries of any size (if they are not depository institutions, broker-dealers or asset-managers).[9] The Federal Reserve's proposed language could even be construed as applying to subsidiaries having assets of less than $1 billion, which would be a clear contravention of the statute and at odds with the discussion in the NPR.[10] Similar language in the OCC's and FDIC's proposed regulations would apply to subsidiaries of covered institutions (national banks and state non-member banks) that are not owned by a bank holding company when the subsidiaries are not excluded as broker-dealers, asset managers or persons or because of asset size of less than $1 billion.[11]

***ABA recommends that "senior executive officers" be limited to those officers having those* titles, or performing those functions, only across the entire enterprise of a covered institution.** To cover other employees whose compensation should appropriately be subject to the final rule, the improved definition of "significant risk taker" described above would be sufficient. Many covered institutions (including holding companies with subsidiaries whose assets alone would not bring them within the scope of the proposed rule) assign to lower-level officials job titles listed in the Agencies' definition of "senior executive officer." Such titles are often desirable, in the case of employees who deal with customers or other third-party relationships, apart from their internal governance and risk management responsibilities. The titles convey to customers, vendors, counterparties and others the seniority of the person with whom they deal and set the appropriate expectations for the business relationship. The titles' relevance to risk management and governance is an internal matter often unrelated to the reason for assigning the titles for management of external relationships. The appropriate application of supervisors' risk management requirements, including incentive compensation controls mandated under DFA Section 956, should be driven by the internal management responsibilities of and allocation of authority to the individuals concerned, and not simply made a function of their position titles. This improvement, together with improvements to the "significant risk taker" component of the proposal discussed above, would assure that incentive compensation of all employees who can significantly affect the material risk exposure of the firm would be covered by the final regulation. ABA also notes that other longstanding regulatory regimes of some of the Agencies define a scope of "executive officer," "senior executive officer," and similar terms, providing useful examples should the Agencies continue to require a minimum group of designated individuals with firm-wide or business line responsibilities, underlying a broader principles-based approach.[12]

In additional to over- and under-inclusion concerns that our recommendations would address a second set of issues that would impair covered institutions' investor relations and, ultimately, their ability to raise capital in the market. Institutional shareholder consultants are often highly influential in shareholder-level governance for many public companies, including covered institutions. One of the factors they measure in evaluating equity-based employee compensation

[9] See NPR at 37,808-37,809.
[10] See NPR at 37,684.
[11] See, e.g., NPR at 37,800.
[12] See, e.g., Federal Reserve Regulation O, 12 CFR §215.2(e)(1), the 2010 Guidance and SEC Exchange Act Rules 3b-7 and 16a-1(f).

plans is the so-called "burn rate," a ratio of equity awarded under employee incentive compensation programs to total shares outstanding, measured over time and relative to the company's peers (in terms of both its industry and its market capitalization). Thus under the proposed rule, institutional shareholders would be encouraged to compare covered institutions not only with other banks, but with other public companies of similar market capitalization, in terms of the relative share of equity awarded to employees.[13]

Despite the oft-repeated and oversimplified notion that shareholders want employees to have equity and thus "skin in the game," the burn-rate test demonstrates that shareholders resist equity awards that foster excessive dilution of equity holders generally. If the net of the rule is cast as widely as proposed, with the required equity component as large as proposed, many covered institutions anticipate difficulty meeting their shareholders' expectations under the burn-rate test. As long as institutional shareholders apply such comparisons, a poor relative showing is likely to cause banking organizations difficulty in tapping the capital markets. The Agencies surely do not intend this result.

III. *The NPR's approach to consolidation of covered institutions and their* **subsidiaries is problematic in many respects, but resolution of compensation for risk takers and senior executive officers as recommended above, would address or significantly mitigate many of these concerns.**

Though the NPR contains many complex features outlining the proposed rule's application to consolidated organizations, much of this complexity will likely resolve itself if the recommendations described above are adopted. If "senior executive officers" are specifically identified in reference to the whole enterprise, the application to officers with particular titles in small subsidiaries and non-material lines of business is eliminated. Similarly, if the universe of risk takers to which the final rule applies is determined for each institution on the basis of ability to expose the covered institution to material risk, rather than by artificial percentage tests, alignment of incentive compensation to management of material risk at the enterprise level becomes much more transparent.

IV. **In addition to expanding the scope of employees to include those who do not** ***significantly affect risk, the NPR's definitions of incen*****tive-based compensation arrangements would unnecessarily include plans that do not incent risk-taking.**

The scope of compensation plans that the proposal would affect is broader than necessary to accomplish the Agencies' objectives. As written it would unnecessarily impede covered institutions' efficient management of employee compensation. Specifically, the overly broad nature of the definitions for incentive compensation[14] would capture plans, such as 401(k) defined-contribution plans and organization-wide plans, that contain no incentives for potential inappropriate risk-taking. Holding these plans to the enhanced standards for plans that do contain such incentives would waste time and resources on very low-risk areas and operations.

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[13] For a more detailed discussion of one shareholder advisory firm's use of "burn rate" in evaluating issuers' equity compensation plans, see https://www.issgovernance.com/file/policy/faq-on-iss-us-equity-plan-scorecard-methodology.pdf, especially pp. 8-9.

[14] See NPR at 37,702.

The final rule should allow for a risk management and governance approach commensurate with the risks presented. Plans under which the individual performance measures are based on qualitative factors or measures that are only distantly linked to the employee's activities, or under which payout is discretionary on management's part – and therefore inherently contain a strong non-financial override – encourage risk-mitigating behaviors and controls by management, not risk-taking. Three of the Agencies have previously recognized this important distinction: "[P]lans that provide for awards based solely on overall organization-wide performance are unlikely to provide employees, other than senior executives and individuals who have the ability to materially affect the organization's overall risk profile, with imbalanced risk-taking activities."[15]

ABA urges the agencies to exclude these plans from the scope of the final rule. Plans of this type are also an important part of balanced compensation arrangements and help align incentives of employees with the incentives of shareholders and other stakeholders. Subjecting these plans to the requirements of the NPR, and (if the recommendations above are not adopted) capturing under the relative compensation test employees who are not specifically identified as affecting material risk because they receive incentive compensation from such a plan, creates significant and unnecessary administrative cost for an institution and diverts attention and resources from both prudent risk management and the Agencies' objectives.

Neither the preamble nor the Proposed Rule itself appropriately considers the potential accounting implications on covered institutions' financial reporting. The Proposal may have a significant impact by changing the accounting treatment for certain types of incentive-based compensation arrangements, particularly equity-based awards. We urge the Agencies to carefully consider these potential accounting implications before adopting the Final Rule. In particular, the Final Rule should be carefully constructed to avoid the requirement that equity-based awards be deemed liabilities and subject to liability accounting.

V. ***The NPR's proposed requirement for substantial equity compensation may have*** **unintended consequences, due to accounting guidance currently applicable to stock-based deferred-compensation plans.**

ASC 718 requires that equity awards with conditions or other features that are indexed to something other than a market be accounted for as liabilities. The proposed required non-financial performance measures may result in compensation plans being deemed to be indexed to something other than a market, and thus could result in liability accounting for equity-based awards. Under current accounting practice at many banking organizations, equity-based incentive compensation is accounted for at fair value as of the grant date.[16] Under the terms of the NPR if "liability accounting" applies, the fair value of equity awards would be adjusted for each reporting cycle, essentially being marked to market through earnings and thereby affecting regulatory capital. Similar to other fair-value accounting elections and requirements, the earnings and capital of the reporting institution would thus be subject to volatility typically unrelated to company performance as the awards are revalued each period. ABA believes that

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[15] See 2010 Guidance at 36408.

[16] See Financial Accounting Standards Board's Accounting Standards Codification (or "ASC") 718: Compensation-Stock Compensation.

the Agencies do not intend this result, as it could adversely affect the ability of covered institutions to raise capital.

The requirement that non-financial performance measures be included in order for awards to appropriately balance risk and reward should be eliminated from the final rule in order to avoid the potential mandate of liability accounting.

VI. The competitive impact of the proposed rule on critical talent management will place banking organizations at a severe competitive disadvantage.

The competitive strength of a banking organization, which directly and centrally determines its ability to serve its customers and the broader public, is a direct function of the talent and motivation of its workforce. At present banking organizations are under significant competitive pressure to innovate and offer more efficient, convenient and secure services and communication channels to their customers. Many of the innovations banking organizations are striving to create and implement draw on customer experiences with providers of nonfinancial products and services. An inevitable corollary is that both current and potential bank employees have significant opportunities, and in some fields are in high demand, outside the banking industry. The banking industry therefore must compete for talent with many employers whose incentive compensation practices will not be subject to the final rule on incentive compensation. Though it may be impossible to eliminate all competitive imbalances between the financial sector and other parts of the economy, especially over time, blanket restrictions on some compensation options, such as certain brokerage commissions,[17] excessive and redundant deferral periods and other features described below are unnecessary to achieve the proposed rule's objective but would significantly impair banking organizations' ability to compete with unregulated employers.

ABA recommends that the deferral, forfeiture and clawback requirements be shortened or consolidated because this aspect of the NPR is redundant and unnecessarily complex. The NPR contemplates both that deferred compensation be subject to forfeiture and that incentive compensation previously paid out be subject to clawback. In addition, it would require application of these mechanisms separately to long-term incentive compensation plans and "qualifying incentive-based compensation."[18] These requirements ignore the fact that covered institutions would still have the ability to cause forfeiture of any deferred compensation not yet paid out to the employee, even if the deferred compensation is unrelated to the performance period from which an inappropriate risk later emerged. In other words, as long as sufficient deferred compensation remains unpaid and subject to forfeiture, it is irrelevant that the compensation related to the performance period has been paid out. Similarly, it is irrelevant that it accrued under a long-term incentive compensation plan or other plan. To the extent of such remaining deferred compensation, the institution can hold the employee accountable, and tracing of funds to a particular award (which might trigger a clawback rather than a forfeiture) is unnecessary to the purposes of the NPR. These simplifications will help covered institutions maintain their competitiveness as employers in two ways: they will eliminate unnecessary and negative distinctions between the institutions' plans and those of competing unregulated

[17] ABA notes that in other contexts in which bonuses and other compensation were subjected to restrictions, commissions for sales and services to unrelated parties were excluded because they, "characteristically are viewed as a component of base salary rather than bonus compensation…" See 74 Fed. Reg. at 28,400.
[18] See NPR at 37,702-37,703.

employers; and they will reduce the unnecessary complexity of the compensation plans and thus the potential negative impressions on employees and potential employees.

ABA urges the Agencies to expand the triggers that would permit accelerated vesting and payout of incentive compensation. A critical element affecting competitiveness in the hiring market, as well as considerations of basic fairness to employees, is the proposed restrictions on acceleration of vesting and payout. Though it is in the interest of sound management of covered institutions (as well as necessary for compliance with applicable tax and accounting standards) that the circumstances of accelerated vesting be specified in detailed policies and plan documents, limiting acceleration to cases of death or disability will impose significant hardship on employees. In particular, employee terminations as a result of changes in control or other involuntary terminations without cause mean that employees would lose substantial portions of their compensation, without regard to any losses or risks. In an industry that continues to experience a degree of potential for volatility and consolidation, the risk that deferred compensation is subject to risks outside the control of the affected employees, when that deferred compensation is substantial in relation to total compensation, will make employment with covered institutions relatively unattractive. Banking organizations should not be exposed to such a degree of risk of a talent drain in pursuit of broader risk management. The goals of the NPR can still be served without the prospect of punishing employees for behavior unrelated to their prudence in performance of their duties. Similar considerations apply to tax compliance and compliance with ethics requirements upon entry into government service, features that have commonly been included in incentive compensation plans for some time.

ABA urges the Agencies to make clear in the final rule that employer contributions to retirement plans such as 401(k) are outside the scope of the rule. Given the importance of competitive benefit packages in attracting and retaining employees, the Agencies should be careful that the final rule not render uncompetitive defined-contribution retirement plans at covered institutions. Specifically, the final rule should clarify that incentive compensation does not include any employer contributions to retirement plans qualified under Section 401(a) of the Internal Revenue Code and regulated under associated Treasury regulations, including employer contributions to a 401(k) retirement savings plan computed based on a fixed percentage of an employee's bonus. Such contributions should be excluded from the definition of incentive compensation because they are intended to encourage employees' saving for retirement rather than to incent current performance. Furthermore, such contributions are subject to extensive rules under the IRC and Treasury regulations and can be withdrawn from the qualified plan only under limited circumstances, including termination of employment, retirement and death. Such contributions' limited availability under already-existing rules significantly reduces their potential to incent inappropriate risk-taking, and subjecting these employer contributions to forfeitures and clawbacks would be inconsistent with other applicable laws.

VII. Several technical aspects of the NPR should be improved.

First, consistent with traditional divisions of regulatory responsibility for holding company structures, the final rule should clarify that depository institutions **and their subsidiaries** should be subject only to the rules of the depository's primary Federal regulator. The Federal Reserve's proposed "regulated institution" definition[19] appears to include non-depository subsidiaries of depository institutions owned by holding companies. Absent clarification, the Federal Reserve's jurisdiction would overlap that of the OCC or FDIC, in cases of subsidiaries of national banks and state non-member banks, respectively.

Second, the reservation of authority to alter the scope of covered institutions should be expanded. The Agencies may subject a Level 3 institution to the more stringent features of the final rule, "if the appropriate Federal regulator determined that the covered institution's complexity of operations or compensation practices are consistent with those of a Level 1 or Level 2 covered institution, based on the covered institution's activities, complexity of operations, risk profile, or compensation practices."[20] This reservation to deal with the specific circumstances of an individual institution should be complemented by a similar reservation to exempt a covered institution whose lack of complexity, risk profile or compensation practices warrant it.

Third, the consolidation provisions in the NPR should be adjusted to avoid unequal treatment of bank subsidiaries based on charter type. The consolidation provisions in the FDIC's and OCC's proposal would permit a covered institution's subsidiary to satisfy the rule's requirements by implementing a compliant program at the parent covered institution. However, the term "covered institution" in the OCC's and FDIC's version of the proposal does not include a parent bank holding company. In contrast, the Federal Reserve's proposal would explicitly permit a state member bank to use its parent bank holding company's program.[21] This difference in rule text would result in disparate treatment between state member banks, which would be permitted to consolidate their program at the holding company level, and state nonmember banks and national banks, which would not. As noted in the NPR, holding companies often implement organization-wide compensation programs.[22] The final rule should permit all subsidiary banks of a holding company to utilize their parent holding company's program equally regardless of their primary federal regulator.

Fourth, the Agencies should permit vesting schedules other than a simple annual schedule as stated in the NPR. Other vesting schedules that vest ratably over the deferral period, in particular quarterly vesting schedules, would allow for more efficient institutional cash management on a quarterly basis. A quarterly vesting schedule would not front-load the payment of deferred incentives, and forfeiture and clawback would still apply.

Fifth, if the board of directors of a covered institution has approved an incentive compensation arrangement of a senior executive officer, and if such approval includes vesting amounts and a vesting schedule, then the actual payout at the time of vesting should not require a second Board

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[19] See NPR at 37,809.
[20] See NPR at 37,715.
[21] See Sections 326.2(i) & (dd) and 236.3(c) (permitting consolidation among covered institutions while defining such to include both state member banks and bank holding companies).
[22] See NPR at 37,685.

approval. The requirement for additional board involvement is not conditioned on a change in circumstances, so it does not further the board's fulfillment of its oversight duties.

Finally, the definition of "subsidiary" in the NPR presents practical problems related to compensation administration and should be clarified. The proposed definition would include as a subsidiary any entity that is "owned or controlled" by another company. As under the Bank Holding Company Act, the proposed definition of "control" would include entities of which the parent covered institution owns as little as 25 percent of a class of voting securities. The parent covered institution may not, however, be able to exercise functional control over the minority-owned company, and thus it would lack the ability to direct the compensation practices of the "subsidiary." It would be inappropriate to impose legal requirements on a covered institution where it does not have the legal power to effect compliance. The definition of "subsidiary" in the final rule should therefore be clarified to include only entities that are under the practical control of the parent covered institution.

VIII. A principles-based approach would address not only the mandate of DFA Section 956 and the practical supervisory concerns of the Agencies, but also the interests of the public.

The Agencies' proposed response to the mandate prohibiting excessive employee compensation and arrangements that could lead to material financial loss includes many detailed proscriptive features. As noted above , many of these features fail dramatically to take into account the highly individualized risk governance policies and procedures of covered institutions, including the elements of their compensation plans that, over time, are reviewed for alignment with their risk profiles. The current practice under the 2010 Guidance allows at least a significant degree of customization in identifying the individuals and groups within each firm and their relation to the overall risk, as well as providing an opportunity for management to demonstrate to supervisors that their compensation plans are consistent with that risk profile.

If banking institutions have strong risk management governance, including over incentive compensation practices, and if the compensation scheme provides both rewards for success and accountability for failures to follow the applicable governance, banking organizations will satisfy both the mandate of Section 956 and broader principles of sound risk governance, furthering the interests of all their stakeholders. This process inherently draws on the judgment of both bank leadership and bank supervisors, but these are only a subset of the judgments inevitably at the core of the banking business. A proscriptive approach to incentive compensation management, as demonstrated above, would be a step backward.

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Thank you for the opportunity to respond to your request for comments. Should you have any questions or desire further discussion, please do not hesitate to contact the undersigned at (202) 663-5042 or hbenton@aba.com.

Very truly yours,

Hu A. Benton
Vice President
Banking Policy