July 22, 2016

Legislative and Regulatory Activities Division
Office of the Comptroller of the Currency
400 7th Street SW
Washington, DC 20219

Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549

Mr. Robert deV. Frierson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW

Alfred M. Pollard
General Counsel
Attention: Comments/
Washington, DC 20551
Federal Housing Finance Agency
400 7th Street SW
Washington, D.C. 20219

Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Gerard S. Poliquin, Secretary
NCUA
1775 Duke Street
Alexandria, Virginia 22314

Re: Incentive-Based Compensation Arrangements

Dear Sir or Madam:

The Independent Community Bankers of America (ICBA)[1] appreciates the opportunity to comment on a proposal by the Federal Reserve, the FDIC, the OCC, the SEC, the NCUA and the FHFA (the "Agencies") to regulate incentive-based compensation practices at certain financial institutions. The regulations would implement Section 956 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). Section 956

[1] The Independent Community Bankers of America®, the nation's voice for more than 6,000 community banks of all sizes and charter types, is dedicated exclusively to representing the interests of the community banking industry and its membership through effective advocacy, best-in-class education and high-quality products and services.

With 52,000 locations nationwide, community banks employ 700,000 Americans, hold $3.6 trillion in assets, $2.9 trillion in deposits, and $2.4 trillion in loans to consumers, small businesses and the agricultural community. For more information, visit ICBA's website at www.icba.org.

requires that the agencies prohibit any types of incentive-based compensation arrangements that the agencies determine encourage inappropriate risks by a covered financial institution: (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. Section 956 of the Dodd-Frank Act covers only financial institutions that have $1 billion or more in assets.

The proposal by the Agencies applies a tiered approach to three size categories of institutions based on average total consolidated assets, applying less prescriptive incentive-compensation program requirements to the smallest covered institutions and progressively more rigorous requirements to the larger covered institutions. The three categories of covered institutions are: Level 1 ($250 billion of assets or more); Level 2 ($50 billion of assets or more, but less than $250 billion); and Level 3 ($1 billion of assets or more, but less than $50 billion). The Agencies previously issued a notice of proposed rulemaking in 2011 to implement Section 956 of the Dodd-Frank Act but have now opted to withdraw the 2011 proposal and replace it with a new proposal to regulate incentive compensation arrangements.

ICBA's Position

ICBA commends the Agencies for proposing a tiered approach to regulating incentive compensation arrangements. We agree that there is substantial evidence that the flawed incentive-based compensation arrangements among the large banks contributed to the financial crisis that began in 2007. Some compensation arrangements rewarded employees—even non-executive personnel such as traders and loan officers—for increasing an institution's revenue or short term profit without sufficient recognition of the risks the employees' activities posed to the institutions. For instance, some institutions gave loan officers incentives to write a large amount of loans or gave traders incentives to generate high levels of trading revenues without sufficient regard for the risks associated with those activities.

The incentive compensation arrangements at Washington Mutual (WaMu) epitomize the problems that occurred prior to the economic downturn. At that institution, loan officers and processors were paid primarily on volume and were paid more for issuing higher risk loans. These risky practices enriched WaMu in the short term, but eventually led to its failure.

ICBA agrees with the Agencies that there should be at least three levels or categories of institutions. In the 2011 proposal, there was no intermediate category between the largest too-big-to-fail banks and other banks over $50 billion in assets. Establishing an additional category of institutions with at least $250 billion in average total consolidated assets allows the Agencies to further tailor the requirements based on the size and complexity of the institution.

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For instance, Level 3 institutions would not be required to include deferral, forfeiture, downward adjustment, and clawback provisions in their incentive compensation arrangements. However, both Level 2 and Level 1 institutions would have to include such provisions for deferred compensation arrangements with their senior executive officers and their significant risk-takers. A Level 1 institution would be required to defer at least 60 percent of a senior executive officer's "qualifying incentive-based compensation" and 50 percent of a significant risk-taker's qualifying incentive-based compensation for at least four years. A Level 2 institution would be required to defer at least 50 percent of a senior executive officer's qualifying incentive-based compensation and 40 percent of a significant risk-taker's qualifying incentive-based compensation for at least three years. The proposal would also require a Level 1 or Level 2 institution to make subject to forfeiture all unvested deferred incentive-based compensation of any senior executive officer or significant risk-taker, including unvested deferred amounts awarded under long-term incentive plans. Forfeiture, downward adjustment, and clawback provisions would also be required in all deferred compensation arrangements for Level 1 and 2 institutions.

Banks with Assets Less than $50 Billion Should Be Exempt

Even though the great majority of the proposal applies to Level 1 and Level 2 institutions, there are still many requirements that apply to Level 3 institutions, i.e., those institutions with average total consolidated assets equal to or greater than $1 billion but less than $50 billion. For instance, incentive compensation arrangements for these institutions must include financial and non-financial measures of performance, must be designed to allow non-financial measures of performance to override financial measures of performance, and must be subject to adjustment to reflect actual losses, inappropriate risks taken, compliance deficiencies, or other measures or aspects of financial and non-financial performance. Level 3 institutions also are required to create annually, and maintain for at least seven years, records that document the structure of incentive-based compensation arrangements and that demonstrate compliance with the proposed rule. The records would be required to be disclosed to the institution's appropriate Federal regulator upon request.

ICBA believes that Level 3 institutions should be completely exempt from the rule. As the Agencies indicate in their proposal, Level 1 and 2 institutions have more complex structures and operations and tend to be significant users of incentive-based compensation. Significant use of incentive-based compensation combined with more complex business operations can make it more difficult for regulators to immediately recognize and assess risks for these institutions as a whole. However, Level 3 institutions generally are significantly less complex, are not significant users of incentive-based compensation arrangements, and pose little risks to the financial system. Furthermore, regulators should be able to immediately assess the risks these incentive compensation arrangements create for these institutions.

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Furthermore, even if Level 3 institutions were exempted from the rule, they would still be subject to the rigorous 2010 Federal Banking Guidance governing incentive-based compensation programs which prohibits excessive compensation or compensation that could lead to material financial loss consistent with the mandates of Section 965 of the Dodd-Frank Act.

By being subject to the rule, Level 3 institutions will not only be subject to an additional regulatory burden of having to understand completely the entire rule—including the parts that don't apply to them—but also will be constantly concerned that supervisors may apply the requirements of Level 1 and 2 to them. This "trickle down" fear is a legitimate concern since the proposal allows the agencies to apply the requirements of Level 1 and 2 institutions to Level 3 institutions "if the appropriate Federal regulator determines that the institution's complexity of operations or compensation practices are consistent with those of a Level 1 or 2 institution." Under the proposal, this reservation of authority for Level 3 institutions would only be used on institutions with assets of between $10 billion and $50 billion. However, the asset range for this reservation of authority is so broad that most Level 3 institutions would be constantly concerned that an examiner could suddenly conclude that their operations were sufficiently complex enough that the entire rule should apply to them. This concern would no doubt be amplified by consultants and even some examiners who would say that as a matter of "best practices," these institutions at a minimum should comply with the Level 2 requirements.

If the Agencies want to proceed with their proposed reservation of authority and have the authority to apply Level 1 and 2 requirements to Level 3 institutions, the reservation should be limited only to those institutions that are close to the $50 billion asset cap. In other words, the reservation should cover at most those institutions with average consolidated assets of between $40 billion and $50 billion—not those with average consolidated assets of between $10 billion and $50 billion. To do otherwise would subject a large number of smaller institutions with the concern that their deferred compensation arrangements could be in violation of the rule.

New Responsibilities Imposed on Boards

ICBA is concerned that the proposal's new governance requirements for covered institutions may become a future standard for all banks—including community banks. Specifically, the board of directors (or a committee thereof) would be required to:

- Conduct oversight of the covered institution's incentive based compensation program
- Approve incentive-based compensation arrangements for senior executive officers, including the amounts of all awards and, at the time of vesting, payouts under such arrangements, and
- Approve any material exceptions or adjustments to incentive-based compensation

policies or arrangements for senior executive officers.

Level 1 and 2 institutions would also need a compensation committee that would be composed solely of directors who are not senior executive officers and that would obtain input on the effectiveness of the institution's incentive-based compensation at balancing risk and reward from the risk and audit committees, management, and internal audit-risk management function.

The proposal is another example of how the banking agencies are imposing more responsibilities on boards of directors. These new governance practices are making it more difficult for many community banks to find competent persons to serve as directors. New directors at community banks are increasingly worried that they are legally responsible for every activity, no matter how insignificant, that occurs at the bank including all the audit, risk, lending, securities, IT and HR activities. ICBA urges the Agencies to make clear that these governance practices should apply only to the covered institutions and that examiners should not apply as best practices these new Board responsibilities to banking institutions with assets less than $1 billion.

Conclusion

ICBA commends the Agencies for taking a tiered approach with their incentive compensation proposal and agrees that, when applying the regulations, there should be at least three levels or categories of institutions. However, ICBA believes that Level 3 institutions should be completely exempt from the rule since they are not significant users of incentive-compensation arrangements and pose little risks to the financial system. Furthermore, they would still be subject to the comprehensive 2010 Federal Banking Guidance governing incentive-based compensation programs which prohibits excessive compensation or compensation that could impair the safety and soundness of the institution.

ICBA is very concerned about the Agencies' proposed "reservation of authority" which would allow Level 3 institutions that have assets over $10 billion to be subject to Level 1 and 2 requirements. We believe the asset range for this reservation of authority is too broad and should be limited only to those institutions that are close to the $50 billion asset cap. Implementing this proposal with this reservation of authority would subject a large number of smaller institutions with the constant concern that their deferred compensation arrangements could be in violation of the rule.

Furthermore, ICBA is concerned that the proposal's new governance requirements for covered institutions may become a future standard for all banks. ICBA urges the Agencies to make clear that these governance practices should apply only to the covered institutions and should not be applied as best practices to all banking institutions.

ICBA appreciates the opportunity to comment on a proposal by the Federal Reserve, the

FDIC, the OCC, the SEC, the NCUA and the FHFA to regulate incentive-based compensation practices at certain financial institutions. If you have any questions or would like additional information, please do not hesitate to contact me by email at [redacted].

Sincerely,

/s/ Christopher Cole

Christopher Cole
Executive Vice President and Senior Regulatory Counsel

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