AFL-CIO
AMERICA'S UNIONS

American Federation of Labor and Congress of Industrial Organizations

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Assistant Director
Office of the Comptroller
of the Currency
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Robert deV. Frierson
Secretary
Board of Governors of the
Federal Reserve System
20th Street and
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Washington, D.C. 20551

Robert E. Feldman
Executive Secretary
Federal Deposit Insurance
Corporation
550 17th Street N.W.
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Alfred M. Pollard
General Counsel
Federal Housing Finance Agency
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Gerard S. Poliquin
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street N.E.
Washington, D.C. 20549

Submitted electronically via www.regulations.gov

Re: Incentive-Based Compensation Arrangements

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

On behalf of the American Federation of Labor and Congress of Industrial Organizations (the "AFL-CIO"), I appreciate the opportunity to comment on the proposed rule that has been jointly developed by the Federal Reserve Board, the Federal Deposit Insurance Corporation, the Comptroller of the Currency, the Federal Housing Finance Agency, the National Credit Union Administration, and the Securities and Exchange Commission (the "Agencies") on incentive compensation arrangements at financial institutions as mandated by Section 956 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").

The AFL-CIO is the umbrella federation for U.S. labor unions, including 56 unions representing 12.5 million members. Union-sponsored and Taft-Hartley pension and employee benefit plans hold more than $646 billion in assets. The retirement savings of working people depend, in part, on financial institutions having responsible compensation practices for their executives and other employees. Moreover, working people suffered devastating losses from the Wall Street financial crisis not just as savers for retirement, but also as employees, homeowners, and taxpayers.

The Financial Crisis Inquiry Commission described how incentive compensation practices at financial services companies helped to create the Wall Street financial crisis. Compensation practices "encouraged the big bet—where the payoff on the upside could be huge and the downside limited. This was the case up and down the line—from the corporate boardroom to the mortgage broker on the street."[1] For this reason, the AFL-CIO strongly supports the efforts of the Agencies to ban incentive pay that encourages inappropriate risk-taking at financial institutions.

We commend the Agencies for strengthening the proposed rule to implement Section 956 of the Dodd-Frank Act. The 2016 re-proposed rules have been significantly improved compared to the originally proposed version in 2011 that lacked meaningful constraints on incentive compensation at financial services companies. However, as described below, we urge the Agencies to revise the final rule to better regulate incentive compensation at financial services companies.

Covered Employees

We are pleased that the Agencies have expanded the scope of the proposed rule to go deeper down into the organizational hierarchy. The 2011 proposal covered only named executive officers and heads of major business lines, and gave the boards of directors the discretion to identify employees such as traders who could cause financial institutions to suffer large losses. The 2016 re-proposed rule extends coverage to senior executive officers ("SEOs") who perform certain functions, as well as significant risk-takers ("SRTs") who could risk a financial institution's safety and soundness.

We believe that extending mandatory coverage of the proposed rule to SRT compensation could help prevent a repeat of the 2012 "London Whale" incident in which a trader in the London office of JPMorgan Chase caused the bank to lose more than $6 billion through risky trades, and resulted in the bank paying $1 billion in fines for violations of securities laws.[2] Nonetheless, we believe that the proposed test for

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[1] The Financial Crisis Inquiry Report, Financial Crisis Inquiry Commission, January 2011, at xix. Available at http://fcic-static.law.stanford.edu/cdn_media/fcic-reports/fcic_final_report_conclusions.pdf

[2] Jenny Strasburg, *Former J.P. Morgan Executive Fined Over $1 Million by U.K. Regulator for 'London Whale' Trades,* The Wall Street Journal, February 9, 2016.

determining who are SRTs is too narrow, and that the definition should be expanded to more broadly encompass risk takers at financial institutions.

Deferral Periods

We urge the Agencies to strengthen the required deferral periods for incentive compensation. As proposed, the most stringent deferral requirements only require deferral of 60 percent of incentive pay awards for SEOs at the largest financial institutions. Within two years of the conclusion of the applicable performance period, 70 percent of short term incentive pay and 100 percent of long term incentive pay will vest under the proposed rules. These mandatory deferral periods should be lengthened to at least five years to better reflect performance over an entire business cycle.

Moreover, a substantial portion of incentive pay should be required to be held through retirement age. We note that many financial institutions have voluntarily adopted such holding requirements for their senior executives' equity awards. Bank of America, Citigroup, Goldman Sachs, JPMorgan Chase, Morgan Stanley, and Wells Fargo require that senior executives hold 50 percent of all net shares that they receive from equity awards through retirement. The Agencies risk undermining these holding requirements by proposing less rigorous mandatory deferral periods.

Asymmetric Pay

We reiterate our strong opposition to the use of stock options for incentive pay, particularly at financial institutions.[3] Stock option grants are inherently asymmetrical in their payout structure because they provide all of the benefit of share price increases with none of the risk of share price declines. Stock options also reward stock price volatility – a measure of risk. For example, during the Wall Street financial crisis, many executives received stock option grants at depressed prices. These executives then profited handsomely when stock prices rebounded to previous levels.[4]

For these reasons, we are puzzled as to why the Agencies propose limiting stock options to 15 percent of deferred pay instead of proposing an outright ban on the use of stock option compensation. We note that many financial services companies have already moved away from stock options. The proposal acknowledges that out of 14 large financial institutions surveyed, only two institutions awarded stock options as part of their incentive compensation packages in 2015. If stock options encourage excessive risk-taking, why should they be permitted at all?

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[3] AFL-CIO comment letter, May 31, 2011. Available at: https://www.sec.gov/comments/s7-12-11/s71211-705.pdf

[4] Scott Thurm, *Options Given During Crisis Spell Large Gains for CEOs,* The Wall Street Journal, April 26, 2011.

We also urge the Agencies to require that incentive pay be more aligned with the interests of bondholders, depositors, and taxpayers. Equity compensation alone encourages moral hazard because equity holders do not suffer the full costs of a bank failure. To remedy this asymmetry, SEOs and SRTs could be required to hold loss-absorbing capacity bonds. Aligning the self-interest of SEOs and SRTs with the interests of bondholders, depositors, and taxpayers will motivate SEOs and SRTs to maintain the safety and soundness of their financial institutions.[5]

Acceleration of Awards

We commend the Agencies for proposing a ban on the accelerated vesting of deferred pay except in the case of death or disability. The proposed rule correctly identifies the acceleration of awards as a risk factor because it reduces the long-term incentives of deferral and eliminates the possibility of forfeiture. However, we believe the prohibition on accelerated awards should apply to all incentive pay, not just to deferred amounts. Executives who voluntarily resign—for example to enter into government service—should not be entitled to accelerated or continued vesting of compensation that otherwise would be forfeited.

Hedging

As with stock options, we are puzzled by the Agencies' acknowledgement that hedging by SEOs and SRTs may undermine the effect of risk-balancing mechanisms, but then fail to ban SEOs and SRTs from individually hedging their own deferred compensation. Hedging of executive stockholdings was common leading up to and during the financial crisis. For example, more than a quarter of Goldman Sachs' partners employed hedging strategies between July 2007 and November 2010.[6]

The Agencies should strengthen the final rule by prohibiting SEOs and SRTs from engaging in personal hedging strategies. Many financial institutions already prohibit hedging by their employees. For example, JPMorgan Chase employees are banned from hedging of unvested restricted stock units and performance share units, as well as unexercised options or stock appreciation rights. The firm's operating committee members cannot hedge any shares owned outright or through deferred compensation.[7]

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[5] Bebchuk, Lucian A. and Spamann, Holger, Regulating Bankers' Pay (October 1, 2009). Georgetown Law Journal, Vol. 98, No. 2, pp. 247-287, 2010. Available at http://georgetownlawjournal.org/articles/regulating-bankers-pay/

[6] Eric Dash, *Stock-Hedging Lets Bankers Skirt Efforts to Overhaul Pay,* The New York Times, February 5, 2011.

[7] 2016 Proxy Statement (Form DEF 14A), JPMorgan Chase, April 7, 2016, p. 37.

Forfeiture and Clawback

The proposed rule requires systemically important financial institutions *to consider* forfeiture and clawback of incentive pay under certain circumstances, but does not mandate it. Such policies should be mandatory, and financial institutions should be required to publicly disclose the identities of SEOs and SRTs from whom pay has been forfeited or clawed back, and the amounts in question. Moreover, deferred compensation arrangements should contain a forfeiture provision to ensure a recovery in the event that previously transferred compensation becomes subject to a clawback.

Effective Date

Finally, we believe a 540-day transition period is unnecessarily generous for financial services companies to implement the rules after they are finalized. Section 965 of the Dodd-Frank Act required the Agencies to issue these rules within nine months after its passage. Six years later, the Agencies have still not issued a final rule. The financial services industry has long known that this rule is coming, and we believe that implementation should be required within 365 days after the rule is finalized.

Conclusion

We support the improvements that have been made in the Agencies' re-proposed rule, but believe that the final rule needs to go further to protect the financial system from incentive compensation that can promote excessive risk-taking. We appreciate the opportunity to comment on this important rulemaking. If the AFL-CIO can be of further assistance, please contact me at [redacted].

Sincerely,

HSC

Heather Slavkin Corzo,
Office of Investment

HSC/sdw
opeiu #2, afl-cio