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Patrick T. Tierney
Assistant Director
Department of the Treasury
Office of the Comptroller of the Currency
Legislative and Regulatory Activities Division
400 7th Street SW
Suite 3E-218, Mail Stop 9W-11
Washington, DC 20219
E-mail: regs.comments@occ.treas.gov
In re: OCC Docket ID OCC-2011-0001, Incentive-Based Compensation Arrangements

Robert deV. Frierson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551
E-mail: regs.comments@federalreserve.gov
In re: Docket No. 1536 and RIN No. 7100 AE-50, Incentive-Based Compensation Arrangements

Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429
E-mail: Comments@FDIC.gov
In re: RIN 3064-AD86, Incentive-Based Compensation Arrangements

Alfred M. Pollard
General Counsel
Federal Housing Finance Agency
Eighth Floor, 400 7th Street NW
Washington, DC 20219
E-Mail: RegComments@fhfa.gov
In re: Comments/RIN 2590-AA42, Incentive-Based Compensation Arrangements

Gerard S. Poliquin
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428
E-Mail: regcomments@ncua.gov
In re: Notice of proposed rulemaking for Incentive-Based Compensation Arrangements

Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549
Email: rule-comments@sec.gov
In re: File Number S7-07-16, Incentive-Based Compensation Arrangements

Hermes Equity Ownership Services Limited: Registered office: Lloyds Chambers, 1 Portsoken Street, London E1 8HZ. Registered in England No. 5167179.

Dear Messrs. Tierney, Frierson, Feldman, Pollard, Poliquin and Fields:

We appreciate the opportunity to comment on the proposed rule jointly developed by five agencies—the Office of the Comptroller of the Currency ("OCC"); Board of Governors of the Federal Reserve System ("Board"); Federal Deposit Insurance Corporation ("FDIC"); Federal Housing Finance Agency ("FHFA"); National Credit Union Administration ("NCUA"); and the U.S. Securities and Exchange Commission ("SEC"); (collectively, "Agencies")—to implement Section 956 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd- Frank").

By way of background, Hermes is a London based asset manager, wholly owned by the BT Pension Scheme, one of the UK's largest pension schemes. As part of our Equity Ownership Service (Hermes EOS), we also respond to consultations on behalf of many clients from around Europe and the rest of the world. In all, Hermes EOS advises over 40 clients with regard to assets worth a total of over $240 billion (as at 30 June 2016).

The proposed rule includes changes to a version introduced in 2011—changes made "to incorporate practices that financial institutions and foreign regulators have adopted to address the deficiencies in incentive-based compensation practices that helped contribute to the financial crisis that began in 2007."

We believe the proposed rule represents a positive and meaningful response to some of the most important lessons learned from the 2008 financial crisis. The proposed rule preserves a role for incentive-based compensation at financial institutions—one that points toward greater emphasis on risk management and long-term outcomes, and by extension, greater stability for the overall market.

Hermes EOS policies support reasonable, appropriately structured pay-for-performance programs that reward executives for sustainable, superior performance over the long-term.

Hermes EOS supports the proposed rule's over-arching requirements that incentive-based compensation arrangements at covered financial institutions 1) appropriately balance risk and reward, and 2) bar arrangements that could encourage inappropriate risks by providing excessive compensation or that could lead to material financial loss. We also support the proposed rule's recognition of the board's important role to oversee incentive-based compensation programs. We address particular aspects of the proposed rule below.

Definition of "significant risk taker"

The proposed rule applies to senior executive officers ("SEOs") at financial institutions holding at least $1 billion in average total consolidated assets ("assets") and significant risk takers ("SRTs") at financial institutions holding at least $50 billion in assets ("systemically important financial institutions").

For potential SRTs at systemically important financial institutions, the proposed rule provides two paths to exemption from SRT status. A potential SRT could avoid automatic designation if:

- The individual's incentive-based compensation is less than one-third of his or her total compensation; or

- The individual meets both of the following tests: 1) Total compensation below a sliding percentile among non-SEO employees at the institution; and 2) Does not hold the authority to commit at least 0.5 percent of the capital of the covered institution.

Hermes EOS is concerned that under the proposed definition, non-SEO employees placing billions of dollars at risk at systemically important financial institutions would avoid automatic SRT status.

We believe the final rule would better serve investors and the safety and soundness of the capital markets if the SRT definition were revised to more broadly cover non-executive significant risk takers.

Appropriate balance of risk and reward

Hermes EOS's policies support the use of multiple performance measures that align the recipient with both short- and long-term strategic goals. Hermes EOS policies envision the use of both qualitative and quantitative performance measures. Although the three conditions above by no means assure a balance of risk and reward, we believe this guidance increases the likelihood of an appropriate balance.

Forfeiture, downward adjustment and clawback

The proposed rule would require systemically important financial institutions to consider forfeiture or downward adjustment of incentive-based compensation in the event of certain developments, but such forfeiture or downward adjustment is not mandated. The developments triggering the consideration requirement include: poor financial performance attributable to significant deviation from risk parameters stipulated in the institution's policies and procedures; inappropriate risk-taking (regardless of impact on financial performance); and material risk management or control failures.

Hermes EOS supports mechanisms ensuring the recovery of erroneous incentive-based compensation and mechanisms to prevent erroneous awards from being paid in the first place. We expect companies to pursue recovery when clawback terms are triggered, except in very limited circumstances, such as when "costs of recovery could exceed or be disproportionate to the recoverable amounts."

However, we feel regulators should examine how to work most effectively with banks and others to minimize the need for such actions after the event. We expect bank's business models, conduct, and culture to be based on a "customers first" perspective with all activity including recruitment, training, promotion, internal controls, management practice, and board oversight to be dedicated to this end. While post event measures should be in place as a backstop, it is the prevention of misconduct and the promulgation of good conduct that is even more important. Rule help improve conduct but culture it often even more powerful.

We observe that the proposed rule does not identify any circumstance for which forfeiture, downward adjustment or clawback is mandatory. In light of failure of some compensation committees and management to seek appropriate clawbacks in the past and the importance of systemic risk posed by covered financial institutions, we encourage the Agencies to consider the feasibility of identifying in the final rule some circumstances when forfeiture, downward adjustment or clawback of incentive-based compensation is mandatory, while preserving discretion for less conclusive situations.

<u>Deferrals</u>
For systemically important financial institutions, the proposed rule mandates deferral of 40 percent to 60 percent of incentive-based pay, with short-term incentive-based pay requiring longer deferral than long-term incentive-based pay.

We would support revisions to further increase the percentages of annual incentive-based compensation subject to mandatory deferral.

<u>Certain prohibitions</u>
Under the proposed rule, systemically important financial institutions:

- May not purchase hedging instruments to offset any decrease in a covered individual's incentive-based compensation

- May not distribute incentive-based compensation in excess of 125 percent of target awards for SEOs and 150 percent for SRTs

- May not rely solely on industry peer performance comparisons to determine incentive- based compensation

- May not provide incentive-based pay based solely on transaction or revenue volume without regard to transaction quality or the covered person's compliance with sound risk management

We support the limits outlined in the proposal, as they would serve to flatten the risk/reward curve for SEOs and SRTs.

We support the proposed prohibition against basing incentive-based pay on transaction or revenue volume without regard to transaction quality or the covered person's compliance with sound risk management. The provision would deter, for example, mortgage originators from being rewarded solely for the volume of loans they approve. Hermes EOS and many experts believe this type of incentive-based compensation contributed directly to the 2008 financial crisis.

<u>Independent risk management and governance</u>
Under the proposed rule, systemically important financial institutions would be required to:

- Adopt a risk management framework that is independent of any lines of business and includes an independent compliance program

- Provide individuals in key control functions with the authority to influence the risk-taking of their business areas

- Ensure covered individuals in control functions are compensated in accordance with the achievement of performance objectives linked to their control functions and independently from the performance of the business areas they oversee

- Provide for independent monitoring of risk/reward balance, events related to forfeiture and downward adjustment, and compliance of incentive-based compensation with the covered institution's policies and procedures

- Have a compensation committee comprised solely of non-SEO directors, who would be required to obtain input from the risk and audit committees

- Direct management to provide the compensation committee with an annual assessment of the effectiveness of the incentive-based compensation program and related compliance and control processes

- Direct the compensation committee to obtain an independent assessment from the internal auditor and risk management function of the incentive-based compensation program and related compliance and control processes

Hermes EOS generally supports the safeguards proposed above, which would reduce conflicts of interest and the likelihood of inappropriate risk-taking. Our policies' explicit support for fully independent compensation committees and robust board oversight of risk share these common objectives.

Hermes EOS commends the Agencies for the work involved to implement Section 956 of the Dodd-Frank Act, and we appreciate the Agencies' consideration of the our views.

Sincerely,

Darren Brady
Hermes EOS