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July 22, 2016

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Washington, D.C. 20219
Attention: Legislative and Regulatory Activities Division

Robert deV. Frierson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
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Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, D.C. 20429
Attention: Comments

Alfred M. Pollard
General Counsel
Federal Housing Finance Agency
400 7th Street SW, Eighth Floor
Washington, D.C. 20219
Attention: Comments/RIN 2590-AA42

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 NE
Washington, D.C. 20549

Re: Reproposed Rule on Incentive-Based Compensation Arrangements
(Docket ID OCC-2011-0001; Federal Reserve Docket No. 1536 and RIN No. 7100 AE-50; FDIC RIN 3064-AD86; FHFA RIN 2590-AA42; SEC File Number S7-07-16)

Ladies and Gentlemen:

The Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates the opportunity to provide you[2] with its comments on your reproposed rule (the "Reproposed Rule") regarding incentive-based compensation arrangements under Section 956 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). Section 956(b) of the Dodd-Frank Act requires the Agencies to jointly prescribe regulations or guidelines that prohibit incentive-based compensation arrangements that the Agencies determine encourage inappropriate risks by providing excessive compensation or incentives that could lead to material financial loss to financial institutions.

We appreciate the significant efforts undertaken in developing rules that meet the requirements of Section 956 and agree with the objective of ensuring that incentive-based compensation arrangements do not undermine the safety and soundness of financial institutions by encouraging inappropriate risk-taking. For the reasons discussed below, we are deeply concerned that the Reproposed Rule exceeds this statutory mandate and will have serious and wide-reaching consequences that increase rather than mitigate risk at financial institutions. [3]

[1] SIFMA is the voice of the U.S. securities industry. We represent the broker-dealers, banks and asset managers whose nearly 1 million employees provide access to the capital markets, raising over $2.5 trillion for businesses and municipalities in the U.S., serving clients with over $20 trillion in assets and managing more than $67 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org.

[2] The Office of the Comptroller of the Currency (the "OCC"), Board of Governors of the Federal Reserve System (the "Board"), Federal Deposit Insurance Corporation (the "FDIC" and, together with the OCC and Board, the "Federal Banking Agencies"), Federal Housing Finance Agency (the "FHFA"), National Credit Union Administration (the "NCUA") and the Securities and Exchange Commission (the "SEC" and, together with the Federal Banking Agencies, the FHFA and NCUA, the "Agencies").

[3] This comment letter supplements our comment letter submitted in respect of the rules originally proposed in 2011 pursuant to Section 956 (the "Original Proposal"), at https://www.sec.gov/comments/s7-12-11/s71211-690.pdf.

TABLE OF CONTENTS

PAGE

I. Background and Executive Summary

Incentive compensation lies at the heart of how financial institutions recruit and retain talent. The competition for talent is intense. Financial institutions compete for key personnel within the larger financial services industry, including with private equity firms, with international financial institutions whose operations are not subject to similar regulation and with other sectors of the economy that attract employees in key enterprise control functions such as technology, legal and human resources. Many of the employers with whom financial institutions compete for talent have immense resources. The target labor force is highly mobile and well-informed about opportunities, and there has already been a demonstrable movement of young talent to less regulated sectors of the economy. [4] Being able to recruit and retain highly capable employees, in revenue-generating functions as well as enterprise control functions and many other functions that do not directly involve taking risk, is critical to our members' ability to responsibly operate and risk-manage their businesses.

The events of the last decade – most recently, the referendum vote by the United Kingdom to cease its membership in the European Union – have highlighted that financial markets and the financial services industry are highly dynamic. Furthermore, financial institutions are, and have been for decades, highly diverse and differentiated. By contrast, the Reproposed Rule includes a comprehensive framework of often inflexible requirements. Because it will be promulgated and enforced by six independent agencies, once finalized it will be unusually difficult to adjust. It may significantly impact the financial services industry for a long time, through many business cycles and evolutions in the financial markets.

We believe that our members and the Agencies have very similar views about the objective of having compensation-related principles that will contribute to responsible practices. We also agree that financial institutions' design of compensation programs should contribute to the creation of business cultures that reflect those objectives.

In light of the great variation among our membership, however, the formulaic requirements included in the Reproposed Rule create immediate concerns. Our members are particularly concerned that the financial services industry will inevitably evolve, and prescriptive requirements that remain fixed will, in the long term, fail to properly address the policy objectives of Section 956 in this changing landscape. To date, the Agencies have adopted a principle-based approach, which we think has been appropriate and effective. Our members are concerned about reversing course.

The policy objectives of Section 956 will be better served by balancing specific principles and appropriately focused prescriptive rules when the Reproposed Rule is adopted in final form (the "Final

[4] "Young Wall Street workers, and potential recruits who might once have aspired to jobs in the industry, are already decamping for less regulated corners of finance and corporate America, including Silicon Valley." "Wall St. Regulators Propose Stricter Pay Rules for Bankers," NY Times (Apr. 21, 2016), available at http://www.nytimes.com/2016/04/22/business/dealbook/wall-st-regulators-propose-stricter-pay-rules-for-bankers.html?_r=0. See, also, e.g., "One Expected Casualty of New Compensation Rules: Banker Bonuses" WSJ (Apr. 21, 2016) available at http://on.wsj.com/1T2a2ce ("Big U.S. banks are already struggling to keep top talent from decamping for Silicon Valley or hedge funds. Thursday's proposed new rules on banker pay aren't likely to help."); "New Rules Curbing Wall Street Pay Proposed," WSJ (Apr. 22, 2016), available at http://www.wsj.com/articles/new-rules-curbing-wall-street-pay-announced-1461247600 ("There's a high probability it will drive people out of the heavily regulated part of the financial-services industry."); "Wall Street isn't what it used to be," Business Insider (June 2016), available at http://www.businessinsider.com/where-mbas-want-to-work-2016-6 ("This year, 26.28% of students surveyed chose large bulge-bracket banks or global financial institutions - down from 37.5% in 2010 (down 30% since 2010)."); "New Wall Street Pay Rules a Win for Hedge Funds, Mutual Funds. Money managers likely to be spared the brunt of new rules due to how assets are classified," WSJ (Apr. 21, 2016,) available at http://www.wsj.com/articles/new-wall-street-pay-rules-a-win-for-hedge-funds-mutual-funds-1461264754 ("Big hedge funds and mutual-fund companies emerged as winners of Wall Street pay rules proposed Thursday.").

Rule"), thereby allowing the Agencies and each financial institution to prudently tailor the application of the Final Rule to particular business circumstances. The plain language of Section 956 provides the statutory authority, indeed the mandate, for the Agencies to adopt balanced rules under Section 956 that give the Agencies the discretion necessary to respond to industry changes in a way that protects the financial system and mitigates risks. Of the six Agencies collaborating on the Reproposed Rule, only the SEC has sought to provide an analysis comparing the Reproposed Rule's expected costs and burdens to its claimed benefits, and only with respect to a limited set of covered institutions. The SEC has acknowledged that while it "has attempted to quantify the effects of the [Reproposed Rule]; however,[it] is unable to provide a reasonable estimate because [it] lacks the necessary data."[5] The other Agencies did not adequately weigh the costs the Reproposed Rule would impose on the covered institutions against the Reproposed Rule's claimed benefits and the costs and benefits of other less prescriptive approaches.

In formulating the Final Rule, the Agencies should build on the progress in incentive compensation governance, design and processes that has been made since the financial crisis in consultation with certain of the Agencies as part of the "horizontal review process." The principles-based 2010 Federal Banking Agency Guidance on Sound Incentive Compensation Policies (the "Final Interagency Guidance")[6] and the Original Proposal[7] have been instrumental in causing financial institutions to develop an approach to incentive compensation that takes into account the size, complexity, risk profile and business model of the institutions. Many of our member financial institutions and the various Agencies have undergone extensive work in furtherance of the goals set forth in the Final Interagency Guidance and the Original Proposal. In addition to changes to governance, capital and risk practices that have already been made, incentive compensation is another tool to promote financial stability.

One adverse impact of the overly prescriptive approach in the Reproposed Rule can be seen in the insufficient recognition in it of the difference between, on the one hand, investment advisers and broker-dealers who are primarily engaged in portfolio management or securities brokerage businesses and, on the other hand, other financial institutions whose businesses involve, to a substantially greater extent, the commitment of capital. Capital-intensive businesses in the latter category are more likely to give rise to the types of risks that Section 956 was intended to address. Non-capital-intensive businesses ordinarily do not. Under the Reproposed Rule, a small asset management or broker-dealer subsidiary of a large bank holding company could be subject to the same requirements as the bank holding company, even though the risks that could arise from its business would not be comparable.

Another likely adverse consequence of the overly prescriptive approach in the Reproposed Rule will be an increase in fixed compensation costs, because the competition for talent and the restrictions on variable compensation will require financial institutions to compete for talent by increasing fixed elements of pay.[8]

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[5] See 81 Fed. Reg. 37,758 (June 10, 2016).

[6] 75 Fed. Reg. 36,395 (June 25, 2010).

[7] 76 Fed. Reg. 21,170 (Apr. 14, 2011).

[8] See, e.g., Marilena Angeli and Shahzad Gitay, "Bonus regulation: aligning reward with risk in the banking sector," Bank of England Quarterly Bulletin 2015 Q4 at 322, available at http://www.bankofengland.co.uk/publications/Documents/quarterlybulletin/2015/q401.pdf ("One consequence of the regulation of remuneration, particularly the introduction in the European Union of the bonus cap, has been an increase in fixed remuneration as a proportion of total remuneration. As with excessive variable remuneration without appropriate incentives, this can also impact negatively on resilience within the financial system. Higher fixed pay limits the proportion of total remuneration that can be used to absorb losses in a downturn and that which is aligned to long-term risks.").

Specifically, the Agencies can and should address the foregoing issues in a way that contributes to the achievement of the important policy objectives of Section 956 by incorporating the following changes:

- *Rebalance Toward a More Principles-Based Approach.* Consistent with the standard of Section 956(c)(1), the mix of principles-based guidance and prescriptive rules should be balanced so that incentive-based compensation plans can be designed in a manner that advances the principles of Section 956 while accounting for the diverse array of financial institutions, business models and employee situations to which Section 956 applies. The Original Proposal provides a good model for appropriately balancing principles-based guidance with a very limited number of prescriptive rules that are targeted to a narrow category of employees.

- *Limit Covered Persons to Those Who Expose Institutions to Risk.* We propose that the determination of "covered persons" be revised as follows:

    - The Section __.4 requirements that apply to all covered institutions should only apply to employees who have the ability, either individually or as part of a group, to expose their employers to material amounts of risk ("<u>Risk-Takers</u>") and to "senior executive officers" (together, "<u>covered persons</u>"). Covering all employees who receive incentive compensation, as would be the case under the Reproposed Rule, could result in, at some institutions, several hundred thousand employees being covered, including administrative assistants, bank tellers, technical support assistants and others similarly situated. In any case, Risk-Takers should not include employees whose responsibilities are limited in all material respects to dealing with client funds rather than firm capital, including financial advisors, stock brokers, portfolio managers, analysts and other similar positions. Those activities already are subject to intense regulation.

    - For the group of employees subject to the prescriptive requirements for Level 1 and Level 2 covered institutions, "significant risk-takers" should be a further limited subset of the Risk-Taker group and the definition of "senior executive officers" should track the definition in the Securities Exchange Act of 1934, as discussed in Part III below. For entities that are part of a depository institution holding company group, the determination of significant risk-takers and senior executive officers generally should be made on a consolidated group basis, appropriately focused only on a population that could have the potential to impact material risk or controls.

- *Tailor Covered Incentive-Based Compensation to Those Programs That Could Encourage Inappropriate Risk-Taking; Carve Out Broad-Based and De Minimis Programs.* The Reproposed Rule goes well beyond the scope of the statutory mandate by covering all incentive compensation instead of only covering incentive compensation that could encourage employees to take inappropriate risks. It should be revised to exclude the following categories of compensation that do not encourage taking inappropriate risks as contemplated in Section 956: (i) transaction- or service-based commissions, (ii) portfolio management compensation attributable to client assets, (iii) broad-based profit-sharing and similar arrangements, (iv) non-performance-based arrangements, (v) de minimis incentive-based compensation, such as spot bonuses, and (vi) employer contributions to tax-qualified retirement plans.

- *Approach to Consolidation Should Reflect Business Structure, Risk and Governance Factors.* Consistent with the principle that effective compensation regulation must take into account the specific compensation, governance, risk control and management structures for each financial institution to which Section 956 applies, the approach of the Reproposed Rule should be more flexible.

> Except as indicated below, depository institution holding companies and each of their subsidiaries that have average total consolidated assets in excess of $50 billion should generally be consolidated with one primary regulator, but their subsidiaries that have less than $50 billion in assets should generally not be. Other covered institutions should generally not be consolidated with their affiliates, again except as indicated below. "Control" for purposes of consolidation should be based on a GAAP[9] standard to reflect business and compensation realities. There should be generally applicable exceptions from the foregoing general rules in appropriate circumstances, and the Agencies should also leave themselves the flexibility to provide specific exemptions for specific institutions or employees based on facts and circumstances.

We also have specific comments related to the treatment of investment advisers and broker-dealers, including a suggestion that unregistered investment advisers and certain registered non-U.S. investment advisers should be excluded from the SEC's version of the Final Rule.

In addition to making the foregoing changes, the Agencies should re-examine and address the issues raised by the following recommendations:

- Revise plan design requirements of the Reproposed Rule for Level 1 and Level 2 covered institutions as follows:
    - Unless the definition of "covered persons" is narrowed as we suggest, decrease deferral percentages to a range of 15% to 40% for significant risk takers and a range of 15% to 60% for senior executive officers, with a lower range, in each case, for Level 2 covered institutions.
    - Do not base deferral percentages on the present value of awards.
    - Unless the definition of "covered persons" is narrowed as we suggest, shorten deferral periods for qualifying incentive-based compensation to three years and for long-term incentive-based compensation to one year for Level 1 covered institutions, with a shorter period, in each case, for Level 2 covered institutions.
    - Do not subject voluntary deferrals in excess of required minimums to forfeiture and clawback requirements.
    - Eliminate the requirement for cash deferrals, but if required, permit reasonable notional investment.
    - Permit dividend equivalent rights to be paid when dividends are declared.
    - Increase the limit on the use of options to meet the minimum deferral requirements to 25%.
    - Increase the limit on the leverage in incentive-based compensation plans for both qualified and long-term incentive-based compensation arrangements to 150% for senior executive officers.
    - Clarify that covered institutions are not required to set targets for incentive-based compensation arrangements.

[9] "GAAP" means generally accepted accounting principles in the United States.

- Begin the clawback period at the grant date of award.
- Provide that clawback requirements do not apply to the extent that they would violate other applicable law.
- Permit acceleration of vesting in the event of a change in control or a departure for government service and clarify that forfeiture is not required in the event of involuntary termination without cause or retirement.
- Do not require compensation committees to obtain input from both the audit and risk committees about risk issues related to compensation decisions and only require them to obtain one assessment report on the efficacy of compensation-related risk mitigation efforts.
- Override any Section 956 plan design requirements where outside auditors for the financial institution advise that such design requirement(s) would prevent the financial institution from using fixed plan accounting in respect of deferred equity or equity-like awards.

➢ Revise the following requirements applicable to all covered institutions as follows:

- Eliminate the requirement that incentive-based compensation arrangements at all covered institutions have both financial and non-financial metrics.
- Streamline record-keeping requirements for all covered institutions and clarify the ability of subsidiaries to rely on parent institutions in respect of certain governance-related requirements.
- Reduce incentive-based compensation benchmarking requirements.

➢ Adopt the following recommendations that relate to the identification of covered institutions as follows:

- Revise the definition of average total consolidated assets to focus on risk concerns underlying Section 956, for example, by excluding double-counting of intercompany transactions, goodwill, leases and real property, assets of broker-dealers held for the exclusive benefit of customers, assets of non-covered affiliates of investment advisers and assets of non-U.S. advisers that do not relate to their U.S. businesses.
- Use market value of interests in subsidiaries and funds to determine assets of investment adviser.
- Index the average total consolidated asset thresholds to reflect inflation.
- Have all Agencies adopt exclusion for DPC subsidiaries set forth in the Board's version of the Reproposed Rule.

➢ Adopt the following recommendations that affect foreign banking organizations and other foreign institutions as follows:

- Exclude U.S. commercial subsidiaries of foreign banking organizations ("FBOs") from the definition of "subsidiary" and from the calculation of average total consolidated assets.

- Permit substituted compliance for Qualifying Foreign Institutions (as defined below).

- Conduct an analysis of relevant costs and benefits and appropriate quantitative impact assessments of the Reproposed Rule and provide such analysis to the public before issuing the Final Rule.

- In light of the extensive and interrelated concerns referred to above and discussed below, unless the Agencies adopt a Final Rule that reflects the principles-based approach taken in the Original Proposal, it is critical that the Agencies repropose – and provide to the public an opportunity to review and comment upon – a revised version of the Reproposed Rule.

In addition to these recommendations, we have responded to the Agencies' request for comments in Appendix A hereto.

II. Compliance with Principles-Based Mandate

A. The Final Rule Must Be Within the Statutory Mandate

To the extent that the Final Rule imposes a comprehensive scheme of mandatory plan design features that inflexibly apply to all covered institutions, it would not meet the comparability requirement of Section 956(c)(1) and would be inconsistent with the long-established standards envisioned by Section 39 of the Federal Deposit Insurance Act (the "FDIA")[10] that are referred to therein. That requirement was designed by Congress to limit the scope, nature and standards to be imposed under Section 956. The Final Rule must reflect that statutory requirement.

Section 956(b) requires the Agencies to prescribe regulations or guidelines that prohibit any incentive-based compensation arrangement, or any feature of any such arrangement, that the Agencies "determine encourage[s] inappropriate risks . . . by providing . . . excessive compensation, fees or benefits; or . . . that could lead to material financial loss" to the covered financial institution. Section 956(c)(1) requires that "any standards . . . established under subsection . . . (b)" be "comparable to the standards established under [S]ection 39 of the Federal Deposit Insurance Act."

The Reproposed Rule requires numerous specific uniform design features for incentive-based compensation plans covering financial institutions and employees of financial institutions. These plan design requirements are not compatible with nor comparable to the regulatory flexibility long afforded to and utilized by the Federal Banking Agencies in providing safety and soundness supervision as required by Section 39 of the FDIA.

The preamble to the Reproposed Rule states that "the Agencies are required to ensure that any standards established under this provision of section 956 are comparable to the standards under Section 39 of the FDIA. . . . However, section 39 of the FDIA does not include standards for determining whether compensation arrangements may encourage inappropriate risks that could lead to material financial loss."[11] The preamble asserts that such standards do not exist notwithstanding its acknowledgment of a congressional

[10] 81 Fed. Reg. 37,670, 37,673.

[11] 81 Fed. Reg. at 37,709.

presumption, inherent in Section 956(c)(1), that such standards do exist.[12] We respectfully submit that the Safety and Soundness Guidelines promulgated under Section 39 (the "Safety and Soundness Guidelines")[13] do explicitly provide a standard under Section 39 for determining whether compensation arrangements may encourage inappropriate risks. That standard envisions a flexible approach coupled with close supervisory oversight that takes into account the particular circumstances of each financial institution, employee and compensation arrangement.[14] As explained in detail in Appendix B hereto, the Section 39 standard clearly was intended to be reflected in the Section 956 guidance.

In sum, Section 956 carefully delineates the scope of the required guidance under Section 956. That delineation is also discussed in detail in our letter to the Agencies dated December 17, 2015.[15] The Reproposed Rule exceeds those boundaries in important respects.

B. Prudent and Effective Guidance

The Final Interagency Guidance reflects a conclusion by the Federal Banking Agencies that a principles-based approach is more effective than a prescriptive approach to the regulation of financial industry compensation. As explained in the preamble to the Final Interagency Guidance:

> After reviewing the comments, the Agencies have retained the principles-based framework of the proposed guidance. The Agencies believe this approach is the most effective way to address incentive compensation practices, given the differences in the size and complexity of banking organizations covered by the guidance and the complexity, diversity, and range of use of incentive compensation arrangements by those organizations. For example, activities and risks may vary significantly across banking organizations and across employees within a particular banking organization. For this reason, the methods used to achieve appropriately risk-sensitive compensation arrangements likely will differ across and within organizations, and use of a single, formulaic approach likely will provide at least some employees with incentives to take imprudent risks. (Emphasis added.)

The Reproposed Rule breaks sharply from the conclusions expressed in the Final Interagency Guidance by advancing an intensely prescriptive approach to regulation.[16] Whereas the Safety and

[12] 81 Fed. Reg. at 37,709 ("In enacting Section 956, Congress referred specifically to the standards established under [S]ection 39 of the FDIA, and was presumably aware that in the statute there were no such standards articulated that provide guidance for determining whether compensation arrangements could lead to a material financial loss.").

[13] 12 C.F.R. Part 30 – Appendix A, Interagency Guidance Establishing Standards for Safety and Soundness.

[14] The Federal Banking Agencies each have adopted guidelines implementing the compensation-related and other safety and soundness standards in Section 39 of the FDIA, including guidance explicitly setting the standard for avoiding inappropriate risks that could lead to material financial loss . See Interagency Guidelines Establishing Standards for Safety and Soundness, 12 C.F.R. part 30, app. A (OCC); 12 C.F.R. part 208, app. D-1 (Board); 12 C.F.R. part 364, app. A (FDIC).

[15] SIFMA Comment Letter (Dec. 17, 2015), available at http://www.sifma.org/issues/item.aspx?id=8589958073.

[16] We do not agree with the view that the Reproposed Rule is not an imprudent change from a principles-based to a prescriptive approach, but rather an effort to layer appropriate principles on top of uniform minimum standards that address specific issues of importance for all risk-taking employees, or vice versa. That argument may be persuasive in respect of the Original Proposal, in which the prescriptive elements were targeted to a narrow category of employees and imposed only two actual plan design requirements. However, the Reproposed Rule provides a comprehensive and broad-based prescriptive plan design framework, and it is not credible to suggest that it is in the nature of limited and necessary minimum standards or principles.

Soundness Guidelines, the 2009 Proposed Guidance on Sound Incentive Compensation Policies (the "Proposed Interagency Guidance")[17] and the Final Interagency Guidance did not dictate uniform provisions for incentive-based compensation plan design,[18] and the Original Proposal included only two such mandates for a small number of employees, the Reproposed Rule contains 13 separate plan design requirements, some of which cover all employees of covered institutions.[19]

It is particularly noteworthy that the Reproposed Rule includes several requirements that were highlighted by the Federal Banking Agencies themselves in the Final Interagency Guidance as examples of requirements that are ineffective and imprudent when applied in the wrong context which they necessarily would be if they were applied uniformly in diverse situations. We discuss those requirements in Appendix C hereto.

At the same time that it proposes prescriptive requirements that will apply formulaically to covered institutions, the Reproposed Rule assigns supervision of its implementation to different regulators that will almost certainly develop different interpretations of, and approaches to, implementing those requirements in the future. The financial services offered by different functionally regulated entities are not always clearly distinguishable, including, for example, activities engaged in by banks that are also performed by broker-dealers. These circumstances will inevitably lead to financial institutions in similar lines of business being regulated in different ways and to different treatment of employees within a single institution, and in some cases under the same incentive-based compensation arrangement, based upon the identity of the employing entity and its particular regulator. A principles-based approach will provide more flexibility for the Agencies than a formulaic approach, facilitating the appropriate application of rules to differently-situated financial institutions.

C. Experience Since the Financial Crisis

As noted in the preamble to the Reproposed Rule, the "supervisory work of the Federal Banking Agencies and FHFA has promoted more risk-sensitive incentive-based compensation practices and effective risk governance. Incentive-based compensation decision-making increasingly leverages underlying risk management frameworks to help ensure better risk identification, monitoring, and escalation of risk issues."[20] In fact, the close supervisory oversight provided by the Federal Banking Agencies, particularly in respect of

[17] 74 Fed. Reg. 55,227 (Oct. 27, 2009).

[18] Further, these rules provided or otherwise allowed for a principles-based framework for, among other things, (i) determining the employees subject to the rules, (ii) designing incentive compensation arrangements for ensuring that risk is appropriately taken into account (e.g., suggesting the use of alternative ex post and ex ante risk adjustments), (iii) monitoring such arrangements, and (iv) achieving effective governance.

[19] The prescriptive plan design requirements include (i) each incentive-based compensation arrangement (the "Plan") must have a mix of financial and non-financial measures; (ii) each Plan must allow non-financial measures to override financial measures; (iii) each Plan must provide for *ex ante* and *ex-post* performance-based adjustments; (iv) each Plan must have minimal deferral periods and amounts (which differ separately for each long-term incentive plan and each qualifying incentive-based plan) based on a present value calculation; (v) acceleration of payment must be limited to death and disability; (vi) the types of notional investments during the deferral period are limited; (vii) notional investments must be in part in cash and in part in equity; (viii) there is a limit on the ability to defer in equity in the form of options; (ix) there is a specified list of required downward adjustment factors; (x) clawback is required for specified periods; (xi) there must be a cap on the relationship between target and maximum bonus payouts; (xii) there is a prohibition on using only relative performance measures; and (xiii) there is a prohibition on Plans in which performance is based solely on transaction or revenue volume. We note that the first two requirements relate to all employees of a covered institution, and the last two requirements relate to all employees of a Level 1 or Level 2 covered institution.

[20] 81 Fed. Reg. at 37,676.

large banking organizations, materially enhances the relative effectiveness of principles-based rules compared to prescriptive rules. It permits the calibration of risk-mitigation features with the actual risks at issue, taking into account the applicable business's ability to attract and retain key employees.

The preamble to the Reproposed Rule reviews the supervisory experience of the Federal Banking Agencies since the issuance of the Final Interagency Guidance, stating that significant progress has been made through the multidisciplinary horizontal review process of 25 large, complex banking organizations and evaluation of those organizations' incentive compensation practices as a part of the Federal Banking Agencies' ongoing supervision responsibilities. Nevertheless, the Reproposed Rule would change the apparently successful approach implemented pursuant to the Final Interagency Guidance.

The Agencies' explanation for the change in course is that the Agencies have learned much about compensation plan design through the horizontal review process and other efforts in the six years since the Final Interagency Guidance. Experience concerning regulation of compensation over the past few decades suggests good reason for caution, however, especially in light of the Agencies' acknowledgement that much progress has been made under the existing approach. As acknowledged by the Financial Stability Board (the "FSB") and as summarized in Appendix D hereto, while significant progress has been made since the financial crisis under a principles-based regime,[21] a review of compensation regulation generally over the past few decades shows that prescriptive regulation has frequently not achieved its objective.[22]

In sum, it is clear that the principles-based approach reflected in the Original Proposal was contemplated by Section 956, and that this approach was expected to be more effective and has proven more effective than the prescriptive approach adopted in the Reproposed Rule would be.

III. Limit Scope of Covered Persons

A. Use a Risk-Taker Standard for Determining "Covered Persons" (Other than Senior Executive Officers) Under Section 956

Like the Final Interagency Guidance, the Final Rule should only impact the design of incentive-based compensation for the subset of employees who are Risk-Takers or senior executive officers. We recommend that Risk-Takers be identified as follows:

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[21] See also, Meridian Compensation Partners, LLC, "Executive Compensation in the Banking Industry: Emerging Trends and Best Practices, 2014–2015" (June 22, 2015), available at https://www.meridiancp.com/wp-content/uploads/Executive-Compensation-in-the-Banking-Industry.pdf; Meridian Compensation Partners, LLC, "New Realities of Executive Compensation in the Banking Industry: The Impact of Regulatory and Shareholder Influence for 2013-2014" (Aug. 1, 2013), available at https://www.meridiancp.com/wp-content/uploads/Executive-Compensation-in-the-Banking-Industry.pdf.

[22] See, e.g., Christopher Kuehn, "Unintended Consequences? The Effects of Regulation on Executive Compensation: Evidence from the Forbes 500," WesScholar (Apr. 2013), available at http://wesscholar.wesleyan.edu/cgi/viewcontent.cgi?article=2086&context=etd_hon_theses&sei-redir=1&referer=http%3A%2F%2F ; J.W. Verret, "Unintended Consequences of Executive Compensation Regulation Threatens to Worsen the Financial Crisis," Geo. Mason Law & Economics Research Paper No. 09-34 (July 20, 2009), available at http://ssrn.com/abstract=1436658; and Wynn Willard, "Unintended Consequences: The Nonsense of Executive Compensation Oversight," 16 Duq. Bus. L.J. 173 (2014), available at http://www.duqlawblogs.org/blj/wp-content/uploads/2015/01/UNINTENDED-CONSEQUENCES-THE-NONSENSE-OF-EXECUTIVE-COMPENSATION-OVERSIGHT.pdf. In the context of the Reproposed Rule, we question whether the comprehensive prescriptive framework would prove suitable in a future period of financial stress.

- Permit financial institutions that have been subject to the Final Interagency Guidance and have already been required to identify their "covered employees" thereunder to leverage their work to date to treat that group as covered persons under the Final Rule. Financial institutions that have not been required to identify "covered employees" under the Final Interagency Guidance should also be permitted to use the approach of the Final Interagency Guidance.

- Alternatively, covered institutions that do not wish to perform the detailed exercise contemplated by the foregoing could treat all of their employees who receive incentive-based compensation and total direct pay of at least $750,000 (adjusted for inflation), but not fewer than 50 individuals, as covered persons.

In any case, consistent with our argument that investment advisers and broker-dealers who are primarily engaged in portfolio management or securities brokerage businesses, neither of which primarily deals with firm capital, do not raise the types of risks contemplated by Section 956, employees of such businesses, whose responsibilities are limited in all material respects to dealing with client funds, should not be considered covered persons.[23] These individuals are generally responsible for developing, recommending and directing the execution of investment programs designed to achieve their client's objectives within established limits. Furthermore, those activities already are subject to intense regulation.

Section 956(b) requires the Agencies to prescribe regulations or guidelines that prohibit incentive compensation arrangements or features "that the regulators determine [encourage] inappropriate risks by covered financial institutions." Section 956 was intended to address the perception that flawed compensation plan designs contributed to financial institutions taking inappropriate risks that in turn contributed to the financial crisis.

Clearly, a compensation arrangement cannot encourage inappropriate risk-taking by a financial institution if the participating employees of that institution do not, either individually or as part of a group, have the ability to expose the financial institution to material risk. The Reproposed Rule should be revised so that the principles-based and prescriptive requirements included in it only apply to the incentive-based compensation arrangements of Risk-Takers and senior executive officers.

We understand that the Agencies may be concerned that the coverage of <u>all</u> employees may be mandated by Section 956. We believe that is a misreading of Section 956. While regulations under Section 956(b) should cover any "employee" who receives incentive-based compensation that "encourages inappropriate risk" to a covered institution, the Reproposed Rule does not give the Agencies the authority to regulate any incentive-based compensation received by any employee. It only grants the Agencies the authority to regulate the incentive-based compensation of those employees who can expose covered financial institutions to inappropriate risk. Given this, the standards for determining Risk-Takers set forth above based upon the Final Interagency Guidance properly identified such employees and should be the standard adopted for purposes of Section 956(b).

Failing to adopt a more appropriately tailored standard for determining covered persons will not advance the purpose of Section 956, but rather will impose unnecessary costs and other burdens on financial institutions. In particular, such unnecessary costs and burdens will arise from the requirements in the Reproposed Rule that all incentive-based compensation paid to all employees of the covered institution include financial and non-financial measures of performance and that each incentive-based compensation plan allow non-financial measures to override financial measures as discussed below in Part VII. The breadth of covered persons under the Reproposed Rule could make it unduly hard for employees who are not Risk-

[23] At many financial institutions, such employees typically have the title "portfolio manager" or "financial advisor," respectively.

Takers to satisfy ordinary life expenses such as student loans, meet mortgage obligations and pay college tuition for their children. In addition, Level 1 and Level 2 covered institutions would have to apply to all of its employees the prohibitions on using only relative performance measures and basing performance solely on transaction or revenue volume. Appendix E hereto discusses additional requirements that will have the same impact.

B. Further Limit Scope of Senior Executive Officers and Significant Risk-Takers so that They Are a Subset of Covered Persons

"Senior executive officers" and "significant risk-takers" should be identified from within the subset of covered persons (modified as suggested in Part III(A)), should generally be based on a functional standard and, where covered institutions are consolidated, should be determined based on each consolidated group of businesses to which the guidelines are applicable, rather than on an entity-by-entity basis.

1. Limit Senior Executive Officers to the Most Senior Executives in an Organization

We recommend that the definition of "senior executive officers" as used throughout the Reproposed Rule be limited in two ways. First, with limited exceptions, "senior executive officers" should be determined on a consolidated group basis, generally at the parent of a Consolidated Entity (as defined below in Part V) group and, if applicable for Separate Entities (as defined below in Part V), on a stand-alone basis. Second, we recommend referencing the term "executive officer" as defined under Rule 3b-7, or "officer" as defined for the purpose of Rule 16a-1(f) under the Securities Exchange Act of 1934 for purposes of defining "senior executive officer" under Section 956, as those long-standing definitions have the merit of being widely applied by financial institutions and are well understood.

These two proposals collectively are appropriate in light of the purposes of Section 956. Generally, the term "senior executive officer" is understood to refer to the most senior executives within a consolidated organization. The definition of "senior executive officers" in the Reproposed Rule fails to reflect this understanding by requiring subsidiary covered institutions to treat their executives as senior executive officers even though those individuals may be relatively low-level executives within the context of a consolidated group.

Example: The Reproposed Rule would treat the chief accounting officer of a $1 billion subsidiary of a $250 billion bank holding company as a "senior executive officer," subjecting the chief accounting officer to the same prescriptive requirements as the chief executive officer of the bank holding company. Such executives of lower-tier entities will rarely have the ability to expose their parent to a material risk of loss arising from inappropriate risk-taking or be responsible for developing policies that, or overseeing other employees who, could expose the parent to a material amount of risk.

Furthermore, persons occupying certain of the senior executive officer positions identified in the Reproposed Rule do not generally have the ability to expose financial institutions to material amounts of risk and therefore their incentive-based compensation could not lead to inappropriate risk-taking by a covered institution. If the Final Rule does not adopt the proposal above, we recommend that the Final Rule adopt a principles-based approach that recognizes that certain of the roles specifically identified in the Reproposed Rule often do not include risk-taking authority of the type contemplated by Section 956. For example, chief legal officers and chief human resource officers frequently do not have the authority to take such risks. In the event such individuals do have such ability, they will be identified as "significant risk-takers."

In particular, in response to the Agencies' request for comment as to whether senior executive officers should include chief technology officers and persons performing similar functions, such persons should not be designated as senior executive officers, as they rarely have the ability to take inappropriate risks within the contemplation of Section 956. Importantly, should their role involve risk-taking authority, they too are more appropriately included in the "significant risk-taker" classification. To be sure, while cybersecurity issues present financial institutions with material and difficult-to-manage risks, such risks are not credit risks or market risks – i.e., risks of the type identified by the Reproposed Rule as the underlying concern of Section 956. Furthermore, as senior technology officers have many opportunities outside the financial sector, inappropriately subjecting them to Section 956 requirements is likely to weaken the ability of financial sector firms to retain the most capable individuals in these fields.

In addition, a covered employee should be considered a "senior executive officer" with respect to an award only if he or she meets the applicable definition on the grant date of the award. That rule would be consistent with the requirements of Section 409A of the U.S. Internal Revenue Code (the "IRC"), which generally requires that deferral periods be fixed not later than the date that a legally binding right with respect to the award first exists.

2. Determine Significant Risk-Takers Based on Risk-Taking Activities

"Significant risk-takers" should be a subset of covered persons (modified as suggested in Part III(A) and not including any senior executive officers), generally determined on a consolidated basis, such that only those individuals whose activities directly may expose the consolidated financial institution to the most material amounts of risk are considered significant risk-takers.

In contrast, the tests set forth in the Reproposed Rule do not identify such individuals based on risk-taking activities, and would therefore not address the statutory goal of Section 956. For example, the relative compensation test under the Reproposed Rule would capture an overly broad group of individuals many of whom would have no relationship to risk taking of the type contemplated by Section 956, leading to the erroneous designation of many persons as significant risk-takers. There are many highly paid employees at a typical financial institution who do not engage in risk-taking activities (e.g., senior information technology professionals who are critical to protecting against threats to cybersecurity) and therefore have no ability to expose the financial institution to inappropriate risks. In addition, the tests may be under-inclusive at the same time, leaving the persons who should be covered excluded altogether.[24]

Thus, we propose two alternative methods for determining a covered institution's significant risk-takers:

- Financial institutions that are already subject to the Final Interagency Guidance and that have previously agreed upon an approach to identifying material risk-takers with their regulators should be allowed to use their existing frameworks to identify the subset of Risk-Takers who should be treated as significant risk-takers. Each significant risk-taker should be an individual who directly may expose financial institutions to significant risk. This method would also be available to other financial institutions that are willing to engage in a similar exercise with their regulators. The approach used by each institution should be permitted to

[24] Moreover, this feature of the Reproposed Rule provides an illustration of the potential for adverse consequences. Under the proposed test, the more non highly paid employees employed by an institution, the greater the number of significant risk-takers. For example, assume a Level 1 institution employs 190,000 lower-paid, non-management employees, and 10,000 management-level employees. Assume that the lowest paid of the 10,000 management-level employees is a recent college graduate earning $50,000 per year and eligible for a maximum $25,000 bonus. Under the Reproposed Rule, 50% of that annual bonus could not be paid for four years, and all of it would be subject to clawback for seven years after the end of the vesting period. The rules create an incentive for the Level 1 institution to lower its headcount of lower-paid employees so that its lowest-paid management employees are not subject to those requirements. Using the same example, if the institution were to reduce its lower-paid headcount by 25,000 employees, it would reduce the number of its significant risk-takers by 1,250 people, or 5% of 25,000. As a matter of public policy, the Agencies should not want to create such an incentive.

continue to evolve over time, as risk-related factors change for each institution. The list of significant risk-takers would be subject to oversight of and review by the applicable Agency.

- In the alternative, financial institutions that do not elect to engage in the more time-intensive and iterative risk-based analysis described above could use the following relative compensation test as a proxy for their most significant risk-takers: significant risk-takers should be 5% (for Level 1 covered institutions) and 2% (for Level 2 covered institutions) of all Risk-Takers of a Consolidated Entity or Separate Entity, as applicable, but in no case should a person be a significant risk-taker unless his or her total direct pay is at least $1 million (adjusted for inflation). Persons with compensation below that level should not have the authority to directly expose a $50+ billion institution to the most material amounts of risk at the organization.

In any case, because of the diverse types of institutions and employee situations covered, the Final Rule should grant the Agencies authority to provide for the exclusion of specific employees from the "significant risk-taker" category based on particular facts and circumstances.[25]

a. Eliminate the Exposure Test

The exposure test under the Reproposed Rule is not necessary and is impractical and inconsistent with financial industry practices and should be eliminated. That test fails to properly identify individuals who have the ability to expose covered institutions to inappropriate risks because it focuses only on whether an employee "may commit or expose" 0.5% of the capital of a covered institution or any affiliated covered institution (measured as specified in the Reproposed Rule for different types of institutions) and does not distinguish between the types or risk-profile of assets or transactions in respect of which an employee has authority.

Example: An employee who has the ability to trade as little as $2.5 million of U.S. Treasury Notes each day would be treated in the same manner as a trader who has authority to buy and sell $10 million of non-investment grade bonds each day. A low-level employee in a financial institution's treasury department might have the authority to invest in the U.S. Treasuries, while authority to trade non-investment grade bonds would typically be limited to a trading desk that could take significant risk.

More importantly, the Reproposed Rule would apply the exposure test based on the capital of each separate covered institution within a Consolidated Entity. That approach is unjustified by the risk-mitigation purpose of Section 956. Significant risk-taker designations should always be based on an assessment of whether the applicable risks are significant for the Consolidated Entity or Separate Entity, as applicable, to which the Section 956 guidance is being applied.

Furthermore, the phrase "may commit or expose" does not provide a basis to distinguish between (i) persons who have transaction-level authority, and who by virtue of such authority may be significant risk-takers, (ii) committee members or others who may have authority to establish transaction limits or otherwise oversee or supervise trading activity but who are not themselves in a position to expose the financial institution to the most material amounts of risk and (iii) persons who act solely in advisory or general oversight capacity. Persons in category 2 and, depending on the facts, potentially in category 3 above may be

[25] The European Union utilizes this approach. "[P]resumptions based on quantitative criteria should not apply where institutions establish on the basis of additional objective conditions that staff do not in fact have a material impact on the institution's risk profile, taking into account all risks to which the institution is or may be exposed." Commission Delegated Regulation (EU) No 604/2014 of 4 March 2014 supplementing Directive 2013/36/EU of the European Parliament and of the Council with regard to regulatory technical standards with respect to qualitative and appropriate quantitative criteria to identify categories of staff whose professional activities have a material impact on an institution's risk profile.

appropriately categorized as covered persons, but should not be characterized as significant risk-takers. The lack of clarity in the Reproposed Rule would create substantial administrative challenges, including difficulty in assigning qualified persons to serve in oversight roles, including on committees.

Finally, the test as proposed is impractical and inconsistent with financial industry practices. Many banks have individual delegations of authority on a transactional basis, but do not monitor aggregate exposure on a daily basis by individual, making it impossible to monitor the test as proposed.

b. Eliminate or Modify the "One-Third Threshold" Test

If the foregoing approach were adopted, the "one-third threshold" test would not be necessary and should also be eliminated. The one-third threshold is not an appropriate test for determining the pool from which significant risk-takers are identified. The preamble to the Reproposed Rule states that the threshold is based in substantial part on the Agencies' 2012 large banking organization review.[26] However, such review was primarily focused on persons who were otherwise identified as risk-takers. A very large portion of employees at the financial institutions who were not designated as risk-takers also have more than one-third of their total annual compensation paid as incentive-based compensation.

If the Agencies believe it is important to retain this test, and especially if they determine not to limit the definition of covered persons as recommended above, then a meaningful threshold of incentive-based compensation relative to total annual compensation for identifying significant risk-takers should be set at 50%.

IV. Incentive-Based Compensation Should Be Limited to Compensation That Could Incentivize Employees to Take Inappropriate Risks

The Reproposed Rule should be revised to exclude the following categories of compensation that do not encourage taking inappropriate risks as contemplated in Section 956: (i) transaction- or service-based commissions, (ii) portfolio management compensation attributable to client assets, (iii) broad-based profit-sharing and similar arrangements, (iv) non-performance-based arrangements, (v) *de minimis* incentive-based compensation, such as spot bonuses, and (vi) employer contributions to tax-qualified retirement plans. These arrangements are not based on business activities that involve any commitment of firm capital or any risk to firm capital following the time that compensation is paid or otherwise do not incentivize employees to take inappropriate risks.

In addition, the preamble to the Reproposed Rule specifically states that "dividends paid or appreciation realized on stock or other equity-like instruments that are owned outright by a covered person" are excluded from the definition of "incentive-based compensation." Given that holders of equity-like instruments (such as partnership and limited liability company interests) owned outright are entitled to a share of the issuers' earnings, similar to dividends paid and appreciation realized, we request that the Agencies specify in the Final Rule that all earnings on equity-like instruments are also excluded from the definition of "incentive-based compensation."

A. Transaction- or Service-Based Commissions Should Not Be Considered Incentive-Based Compensation

Transaction- or service-based commission arrangements, defined to mean an employee's percentage of revenue attributable to securities brokerage commissions, investment advisory fees or other fees attributable to the servicing or management of client assets, do not by their nature and design encourage

[26] 81 Fed. Reg. at 37,693.

inappropriate risk-taking by a covered institution and they should be excluded without condition from the definition of incentive-based compensation. The SEC's version of the Reproposed Rule recognizes that dealing with client assets does not give rise to the risks contemplated by Section 956 in carving out non-proprietary assets from the definition of "average total consolidated assets." Based on the same logic, broker-dealers' transactions involving assets held for the exclusive benefit of customers do not raise the concerns that Section 956 was intended to address. The business of securities brokerage was not deemed in any way to be a contributing factor in the financial crisis.[27]

Furthermore, the business of securities brokerage, and the commission arrangements that are routinely used in that business, is subject to substantial additional regulation, including regulation by FINRA, under the Securities Exchange Act of 1934, in some instances the Investment Advisers Act of 1940 (the "Advisers Act") and the Employee Retirement Income Security Act of 1974, and to extensive internal compliance and audit processes. Section 956 is not an appropriate vehicle for addressing all risks and should not be used as such.

Moreover, the clawback, downward adjustment and forfeiture provisions of the Reproposed Rule could not apply in many U.S. jurisdictions in which such commissions are treated as wages and protected against such conditions. Violation of applicable wage laws is in many states a criminal offense. That characterization reflects the reality that for many employees such compensation is in the nature of base pay, like salary.

Finally, consistent with all of the foregoing, commission-based compensation was not treated as variable compensation under the Department of the Treasury's 2009 TARP Standards for Compensation and Corporate Governance.[28]

B. Client Portfolio Management Compensation Should Not Be Considered Incentive-Based Compensation

Under a carried interest arrangement, an employee is entitled to share in the profits arising from the management by an investment adviser of the investments in an advisory client's portfolio (e.g., the profits generated at the time of the sale of an investment in a client's portfolio or the dividend or interest income generated by the investments in a client's portfolio). The amount of carried interest is typically an agreed-upon percentage of the client's profits based on the performance of investments in the client's portfolio and is paid or distributed on an annual basis or upon the occurrence of certain events (such as the realization of investments in the client's portfolio), depending upon the type of investment strategy applicable to the client's portfolio. Carried interest is generated by the performance of a client's investment portfolio and not by the investment of capital on the part of the investment adviser. As a result, in the typical third-party advisory client arrangement, employees are not putting any firm capital at risk in order to generate carried interest and are not incentivized to engage in conduct that exposes the firm to material amounts of risk. Accordingly, we assume that carried interest, phantom carried interest and other similar arrangements are not incentive-based compensation under the Reproposed Rule, but in light of the broad definition of incentive-based compensation we would appreciate confirmation.

[27] The discussion above is not intended to refer to mortgage origination commission arrangements or transactions involving mortgage-backed securities that are created by the broker-dealer or its affiliates.

[28] 74 Fed. Reg. at 28,400.

C. Broad-Based Profit-Sharing and Similar Arrangements Should Not Be Considered Incentive-Based Compensation

Other compensation arrangements that do not involve any commitment of firm capital or any risk to firm capital do not, in fact, encourage inappropriate risk-taking by a covered institution for purposes of Section 956. An example of such an arrangement is a broad-based profit-sharing plan. Section 956 was not intended to address all types of compensation plans, but only those that encourage inappropriate risk-taking by the covered institution, and it is not an appropriate vehicle for addressing other potential concerns.

D. Non-Performance-Based Compensation Should Not Be Considered Incentive-Based Compensation

Many employers make regular annual grants of stock or other awards that are not based on past measures of performance or subject to future performance-based conditions. The amount awarded to each employee each year may be negotiated in advance or determined by reference to employment level, category or status, or other similar factors that are not tied to performance in the manner contemplated by the Reproposed Rule. For example, some employers make regular annual stock option awards based on employment level or category. Some employers make regular annual restricted stock unit awards with values based on a fixed percentage of each employee's base salary. Some employers make "matching" grants of stock awards to employees who acquire company stock out of their payroll deductions. Some employers make periodic stock grants to all persons who are employees "in good standing" on the award date. The Final Rule should clarify that such awards are not "incentive-based compensation."

In addition, we agree with the Reproposed Rule that retention bonuses or other awards that are designed simply to incentivize employees not to voluntarily terminate employment should not be treated as incentive-based compensation.

E. Incentive-Based Compensation of Less than $50,000 per Year Should Not Be Considered Incentive-Based Compensation

The Final Rule should except from its deferral, forfeiture and clawback requirements *de minimis* amounts of incentive-based compensation of less than $50,000 paid to any employee in any year (indexed for inflation).[29] For any such employee, the compensation received should not be subject to the requirements of the Final Rule. Employers may implement a wide variety of such arrangements, including project completion awards, quality of service awards, spot bonuses, *de minimis* sales incentives and various other recognition programs.

F. Employer Contributions to Tax-Qualified Retirement Plans Should Not Be Considered Incentive-Based Compensation

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 ("IRC") and regulated under associated U.S. Treasury Department regulations, including employer contributions to a 401(k) retirement savings plan computed based on a fixed percentage of an employee's bonus.[30] Such contributions should be excluded from the definition of incentive-based compensation because they are primarily intended to encourage employees' saving for retirement rather than current performance.

[29] Employees who receive $50,000 or less in incentive-based compensation per year typically make less than $200,000 per year or receive such a large portion of their compensation in fixed compensation that incentive-based compensation forms such a small portion of their overall compensation that it cannot meaningfully encourage inappropriate risk-taking.

[30] The Final Rule should also treat similar non-U.S. plans in the same manner.

Furthermore, such contributions are subject to extensive rules under the IRC and Treasury regulations and can only be withdrawn from the qualified plan under limited circumstances.

V. Consolidation

If the principles-based approach is not adopted, we have the following recommendations with respect to the topic of "consolidation," which term we use to cover the following issues: (i) how to determine the Level for any covered institution, (ii) who the functional regulator is for each covered institution, (iii) governance (i.e., which entity's board oversees incentive-based compensation programs) and (iv) how to determine covered persons, senior executive officers and significant risk-takers:

- Depository institution holding companies (or other parent covered institutions) and each of their subsidiaries that have average total consolidated assets in excess of $50 billion should generally be consolidated (a "Consolidated Entity"), but their subsidiaries that have less than $50 billion in assets should generally not be consolidated but should instead be treated separately, subject to the exceptions discussed below. Any entity that is not consolidated, regardless of total assets, is referred to as a "Separate Entity." As discussed below, the Agencies should reserve the authority to impose requirements that would otherwise be inapplicable on Separate Entities in certain circumstances.

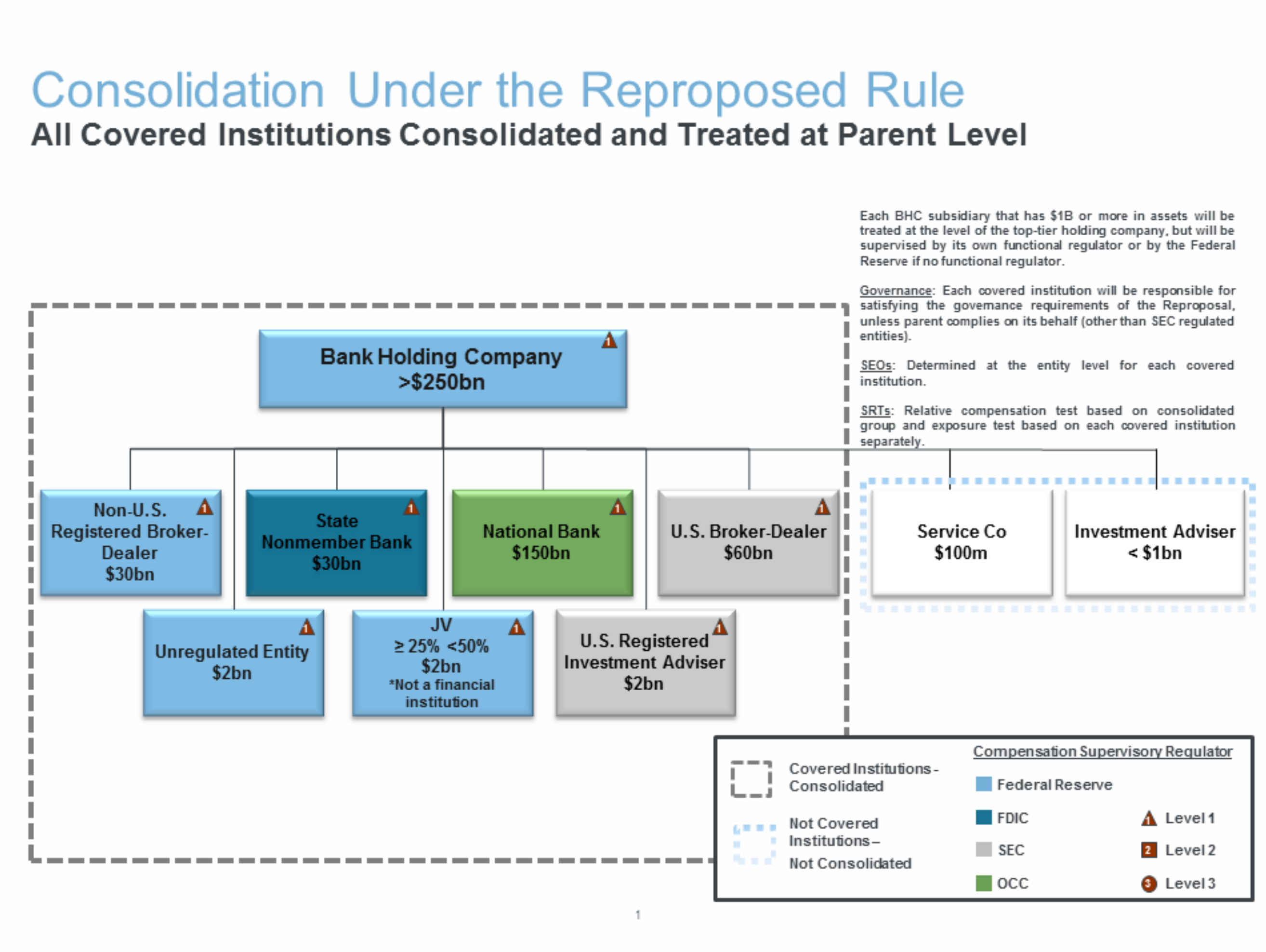
- Other covered institutions should generally not be consolidated with their affiliates, subject to exceptions discussed below.

- "Control" for purposes of consolidation should be based on a GAAP standard to reflect accounting, financial control, profit/loss and related compensation realities.

- The SEC should adopt the same rule as the other Agencies permitting governance to be performed at the parent level for all covered institutions, regardless of whether the applicable entities are consolidated.

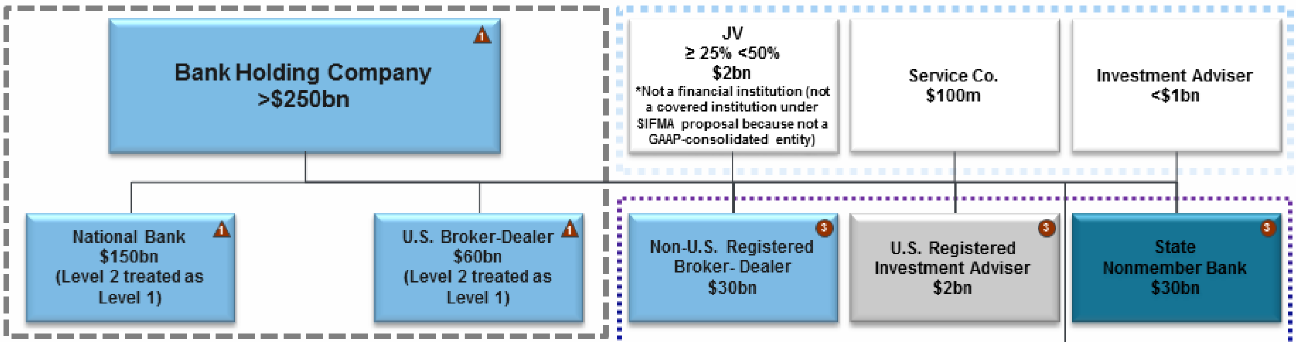
- For Consolidated Entities, the supervisory Agency (e.g., the Board in the case of depository institution holding companies) should have primary oversight responsibility, and for Separate Entities, the functional regulator should have primary oversight responsibility.

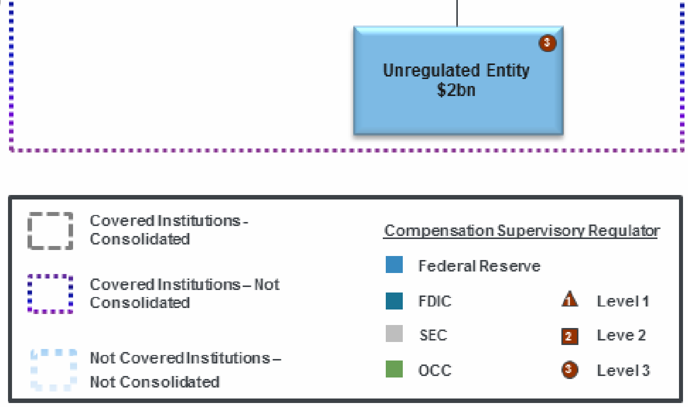
Our consolidation proposal as compared to the consolidation proposal in the Reproposed Rule is illustrated in the slides embedded below. There should be generally applicable exceptions from the foregoing general rules for financial institutions in appropriate circumstances, and the Agencies should also leave themselves the flexibility to provide specific exemptions for specific institutions or employees based on facts and circumstances, all as set forth below.


Consolidation Under the Reproposed Rule
All Covered Institutions Consolidated and Treated at Parent Level
Each BHC subsidiary that has $1B or more in assets will be treated at the level of the top-tier holding company, but will be supervised by its own functional regulator or by the Federal Reserve if no functional regulator.
Governance: Each covered institution will be responsible for satisfying the governance requirements of the Reproposal, unless parent complies on its behalf (other than SEC regulated entities).
SEOs: Determined at the entity level for each covered institution.
SRTs: Relative compensation test based on consolidated group and exposure test based on each covered institution separately.
Bank Holding Company >$250bn
Non-U.S. Registered Broker-Dealer $30bn
State Nonmember Bank $30bn
National Bank $150bn
U.S. Broker-Dealer $60bn
Service Co $100m
Investment Adviser < $1bn
Unregulated Entity $2bn
JV ≥ 25% <50% $2bn
*Not a financial institution
U.S. Registered Investment Adviser $2bn
Covered Institutions - Consolidated
Not Covered Institutions – Not Consolidated
Compensation Supervisory Regulator
Federal Reserve
FDIC
SEC
OCC
Level 1
Level 2
Level 3
1

Base Case Consolidation under the SIFMA Proposal

Consolidate Level 1 & 2 Institutions, Treat Level 3 Institutions as Level 3





For BHCs, Level 1 and Level 2 entities are treated at level of parent on a consolidated basis. Level 3 entities retain Level 3 status, regardless of Level of parent/consolidated group. *, **

Governance: May be performed at the parent level for all covered institutions, including SEC regulated entities – regardless whether consolidated.

SEOs: Determined on a consolidated basis for all consolidated institutions.

SRTs: Relative compensation test determined on consolidated group basis (and if exposure test is required to be preserved, to be based on 0.5% of consolidated group assets).

* In certain circumstances, financial institutions may opt to include Level 3 entities in the consolidated group if they deem appropriate, unless regulator(s) determines doing so would result in inappropriate risk based on safety and soundness concerns. If this option were exercised, the "Non-U.S. Registered Broker-Dealer" indicated above, for example, could be treated as a "Covered Institution – Consolidated" for all purposes (e.g., governance, functional regulator) and its Level would increase to Level 1.

** The U.S. regulator of a U.S. BHC may permit one or more foreign subsidiaries subject to foreign regulatory regime(s) to comply with the applicable host country's regime (rather than U.S. scheme) to the extent that the U.S. regulator determines such regime is substantially equivalent or is otherwise substantially consistent with the purposes of Section 956.

2

A. Challenges Presented by the Reproposed Rule

In general, consistent with the principle that effective compensation regulation must take into account the specific compensation, governance, risk control and management structures for each financial organization to which Section 956 applies, and the fact that our members include a very diverse range of structures, the approach of the Reproposed Rule must be more flexible.

The preamble to the Reproposed Rule acknowledges only one problematic aspect of the approach to consolidation included in the Reproposed Rule, arising from the requirement that Level 3 covered institutions of Level 1 or Level 2 parents would be subject to the requirements applicable to their parents. The preamble seems to assume that this issue only gives rise to governance and record-keeping burdens. It cites to Section __.3(c) as "an effort to reduce the burden."[31] The issues arising from the approach of the Reproposed Rule in respect of consolidation are not, however, limited to the single burden assumed by the preamble. To the contrary, there are two other very important issues arising from the concept of consolidation in the Reproposed Rule.

First, the Reproposed Rule does not appropriately address the reality, cited in the preamble, that "incentive-based compensation programs generally are designed at the holding company level and are applied throughout the consolidated organization." Far from reflecting this reality, the approach of the Reproposed Rule would disrupt covered institutions' compensation practices because of overlapping and inconsistent regulatory guidance and oversight.

Example: Regardless of the reality noted in the preamble to the Reproposed Rule, under the Reproposed Rule a bank holding company would be subject to primary Section 956 supervision by the Board, whereas its broker-dealer and investment adviser subsidiaries would be subject to primary Section 956 supervision by the SEC and its depository institution subsidiaries might be subject to primary Section 956 supervision by the FDIC or the OCC. The Agencies' respective application of their rules to the bank holding company and its subsidiaries could differ, creating conflicting demands on the bank holding company's board of directors and inappropriate incentives for employees to be employed, and businesses to be conducted, in one entity rather than another.

Second, the Reproposed Rule has the obvious effect of applying prescriptive incentive-based compensation plan design requirements applicable to very large (Level 1) organizations to employees of their much smaller (Level 3) subsidiaries, potentially impairing the critical need of the subsidiaries to attract and retain employees in competition with other employers not subject to similar requirements.

Neither of those two issues is mitigated by Section __.3(c). Furthermore, the conclusion in the preamble to the Reproposed Rule that its approach helps to reinforce the ability of institutions to establish and maintain effective risk management is not explained and is not clear. Certainly, to the extent the approach results in a division of supervisory labor between Agencies, it has the risk of not being as effective and will likely hinder a financial institution's ability to maintain effective risk management. In larger organizations, risk is not generally managed on an entity-by-entity basis, but rather is considered across businesses. Effective compensation rules must work in a manner that reflects and is compatible and otherwise consistent with such risk frameworks. The application of the Section 956 requirements with respect to the parent in a consolidated approach should be effective to address risk issues arising from its subsidiaries, without subjecting the subsidiary to the parent's level of regulation.

Moreover, the argument that it is necessary to subject a small subsidiary to the rules applicable to its larger parent seems to neglect the basic premise of proportionality underlying the tiering approach of the

[31] Section __.3(c) is not applicable under the SEC's version of the Reproposed Rule.

Reproposed Rule – i.e., that smaller businesses require less regulation because they are less likely to incur large losses.

B. Consolidation Should Generally Reflect Business Structure and Circumstances

1. Base Case and Alternative Case

The consolidation approach of the Final Rule will be most effective and appropriate if it reflects the business and organization of each financial organization. Such an approach would permit risks to be considered in the appropriate business context, and incentive-based compensation plan design and other elements of such arrangements (such as identification of senior executive officers and significant risk-takers and governance) to reflect the way in which the businesses are organized and governed. This general principle should be implemented as follows:

- *Base Case – Consolidated Entity Treatment*. For a depository institution holding company (or other covered institution parent of one or more covered institutions) with average total consolidated assets in excess of $50 billion and each of its subsidiaries that has average total consolidated assets in excess of $50 billion, the Level, governance and related requirements, identification of significant risk-takers and senior executive officers, responsible Agency and applicable rules should generally be determined by reference to the Consolidated Entity consisting of the holding company and such subsidiaries, as if they were a single entity.[32]

- *Base Case – Separate Entity Treatment*. In all other cases, including cases in which there is no depository institution holding company, the Level, governance and related requirements, identification of significant risk-takers and senior executive officers, responsible Agency and applicable rules for each covered institution should generally be determined on a Separate Entity basis.

  - *Example 1 (Base Case – Separate Entity Treatment)*. If a holding company that is not a covered institution, such as a mutual insurance company, owns one or more subsidiaries that are covered institutions, the requirements of the Final Rule generally should apply to the subsidiaries as Separate Entities for all purposes, and each of the subsidiaries should be subject to primary Section 956 supervision by its functional regulator (and the rules promulgated by the functional regulator under Section 956 would apply to the Separate Entity).

  - *Example 2 (Base Case – Separate Entity Treatment for Level 3 Subsidiary)*. If a bank holding company with $110 billion in average total consolidated assets owns a bank with $90 billion in average total consolidated assets and a registered investment adviser with $5 billion in average total consolidated assets, the bank holding company and the bank generally should be treated as a Consolidated Entity for purposes of the Final Rule and subject to primary Section 956 supervision by the Board (and the rules promulgated by the Board under Section 956 would apply to the Consolidated Entity group), while the investment adviser generally should be treated as a Separate Entity for purposes of the Final Rule and subject to primary

[32] For purposes of clarity, we are not suggesting here that the determination of "average total consolidated assets" should be made on a basis that is different than is described in the Reproposed Rule. Thus, for example, if a Consolidated Entity consists of a bank holding company parent, a national bank subsidiary and a broker-dealer subsidiary, and the broker-dealer is not part of the Consolidated Entity group, the Level of the bank holding company would be determined based on the FR Y-9C without reference to the consolidation status of the broker-dealer under Section 956.

Section 956 supervision by the SEC (and the rules promulgated by the SEC under Section 956 would apply to the Separate Entity). However, if the bank and the investment adviser each had $55 billion in average total consolidated assets, the bank holding company, bank and investment adviser generally should be treated as a Consolidated Entity and subject to primary Section 956 supervision by the Board (under the rule described above in the paragraph entitled "Base Case – Consolidated Entity Treatment").

In this Example 2 the Separate Entity approach for the $5 billion investment adviser is appropriate because the size of the investment adviser limits the risk that could arise from its business. Furthermore, the Board, as primary regulator for its parent bank holding company, would have authority with respect to the risks that the investment adviser might pose to the bank holding company. Since the rules applicable to the Level 3 investment adviser should not include any of the supplemental rules applicable to significant risk-takers and senior executive officers of its parent, the need for a single regulator in order to ensure consistency is substantially diminished. This treatment would give the investment adviser needed flexibility to compete with other similarly sized employers to attract and retain employees. [33]

There should be exceptions to the general rules, as follows:

- *Alternative Case – Separate Entity Treatment*. Different incentive-based compensation programs are designed and implemented at a subsidiary of a bank holding company (or other covered institution parent of one or more covered institutions) that might be a Consolidated Entity under the general rule than are maintained at the bank holding company (or the parent), or where a financial company is "controlled" by a parent bank holding company or regulated institution within the meaning of the Reproposed Rule but is not integrated (in terms of business lines, systems, management and policies and procedures) into the parent's consolidated operations, to reflect different business and risk circumstances of the subsidiary. In these situations, a Separate Entity approach for the subsidiary may be appropriate.

    - *Example 3 (Alternative Case – Separate Entity Treatment of GAAP Consolidated Subsidiary)*. Assume that a bank holding company with average total consolidated assets of $260 billion (the "BHC") owns a 100% interest in a bank with average total consolidated assets of $200 billion (the "Bank") and a 60% interest in a covered institution with average total consolidated assets of $100 billion (the "CI"). Assume that another person or persons own the remaining 40% interest in the CI. Assume that the BHC and the Bank, as is customary, share benefit plans and governance and risk structures, but that for historic or business reasons the CI maintains incentive-based compensation plans that are separate from the plans of the BHC and the Bank, is governed by a separate board of directors, has separate management, does not integrate its operations with the business of BHC and the Bank, and is engaged in a business that has very different risk characteristics from those of the BHC and the Bank. The CI should be able to be treated on a Separate Entity basis under which it would not be consolidated with the BHC and the Bank for any purposes of the Final Rule, including for purposes of determining the Level of the CI and for purposes of determining its primary Section 956 regulator.

    - *Example 4 (Alternative Case – Separate Entity Treatment of GAAP Unconsolidated Subsidiary)*. Assume that a bank holding company with average total consolidated

[33] As discussed in paragraph F below, the Final Rule should expressly state that a Level 3 covered institution may rely on the governance processes of its parent company on a permissive basis for purposes of compliance with Section __.4, even if the Level 3 covered institution is not consolidated with its parent.

assets of $300 billion (the "BHC") owns a 49% interest in a joint venture with average total consolidated assets of $100 billion that is organized and engaged in business entirely outside the United States (the "JV"). Assume that a foreign banking organization owns the remaining 51% interest. Assume that the JV maintains incentive-based compensation plans that are designed in accordance with customary non-U.S. practices and consistent with the design of its foreign controlling parent and is governed by a separate board of directors from the BHC. Assume that the JV is not consolidated with the BHC for financial reporting purposes under GAAP. The JV should not be consolidated with the BHC for any purposes of the Final Rule, including for purposes of determining the JV's Level. The same result should obtain for the facts of this example based (1) on our suggestion concerning GAAP consolidation in Part V(B)(2) below and (2) on our suggestion concerning substituted compliance in Part IX(B) below. However, even if our suggestions in those parts are not reflected in the Final Rule the consolidation principles of the Final Rule should result in Separate Entity treatment for the JV.

- *Alternative Case – Consolidated Entity Treatment*. If a financial organization does not have a covered institution parent but includes two or more covered institution subsidiaries that are operationally integrated, a Consolidated Entity approach for the subsidiary may be more appropriate. This may also be the case where a depository institution holding company has average total consolidated assets in excess of $50 billion (or other covered institution parent of one or more covered institutions) and has one or more covered institution subsidiaries that have average total consolidated assets of less than $50 billion but is operationally integrated.

  - *Example 5 (Alternative Case – Consolidated Entity Treatment for Some Level 3 Subsidiaries and Separate Treatment for Others)*. Assume that a bank holding company with more than $250 billion in average total consolidated assets has a broker-dealer subsidiary with more than $100 billion in average total consolidated assets and numerous additional broker-dealer and investment adviser subsidiaries that deal with securities brokerage and investment of client assets that each have between $10 billion and $40 billion of average total consolidated assets. Assume that for some of these smaller entities, the brokerage and advisory activities are conducted as part of an integrated line of business of the larger affiliated broker-dealer. Other of these smaller entities operate outside that line of business, for business, foreign regulatory, historical or other appropriate reasons. It might be appropriate to treat the former group of those smaller broker-dealers and investment advisers as part of the Consolidated Entity, but the latter group as Separate Entities.

  - *Example 6 (Alternative Case – Consolidated Entity Treatment)*. Assume that an entity is not a covered institution but owns controlling interests in two or more broker-dealers that are covered institutions. Assume that those covered institutions maintain common incentive-based compensation plans, their businesses are governed by a common governance structure and board, they have common senior management and are operationally integrated or they are engaged in similar businesses that have similar risk characteristics. The covered institutions should be able to be treated as a Consolidated Entity for purposes of the Final Rule.

  - *Example 7 (Alternative Case – Consolidated Entity Treatment)*. Assume that a bank holding company with $110 billion in average total consolidated assets owns a bank with $90 billion in average total consolidated assets and a broker-dealer with $20 billion in average total consolidated assets. Assume that all three entities maintain common incentive-based compensation plans, are governed by a common governance structure and board, have common senior management and are operationally integrated. The entities should be able to be treated as a Consolidated Entity for purposes of the Final Rule. These are essentially the same facts as in Example 2 above, in which the "base case" rule would result in the broker-dealer being treated as a Separate Entity. However, the alternative of Consolidated Entity treatment should be available and may be desirable because of the common governance, management, risk and compensation structure. If the covered institution elects such Consolidated Entity treatment, the broker-dealer would be subject to Level 2 requirements, and the determination of senior executive officers and significant risk-takers would be based on the Consolidated Entity.

In these situations, the structure of the financial organization, its existing risk management / governance framework and its incentive-based compensation system should dictate the application of Section 956. As discussed below in connection with the Agencies' discretion under Section __.6 of the Reproposed Rule, the Agencies should reserve the authority to impose otherwise inapplicable requirements on covered institutions with less than $50 billion in average total consolidated assets in certain circumstances. See subpart C below for additional discussion with respect to Agency discretion. In the absence of the exercise of Agency discretion, a determination that alternative treatment is warranted in a particular situation could be made by the financial institution based on its particular situation, subject to the review of the relevant Agencies based on safety and soundness considerations (for banking institutions) or other appropriate risk control standards (for other institutions).

2. GAAP Consolidation Principles Should Apply

Following GAAP consolidation principles in the application of the Reproposed Rule's approach to consolidation would help address a number of scenarios where a "subsidiary" does not present the financial risks or the level of systems and administrative integration that should be required for consolidation under Section 956.

Under the Reproposed Rule, the definition of "control" for purposes of determining the status of an entity as a "subsidiary" that might be subject to consolidation uses the control standard under the Bank Holding Company Act (the "BHCA"), which employs a lower threshold than GAAP consolidation for finding "control." Control under the BHCA is found whenever a company owns 25% or more of a class of voting securities of another company, controls the majority of its board, or exercises a "controlling influence" over the company.[34] The BHCA concept of control was designed to serve other policy purposes—in particular, the separation between banking and commercial activity through the BHCA's many restrictions on companies that acquire "control" or "controlling influence" over banks and on those companies' investments in non-banks.

Section 956 does not amend the BHCA and does not require, or expressly authorize, the use of the BHCA control definition to define covered financial institutions. Its application in this context would be overbroad and lack tailoring to reflect the variety of relationships and levels of integration that may exist. It would also create significant uncertainty by importing into executive compensation the highly qualitative and subjective "controlling influence" test, which is subject to interpretation and re-interpretation by Federal Reserve legal staff. Overall, its use would require consolidation of many minority-owned, but nevertheless "controlled," entities that are not operationally integrated, the activities of which are at best marginally relevant to the risk profile of the parent institution's consolidated operations. Many such "subsidiaries" would not be covered institutions but for a minority "controlling" investment by a covered institution, and

[34] 12 U.S.C. § 1841(a)(2).

yet the Reproposed Rule would require such companies to comply with the prescriptive incentive compensation limits applicable to a much larger financial institution or to a fully integrated subsidiary.

In order to fulfill their compliance obligations under the BHCA, bank holding companies conduct appropriate diligence and implement appropriate controls to manage legal, compliance, reputational and other risks that may arise from joint ventures and "controlling" minority strategic and portfolio investments. However, as a practical matter they often cannot employ the same type of day-to-day or operational management, or the same type of systems integration (including accounting and financial control systems), with respect to these entities that they do with respect to subsidiaries that operate as an integrated part of their corporate groups. There are a number of different business realities and judgments that may prevent a bank holding company from fully integrating management of such companies, such as the influence of an important partner in a joint venture, majority public ownership of the company, or a decision to allow a company to operate independently under management with the appropriate expertise to pursue its particular business strategy. It would not reflect the realities of these varied business relationships to always apply Section 956 to these companies on a consolidated basis.

Therefore, the more appropriate and relevant standard for purposes of Section 956 would instead be whether entities are consolidated for financial reporting purposes under GAAP. The purpose of GAAP consolidation rules is to aggregate businesses for financial reporting purposes the operations of which are sufficiently closely associated as a result of common ownership and other factors that they should be considered as a whole for financial, reporting and operational purposes. GAAP consolidation more accurately reflects which subsidiaries expose a parent's operations to material risk than does the BHCA definition of control, and subsidiaries that are financially consolidated and subject to operational control are generally fully integrated into the parent's enterprise-wide governance, policies, procedures, control framework, business strategies, liquidity and capital management strategy, information technology systems, and management information systems. In addition, GAAP consolidation has a logical connection to financial metrics of the organization, and, therefore, to compensation-related issues. Also, using GAAP, rather than BHCA control, as the standard for consolidation under Section 956 should not give rise to any opportunity for evasion.[35] In particular, persons who have authority to cause a financial institution to take material risks should not be able to avoid the application of the Final Rule by being treated as employees of a non-GAAP-consolidated affiliate of the financial institution. Accordingly, GAAP consolidation should be applied for purposes of determining consolidation under the Final Rule.[36]

- *Example 8 (GAAP Unconsolidated Subsidiary—Public Company)*. Assume that a bank holding company with average total consolidated assets of $100 billion (the "BHC") owns a 30% interest in a covered institution with average total consolidated assets of $60 billion (the "CI"). Assume that the public owns the remaining 70% interest in the CI. Assume that the CI maintains incentive-based compensation plans that are separate from the plans of its

[35] See 81 Fed. Reg. at 37685.

[36] An example of this approach can be found in the Federal Banking Agencies' capital rules, which are designed to measure the capital adequacy of a financial institution on a consolidated basis. These rules default to GAAP consolidation except in special circumstances. See, e.g., 12 C.F.R. Part 217; Consolidated Financial Statements for Holding Companies, Federal Reserve Reporting Form FR Y-9C. More recently, the Federal Banking Agencies, Farm Credit Administration and FHFA adopted accounting consolidation as the standard for determining subsidiary and affiliate status in their final swap margin rules, after initially proposing a 25% "control" standard similar to that used in the BHCA. According to the Agencies, "the vast majority of commenters argued for a modified definition of control that did not use the 25 percent threshold." In adopting GAAP consolidation instead of the "control" test, the Agencies stated their belief that using financial accounting should "address many of the concerns raised by commentators," including by being "responsive to commentators' concerns that the proposed definitions were over-inclusive." See 80 Fed. Reg. 74,840, 74,860 (Nov. 30, 2015).

parent, is governed by a separate board of directors, has separate management and is not operationally integrated with the business of its parent, or is engaged in a business that has very different risk characteristics from those of the BHC. The CI is not consolidated with the BHC for financial reporting purposes under GAAP. The CI should not be consolidated with the BHC for any purposes of the Final Rule, including for purposes of determining the CI's Level.

- *Example 9 (GAAP Unconsolidated Subsidiary—Private Portfolio Investment)*. Assume that a bank holding company with average total consolidated assets of $200 billion (the "BHC") has made a venture capital investment equivalent to a 30% interest in a privately held $3 billion U.S. financial technology company (the "Portfolio Company"). The investment is in the form of a preferred stock investment with separate board representation and typical venture capital voting and consent rights designed to protect the value of the BHC's investment and ensure compliance with applicable laws. However, the Portfolio Company has a majority independent board and separate management, and the BHC is not involved in the routine operation or management of the Portfolio Company and does not integrate its operations with that of the BHC. The Portfolio Company is not consolidated with the BHC for purposes of GAAP. The Portfolio Company should not be consolidated with the BHC for any purposes of the Final Rule.

While GAAP consolidation should be the general standard for consolidation under Section 956, flexibility is necessary. As indicated in Example 3 above, there may be situations where a majority-owned and GAAP consolidated entity is not integrated into a Consolidated Entity group from a systems, management, business planning, and compensation perspective. In that case, Section 956 consolidation would not be appropriate. Numerous examples above depict why this result should apply.

The foregoing approach to consolidation is premised on reasonable revisions to the Reproposed Rule to reduce the number of its prescriptive requirements and the broad scope of covered persons, as described above and subject to the following subparts C, D, E, F and G.

C. Agency Discretion Should Be Retained

Expressly authorizing Agency discretion in the Final Rule is prudent, consistent with the appropriate principles-based standard required for Section 956 and reflective of the wide diversity of facts and circumstances in which the requirements of Section 956 apply.

1. Reserve Authority Relating to Consolidation

Section __.6 of the Reproposed Rule reserves authority for the Agencies to require a Level 3 covered institution with average total consolidated assets over $10 billion to comply with some of the requirements applicable to Level 1 and Level 2 covered institutions if an Agency determines that the Level 3 covered institution's complexity of operations or compensation practices are consistent with those of a Level 1 or Level 2 covered institution. The Final Rule should clarify that "compensation practices" that will be relevant for these purposes are only those practices that may incentivize employees to take inappropriate risks. The Final Rule should also clarify that if an Agency subjects a Level 3 covered institution that is a subsidiary of a Level 1 or Level 2 covered institution to requirements that are applicable to its parent pursuant to the reservation of Authority in Section __.6, then the Level 3 subsidiary should be treated as part of the Consolidated Entity with its parent for all purposes of Section 956.

The Agencies should also explicitly reserve authority to permit a Level 1 or Level 2 covered institution to be treated as if it were a Level 3 covered institution. If the Agencies exercise such discretion, then it should be clear that the Level 1 or Level 2 covered institution would not be part of the Consolidated Entity group for any purpose of Section 956.

Further, the Agencies should reserve authority to exempt a Level 1 or Level 2 covered institution from some or all of the otherwise applicable requirements, when the circumstances warrant based on the risks that Section 956 was intended to address.

2. Reserve Authority to Exempt Non-U.S. Subsidiaries of U.S.-Based Covered Institutions

The non-U.S. operations, subsidiaries, branches and agencies of covered institutions that are subject to consolidated supervisory oversight by one of the Federal Banking Agencies ("Non-U.S. Operations") may also be subject to supervision in their host country. In order to avoid duplicative and conflicting regulation that would not only fail to advance the purposes of Section 956 but would also be overly burdensome to those Non-U.S. Operations insofar as they would be required to comply with parallel sets of compliance, record-keeping and disclosure requirements, as well as, for Level 1 and 2 covered institutions, parallel sets of prescriptive requirements, we make two recommendations:

- The Agencies should reserve express authority to modify the application of the Final Rule to Non-U.S. Operations to the extent necessary to avoid any such duplication or conflicting obligations, including authority to waive the application of the Final Rule if the Agency with primary oversight responsibility determines that the non-U.S. jurisdiction's regime is substantially equivalent to or is otherwise substantially consistent with the purposes of Section 956.

- The Final Rule should expressly provide that the Agencies will continue to coordinate with foreign regulatory authorities to rationalize the exercise of their overlapping authority in a manner that furthers the objectives of Section 956 and avoids the imposition of conflicting or duplicative requirements. We would be hopeful that such a coordinated approach by the Agencies could encourage non-U.S. regulators to adopt an approach of deference, where appropriate, to the regulation of entities that are largely covered by the regulations promulgated by the Agencies.

By deferring to and/or coordinating with foreign regulatory regimes, for example, those consistent with FSB-provided guidance, particularly when the applicable Agency determines that the alternative regime promotes the purposes of Section 956(b), the Final Rule would better foster compliance with both U.S. and non-U.S. regulatory regimes.

3. Reserve Authority to Exempt Smaller Level 3 Covered Institutions

Section __.6 should be revised to add a provision that reserves authority for the Agencies to relieve a Level 3 covered institution with average total consolidated assets below $10 billion from some or all of the requirements under Section __.4 of the Reproposed Rule, upon a showing that the business activities of the covered institution do not give rise to the type of risk contemplated by Section 956.

- *Example 10 (Certain Lines of Business That Do Not Implicate Credit or Market Risk Concerns)*. A registered broker-dealer the business of which is limited to operating electronic securities trading platforms or administering employee stock option plans, or a registered investment adviser the business of which is limited to providing proxy voting advice, does not engage in any business activities that could give rise to such risks.

4. Reserve Authority to Waive Application of Requirements

The requirements of the Final Rule will likely be ill-suited to the facts of particular employee situations or lines of business from time to time, so each Agency should have authority to waive the application of some or all of its requirements to particular employees or particular businesses in appropriate circumstances.

- *Example 11 (Facts and Circumstances Determinations)*. A person temporarily assigned to certain positions, or asked to undertake certain limited responsibilities that are not central to their usual roles, could become subject to deferral and clawback requirements that would otherwise not apply. Financial institutions may find it difficult to convince employees to accept that consequence and the Agencies should have authority to provide case-by-case exceptions in appropriate circumstances.

The Final Rule should recognize the likelihood of these types of situations, and provide for each Agency to have the authority to waive the application of some or all of its requirements to particular employees or particular businesses in appropriate circumstances. This provision would be consistent with the principle of "proportionality" as applied to the European Union financial institution compensation regulations.[37]

D. Certain Governance Considerations

To mitigate the burden arising from certain governance requirements on small subsidiaries of depository institution holding companies (or other larger covered institutions), the Federal Banking Agencies included __.3(c) in the Reproposed Rule, which provides generally that a covered institution that is a subsidiary of another covered institution may meet any requirement of the Reproposed Rule if "the parent covered institution complies with that requirement in such a way that causes the relevant portion of the incentive-based compensation program of the subsidiary covered institution to comply with that requirement." There is no persuasive reason to exclude broker-dealers or investment advisers from this rule, and the SEC should be indifferent as to whether the applicable governance requirements are carried out at the level of a parent or a subsidiary, as long as they are appropriately carried out. Accordingly, the Section __.3(c) rule should be included in the SEC's version of the Final Rule.

Further, the Final Rule should expressly state that Level 3 covered institutions may rely on the parent company on a permissive basis for purposes of compliance with Section __.4 regarding requirements and prohibitions applicable to all covered institutions, whether the Level 3 covered institution is part of a Consolidated Entity or is a Separate Entity. In any case, the reliance by a Level 3 covered institution on the Section __.3(c) rule should not cause the Level 3 covered institution to be subject to Section __.5, __.7, __.8, __.9, __.10 or __.11.

Finally, the Final Rule should clarify that the prohibition on "senior executive officers" serving on a compensation committee under Section __.10(a) refers only to senior executive officers of the financial institution that is governed by that committee. The provision should not prohibit senior executive officers of

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[37] See, e.g., "Opinion of the European Banking Authority on the Application of the Principle of Proportionality to the Remuneration Provisions in Directive 2013/36/EU" (Dec. 21, 2015), available at http://www.eba.europa.eu/documents/10180/983359/EBA-Op-2015-25+Opinion+on+the+Application+of+Proportionality.pdf ("Article 92(2) of Directive 2013/36/EU requires competent authorities to ensure that the remuneration principles in Articles 92 to 94 are applied 'in a manner and to the extent that is appropriate to their size, internal organization and the nature, scope and complexity of their activities'. In this regard, recital 66 of Directive 2013/36/EU states that 'the provisions of this Directive on remuneration should reflect differences between different types of institutions in a proportionate manner, taking into account their size, internal organization and the nature, scope and complexity of their activities. In particular it would not be proportionate to require certain types of investment firms to comply with all of those principles.'").

one financial institution from sitting on the independent compensation committee of another financial institution.

E. When Computing "Average Total Consolidated Assets" Only Combine Assets of Advisers When There Is an Intent to Evade the Final Rule

Footnote 64 of the Reproposed Rule discusses Section __.12 of the Reproposed Rule, which prohibits a financial institution from doing indirectly what it is prohibited from doing directly. Footnote 64 notes, as an example, the SEC's treatment "as a single investment adviser two or more affiliated investment advisers that are separate legal entities but are operationally integrated." This reference draws on long-standing SEC guidance on when affiliated advisers must consider the activities of each other in determining their own registration analyses.[38] As footnote 64 recognizes, the analysis of whether two advisers are "operationally integrated" is based on "facts and circumstances," which of course implies a contextual examination. The idea that "operationally integrated" entities should be viewed as one in the registration context, as contemplated by the SEC's guidance, serves the purpose set out in Rule 208(d) of the Advisers Act. Applying the same standard to the determination of average total consolidated assets under Section 956 would not serve the purposes of Section 956. Accordingly, the Agencies should clarify that aggregation of entities would be appropriate in the Section 956 context only when it serves the purposes of preventing an intention to evade the application of Section 956.

In any event, investment advisers that are operationally integrated with each other should not be required to combine assets for purposes of determining their Level if the investment advisers were formed prior to the publication of the Reproposed Rule. If investment advisers or other institutions were formed separately before the publication of the Reproposed Rule, they could not have been created for the purpose of avoiding the Reproposed Rule and therefore the fact that they are separate entities is not "doing indirectly that which they could not do directly."

F. Unregistered Investment Advisers and Certain Registered Non-U.S. Investment Advisers Should Be Excluded from the SEC's Version of the Final Rule

The Dodd-Frank Act significantly increased the number of investment advisers that need to be registered with the SEC and significantly limited the number and type of advisers that did not need to be registered. Consequently, there are far fewer unregistered advisers than there were before the Dodd-Frank Act. A decision was made at the time of the Dodd-Frank Act, however, that certain types of advisers (e.g., advisers with little U.S. nexus, advisers that are small in size, advisers that are engaged in certain types of investing) do not need the regulatory burdens of registration and the regular oversight of the SEC. It seems incongruous that these unregistered advisers would be considered not risky enough to need registration and oversight by the SEC but would be risky enough to need incentive-based compensation restrictions under the SEC's version of the Final Rule. Although many unregistered advisers will not have enough assets to trigger application of the SEC's version of the Final Rule, that is not true for all of them and is certainly not true for non-U.S. advisers, many of whom will have absolutely no connection to the U.S. in terms of clients or offices. We believe that unregistered advisers have already been determined to have a lower risk profile than other advisers (as evidenced by their exemption from registration) and that the SEC's version of the Final Rule should not apply to them.

Consistent with our discussion above, the SEC's version of the Final Rule should also reserve express authority to the SEC to modify the application of the SEC's version of the Final Rule to SEC-

[38] Uniao de Bancos de Brasileiros S.A. (avail. July 28, 1992) (Unibanco); see also Royal Bank of Canada (avail. June 3, 1998); ABN AMRO Bank N.V. (avail. Jan. 7, 1997); Murray Johnstone Holdings Ltd. (avail. Oct. 7, 1994); Kleinwort Benson Investment Management Ltd. (avail. Dec. 15, 1993); Mercury Asset Management plc (avail. Apr. 16, 1993); The National Mutual Group (avail. Mar. 8, 1993); Richard Ellis, Inc. (avail. Sept. 17, 1981).

registered non-U.S. advisers (including "relying advisers") to the extent necessary to avoid any duplication or conflicting obligations, including authority to waive the application of the SEC's version of the Final Rule if the SEC determines that the non-U.S. jurisdiction's regime is substantially equivalent to or is otherwise substantially consistent with the purposes of Section 956.

In any case, the determination of average total consolidated assets of non-U.S. advisers (including relying advisers) should take into account only the percentage of their business that relates to the United States (e.g., if half of their assets under management is from the United States, half of their assets should be counted towards their average total consolidated assets). This approach would be consistent with how the SEC applies U.S. law to non-U.S. advisers (including relying advisers) with limited assets in the United States.[39]

G. Level 3 Advisers and Broker-Dealers Should Not Be Consolidated with Parent Entities

Even if the approach to consolidation proposed above is not adopted, if an investment adviser or broker-dealer that is a Level 3 covered institution becomes subject to the prescriptive rules applicable to Level 1 and Level 2 covered institutions due to the fact that the investment adviser or broker-dealer is part of a Consolidated Entity, there will be an adverse effect on that investment adviser or broker-dealer and its ability to hire and retain talented professionals. There would likely be a flight of talent from these covered institutions to non-covered entities. Asset and wealth management are stable, revenue-generating businesses that provide earnings stability. Advisers and broker-dealers that engage in these businesses are fundamentally different from insured depository institutions in the nature of their activities and risks they present. Both manage third-party assets, and their ability to expose the parent to material financial loss is low.

VI. Level 1 and Level 2 Specific Prescriptive Measures

The following are our recommendations with respect to the specific prescriptive aspects of the Reproposed Rule for Level 1 and Level 2 covered institutions. To the extent that the Final Rule adopts the largely principles-based approach of the Original Proposal and the Final Interagency Guidance in respect of the identification of employees whose compensation is affected by Section 956, the issues identified herein would be somewhat mitigated.

The prescriptive requirements proposed for Level 1 and Level 2 covered institutions would diminish the value, actual and perceived, to employees of their variable incentive compensation awards. Because financial institutions subject to Section 956 would have to continue to compete for talent with other sectors, there would be a substantial incentive for them to increase fixed components of compensation in response to such diminution in value. Increases in fixed costs negatively impact the safety and soundness of financial institutions, all other things remaining equal. While we recognize that the comprehensive prescriptive framework required under the Reproposed Rule might ease the regulatory burden on the Agencies compared to the close oversight necessitated by a more principles-based approach, the substantial likelihood of increased fixed components of compensation arising from the Reproposed Rule should balance the impulse to retain some of the prescriptive measures discussed below.

[39] The SEC's Final Rule should also be clarified to carve out SEC-registered non-U.S. advisers, including relying advisers, who have no direct U.S. clients and, although they may be required to register, are not required to apply the substantive provisions of the Advisers Act to any of their client relationships under applicable SEC guidance (see "Registration under the Advisers Act of Certain Hedge Fund Advisers," Rel. No. IA-2333 at nn.215-22 and accompanying text). As with unregistered advisers, it seems illogical for the SEC to determine that it need not subject the non-U.S. business practices of such advisers to regulation but nonetheless regulate their compensation practices.

A. Unless the Definition of “Covered Persons” Is Narrowed as Discussed Above, the Deferral Percentages Should Be Lowered

If the definition of “covered persons” is not narrowed as discussed above, the deferral percentages should instead range from (A) a low of 15% for Level 1 and Level 2 covered institutions for both senior executive officers and significant risk-takers to (B) a maximum of 60% for senior executive officers and 40% for significant risk-takers for Level 1 and a lower percentage for Level 2 covered institutions. The precise level for a particular employee should depend on that employee’s absolute level of pay.

- *Example*: A junior employee earning $140,000 in base salary and $70,000 in annual bonus at a Level 1 institution who is among the top 5% of all employees ranked on the basis of total compensation would be required to defer 50% of his bonus. That amount of deferral would far exceed what would be necessary to effectively mitigate risk-taking incentives for many employees so situated, what has been customary in the past in the financial services industry and what has become customary under the principles-based Final Interagency Guidance. It would materially impact the ability of Level 1 covered institutions to attract and retain qualified employees.

If the definition of “covered persons” is narrowed as discussed above, the deferral percentages are reasonable and generally consistent with market practice, except that the maximum deferral percentage for significant risk-takers should not exceed 40% for Level 1 covered institutions.

B. Do Not Base Deferral Percentages on Present Value

Regardless of whether the definition is narrowed, the deferral percentages should not be based on the present value of awards. The Reproposed Rule’s requirement that covered institutions determine the present value of incentive-based compensation at the time of the award, for purposes of determining required deferrals, will place unnecessary and unreasonable burdens on the covered institution while creating confusion for covered individuals regarding the portion of their compensation that must be deferred. The preamble does not provide a policy reason for imposing this burden and fails to prescribe a methodology for determining present value for routine deferrals in cash or equity. As currently envisioned by the Reproposed Rule, any deferral in cash that was credited with a reasonable rate of interest would simply result in an adjustment in the deferral percentage based on the difference between the crediting rate and the discount rate. Any deferral in equity would require an assumption as to future changes in the value of the equity using Black-Scholes and similar valuations for stock options, which is in direct contrast with common industry practice. In effect, requiring present values inappropriately inflates the amount required to be deferred. Furthermore, requiring present value determinations will create uncertainty for employees as to whether the mandatory deferral rules have been properly complied with, as has been the case in other regulations requiring the present value of compensation to be calculated.[40]

C. Unless the Definition of “Covered Persons” Is Narrowed as Discussed Above, Deferral Periods Should Be Shortened

Unless the definition of “covered persons” or the definitions of “senior executive officer” and “significant risk-taker” are narrowed as discussed above, the deferral periods for (A) qualifying incentive-based compensation plans should be shortened to three years for Level 1 covered institutions and a shorter

[40] Determining the present value of deferred compensation is sometimes required for purposes of Section 280G of the Internal Revenue Code. See Treasury Regulation 1.280G-1 Q&A 24. Those rules have given rise to substantial confusion and uncertainty.

period for Level 2 covered institutions and (B) long-term incentive-based compensation plans should be shortened to one year for Level 1 covered institutions and a shorter period for Level 2 covered institutions.

- *Example*: The head of HR of a $2 billion investment adviser subsidiary of a $260 billion Level 1 depository institution holding company earning $150,000 in salary, $30,000 in annual bonus and $45,000 in long-term compensation would be required to defer $37,500 of her variable compensation for at least four years.

That result is not consistent with current market practice which reflects six years of experience under the Final Interagency Guidance and will be a material disincentive to recruitment and retention. Nor is such an extended deferral warranted by risk considerations. The types of risks covered would in large part be expected to surface shortly after the relevant performance period. The long deferral would thus not contribute in a material way to the safety and soundness of the institution. Moreover, employees would presumably demand additional compensation to counterbalance the burden of the long deferral. As a result, financial institutions would likely face a significant rise in fixed compensation costs, limiting the financial institution's flexibility, which would increase risks to the financial institution.

If the definition of "covered persons" is narrowed as discussed above, we are not proposing any changes to the Reproposed Rule with respect to deferral periods.

D. <u>Excess Deferrals Should Not Be Subject to the Forfeiture and Clawback Requirements of the Reproposed Rule</u>

The Reproposed Rule should be clarified to exclude voluntary deferrals made by covered persons or covered institutions in excess of mandatory deferral amounts from the prescriptive requirements regarding forfeiture and clawback. The Reproposed Rule applies the requirements of Section __.7(a)(1)(iii)(A), (a)(2)(iii)(A), (a)(3), (a)(4) and (b)(1)(i) not only to amounts of incentive-based compensation required to be deferred but also to amounts deferred by the covered person or covered institution in excess of the minimum required deferrals. To the extent that deferrals are an effective tool for minimizing inappropriate risk-taking among covered individuals, the Final Rule should create an incentive for covered institutions and covered persons to defer compensation in excess of the minimum required deferral amounts. The prescriptive requirements would have the opposite effect.

Also, the preamble makes clear that deferrals only for tax purposes of compensation that is not incentive-based compensation would not be considered "deferred incentive-based compensation" for purposes of the Reproposed Rule. The Final Rule should make clear that voluntary deferral by employees of any vested compensation (whether or not incentive-based compensation) for tax reasons should not be considered "deferred incentive-based compensation."

E. <u>The Final Rule Should Not Mandate the Form of Required Deferrals; If Minimum Cash Deferrals Are Required, the Final Rule Should Clarify that Any Reasonable Notional Investment Should Be Permitted</u>

The Final Rule should not require minimum deferred amounts in cash as this would not further the purposes of Section 956, but cash deferrals should be permitted to satisfy minimum deferral requirements. Imposing rigid requirements on covered institutions to include substantial amounts of cash in required deferrals is antithetical to long-standing shareholder mandates that are intended to tie the compensation of employees to the long-term success of the company itself. While there are a small number of recent academic papers that theorized that mandatory cash deferrals could lead to lower risk, there is good reason in practice to doubt that conclusion. In contrast, there is strong consensus based on industry experience that mandatory equity deferrals contribute to risk mitigation since employees with stock deferrals have materially greater downside risk if the financial institution takes excessive risks than employees with cash deferrals, while the evidence in respect of mandatory cash deferrals is recent and inconclusive. By contrast, relatively risk-averse shareholders in the financial services industry, as in other sectors, have long considered equity retention requirements to be an appropriate way to mitigate risk.[41] Required stock deferrals should in many settings have an equal or greater risk-mitigating impact than required cash deferrals, since employees with stock deferrals have materially greater downside risk if the financial institution takes excessive risks than employees with cash deferrals. While cash deferrals instead of equity deferrals may in the future be more convincingly shown to mitigate risk generally at financial institutions, there is no persuasive case at this time for a generally applicable cash deferral requirement.

Accordingly, the Final Rule should not include mandatory cash deferral. Cash deferral features are reasonable, as suggested by the recent research, but not clearly more effective than equity deferrals.

Moreover, the Final Rule should not mandate the form of required deferrals. For example, different covered institutions grant deferred compensation in different forms and combinations, whether in cash, equity awards or other notional instruments.[42] Covered institutions should be permitted to determine the appropriate mix, if any, of the types of deferred compensation that must be deferred under the Final Rule so long as such forms of compensation comply with the other requirements of the Final Rule.[43]

If the Final Rule does include mandatory cash deferral, it should confirm that any reasonable notional investment of the cash deferral, other than equity or equity-like instruments of the financial institution that maintains the applicable incentive-based compensation arrangement, should be permitted. Any such notional investment would retain the quality of the deferral as a debt-like instrument of the financial institution, thereby achieving the objective of the requirement as laid out in the preamble of the Reproposed Rule. Furthermore, such a provision would be consistent with the preamble, which provides that "a change in interest rates, or the payment of reasonable interest or a reasonable rate of return according to terms set out at the award date would not be considered increases in the amount awarded for purposes of this restriction."[44] Moreover, if the Final Rule includes mandatory cash deferrals, the rule should permit the cash deferral test to be satisfied on the basis of aggregate compensation deferrals (including qualifying and long-term incentive-based plans) rather than requiring cash deferrals in respect of each individual plan.[45]

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[41] See "Salomon Reduces Bonuses by $110 Million," NY Times (Oct. 30, 1991), available at http://www.nytimes.com/1991/10/30/business/salomon-reduces-bonuses-by-110-million.html [MBsWaf,1] ("Mr. Buffett said that, to insure employees are focused on the interests of shareholders, Salomon would begin to issue much of the compensation in the firm in the form of stock. . . . 'Within a few years, Salomon Inc.'s key employees could own 25 percent or more of the business, purchased with their own compensation.' Other firms may soon follow Salomon's plans on compensation, experts said. 'This a public proclamation of a state of affairs on the street that has been obvious to many people for many months if not years,' said Samuel L. Hayes 3d, a professor of investment banking at the Harvard Business School. I would not be surprised to find other firms very quickly jumping on the Salomon bandwagon.").

[42] Public companies are also required to obtain shareholder approval of equity incentive plans. Requiring equity awards be granted to a broad base of employees could increase burn rates (which can present challenges when seeking shareholder approval of such plans), making it difficult for covered institutions to comply with this requirement.

[43] We also note that the FSB principles state that "a substantial proportion, such as more than 50 percent, of variable compensation should be awarded in shares or share-linked instruments (or, where appropriate, other non-cash instruments), as long as these instruments create incentives aligned with long-term value creation and the time horizons of risk. Awards in shares or share-linked instruments should be subject to an appropriate share retention policy." Such principles afford institutions with flexibility as to the types of non-cash awards granted.

[44] 81 Fed. Reg. at 37,725.

[45] Requiring cash deferrals from certain plans could adversely affect the accounting treatment of those plans.

F. Covered Institutions Should Be Permitted to Pay Dividend Equivalents on Equity Awards Subject to Deferral When Dividends Are Paid to All Shareholders in the Ordinary Course

The Final Rule should clarify the treatment of dividend equivalent rights, so that dividend amounts payable on a deferred equity award with dividend equivalent rights can be paid immediately and on the same schedule applicable to all common shareholders without being subject to further deferral or forfeiture. Subjecting dividend equivalents to deferral and forfeiture will not further the purpose of Section 956, as such amounts are not incentive-based compensation but merely an equivalent payment applicable to all similarly situated shareholders of the covered institution.

For financial institutions that pay dividend equivalents, the incremental administrative cost of deferring dividend equivalent amounts, which are very modest in relation to the deferrals themselves, outweighs any additional risk mitigation impact of imposing the deferral requirement.

G. Increase the Limit on the Use of Options to Meet the Minimum Deferral Requirements to 25%

The limit on the use of options used to meet the minimum deferral requirements should be 25% instead of 15%. The preamble to the Reproposed Rule cites to two sources in support of the 15% restriction, which we believe fail to provide definitive support for this assertion.

The preamble argues that the 15% limit is consistent with industry practice and cites to a practitioner article in the New York Law Journal. That article states that "today, in contrast to the end of the 1990s, stock options do not represent the dominant form of long-term equity incentive awards." But the author's assertion is merely anecdotal and not accompanied by any supporting data. Nor does it refer exclusively to the financial services industry, but to public companies generally and, notably, the author does not attribute the decline in the use of stock options to risk considerations. The preamble next cites to the practices of granting options to CEOs and other named executive officers (typically, four additional persons) at a sample of 14 "large" covered financial institutions reviewed by the Agencies. It should go without saying that a sample so limited in size and nature is not representative of the use of stock options by financial institutions generally.

Furthermore, while there may be a risk-based rationale to limit the use of options as contemplated by the Reproposed Rule, the proposed limit is too low. It would unnecessarily impact the flexibility of financial institutions with average total consolidated assets between $50 billion and $250 billion, in a way that would affect their ability to compete in attracting and retaining employees. The limit on the use of stock options should be increased to 25% to accomplish the purpose of Section 956 in a manner that would be consistent with current stock option granting practices among financial institutions and public companies generally.[46]

H. Increase the Limit on Incentive-Based Compensation Plan Leverage to 150%

The limitations placed on leverage for senior executive officers and significant risk-takers is not in line with current industry pay practices and will have an adverse impact on hiring and retaining talented individuals. Section __.8(b) limits the percentage of target amounts of incentive-based compensation that can be awarded to senior executive officers and significant risk-takers of Level 1 and Level 2 covered institutions

[46] That limit would be consistent with the estimate included in the practitioner article referred to in the preamble for public companies. ("Approximately 50 percent of long-term equity incentive awards made today, measured by values at the time of grant, are in the form of performance shares. The remaining approximately 50 percent is made up of restricted shares and stock options with stock options being in the range of one-half of this remaining 50 percent (i.e., approximately 25 percent of all long-term equity awards)"), taking into account that a very large majority of long-term incentive compensation at public companies relates directly or indirectly to equity and is designed to align the interests of employees with shareholder economics.

to 125% and 150%, respectively. The preamble to the Reproposed Rule does not provide a meaningful justification for this distinction, merely asserting "the differences between the risks posed by senior executive officers and significant risk-takers." In fact, while the risks posed by senior executive officers and significant risk-takers are different, there is no basis to suggest that the 150% limit for significant risk-takers would not also be appropriate for senior executive officers. Moreover, a cap of 150% for both significant risk-takers and senior executive officers would be consistent with the range of plan designs that the Federal Banking Agencies have encouraged financial institutions to use since the financial crisis under the principles-based approach of the Final Interagency Guidance, as described in the preamble to the Reproposed Rule.

I. Clarify Targets Are Not Required for Incentive-Based Compensation Plans

The Final Rule should clarify that covered institutions are not required to set targets for incentive-based compensation arrangements.

As stated in the preamble to the Reproposed Rule,[47] many incentive-based compensation plans do not use targets. Most commonly, an annual bonus plan may simply provide for an incentive bonus opportunity in an amount determined by the compensation committee of the board of directors in its discretion. Other common plan designs that do not include targets include, for example:

- an annual bonus plan that provides for a payout equal to between 125% and 200% of a participant's base salary for a year-over-year increase in return on equity of between 3% and 7%, based on straight-line interpolation for outcomes between a 3% increase and a 7% increase.

- an annual bonus plan that provides for a payment equal to a specified percentage of earnings.

Clearly, plan designs that do not include targets can be effective in furthering the purposes of Section 956. The Final Rule should expressly state that covered institutions are not required to set targets for incentive-based compensation arrangements.

J. Clawback Requirements Should Be Revised

1. Clawback Period Should Start at the Grant Date for an Award

The clawback period as set forth in the Reproposed Rule is not justifiable. If our recommendations concerning covered persons are reflected in the Final Rule, the clawback period should be revised to be seven years from the date of grant of an award, not the vesting of the award.[48] Otherwise, the clawback period should be revised to be five years from the date of grant of the award.

Under Section __.7(c), all incentive-based compensation must be subject to a clawback for seven years after vesting, which will not occur until at least three or four years after an award is granted. This clawback period is unusually long compared to current practices inside and outside the financial services industry and cannot be justified based on risk mitigation or other relevant factors. Experience

[47] "It is the understanding of the Agencies that, under current practice, covered institutions generally establish performance measure goals for their covered persons at the beginning of, or early in, a performance period. At that time, under some incentive-based compensation plans, those covered institutions establish target amounts of incentive-based compensation that the covered persons can expect to be awarded if they meet the established performance measure goals." (Emphasis added.)

[48] We also note that vesting as used in the Reproposed Rule does not track the commonly understood meaning of that term as used by human resources professionals, and we recommend clarification.

overwhelmingly suggests that facts supporting a repayment obligation under a clawback provision are likely to surface shortly after the applicable performance period. At the same time, even an objectively small risk of a clawback claim will be considered by many employees as a substantial burden.[49] Given this reality, balancing the benefits of an ongoing clawback against the burden borne by employees, almost none of whom will actually have engaged or will engage in conduct giving rise to a clawback obligation, militates instead in favor of a clawback limited to the period during which indications of misconduct are likely to surface.[50]

Moreover, the clawback period should not be considered in isolation. Both it and the deferral periods operate to adjust compensation to reflect facts arising after compensation is paid. For this reason, we believe that the required deferral and clawback periods should run concurrently from the date of award.[51]

2. <u>Clawback Requirements Should Not Apply to the Extent that They Would Violate Applicable Law</u>

The Reproposed Rule should be clarified to provide that the reservation of clawback rights are not required if clawback would violate applicable law, including that of any state or non-U.S. jurisdiction. Some state labor laws prohibit recovery of wages after they have been paid. For example, Section 221 of the California Labor Code provides that "it shall be unlawful for any employer to collect or receive from an employee any part of wages theretofore paid by said employer to said employee." Similarly, the clawback requirement of the Reproposed Rule is inconsistent with the obligations of some non-U.S. labor laws. The Final Rule should include an exception from the clawback obligation when it would be impermissible under state or non-U.S. law.

K. <u>Prohibition on Acceleration Should Include Exceptions for Acceleration in the Event of a Change in Control and Departure for Government Service, and Should Clarify that Forfeiture Is Not Required in the Event of Involuntary Termination Without Cause and Retirement</u>

The prohibition on acceleration of vesting should permit accelerated payment in connection with a change in control and departure for government service. In addition, the Final Rule should clarify that forfeiture is not required in the event of involuntary termination without cause or retirement.

First, an exception should be provided to permit accelerated vesting in the context of a change in control. The preamble to the Reproposed Rule acknowledges that "many institutions also currently provide for the accelerated vesting of deferred incentive-based compensation . . . in connection with a change in control of the company" and a change in control is also a permitted payment event under Section 409A of the Code. Acceleration of payments in the event of a change in control is in line with long-standing industry practice. As with payments on death and disability, acceleration of payments on a change in control "generally are not subject to the covered person's control,"[52] because a sale of a covered institution would

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[49] The burden exists even for employees who know that they have not engaged in misconduct, because of the risk that there will be an incorrect allegation that they did.

[50] The clawback requirement presents unique challenges in the context of employees who leave employment with a financial institution and commence employment with one of its governmental regulators. For the same reasons discussed in paragraph J below in connection with the prohibition on accelerated vesting, the potential conflicts arising in that context would outbalance the risk mitigation benefits of extending the clawback requirement to such employees.

[51] This would be consistent with the rules in the U.K. "PRA PS12/15/FCA PS15/16: Strengthening the Alignment of Risk and Reward: New Remuneration Rules" (June 25, 2015) ("UK Remuneration Rules"), <u>available at</u> https://www.fca.org.uk/static/documents/policy-statements/ps15-16.pdf.

[52] 81 Fed. Reg. at 37,719.

almost always be within the control of a majority of the board of directors of the covered institution or the shareholder(s) of the covered institution. Accordingly, the acceleration of payment in the event of a change in control should not weaken the balancing effect of deferral.

Second, an exception should be provided to permit accelerated vesting for employees who accept government employment, where the applicable ethics rules prohibit retention of deferred compensation obligations from prior employers or the relevant ethics officer of the governmental unit advises that continuation of such obligations would not be appropriate. Surely, such an exception would not weaken the effect of deferral since it would apply in such narrow circumstances. Moreover, the exception is not within the control of the covered person, who would need an offer of government employment in order for the exception to apply. Indeed, the concern that an employee would be relatively indifferent to taking inappropriate business risks because he was reasonably certain of obtaining future government employment subject to relevant ethics rules seems unrealistic. The Department of the Treasury has recognized the persuasiveness of these arguments in similar provisions of the tax code.[53]

In addition, the Final Rule should clarify a potential ambiguity arising from the frequent use of the term "vest" in compensatory arrangements to refer to satisfaction of service-based conditions on the right of an employee to fully earn a compensatory award. In particular, the Agencies should clarify that awards should not be required to be automatically forfeited in the event of involuntary termination of employment without cause or retirement prior to the applicable vesting date. Instead, consistent with customary practices, awards should be permitted to continue to vest in those circumstances.

L. Compensation Committees Should Not Be Required to Obtain Input from Both the Audit and Risk Committees and Only One Written Assessment Should Be Required

Compensation committees should be permitted, but not required, to obtain input from both the audit and the risk committee about risk issues related to compensation decisions, and only one annual written assessment of the effectiveness of incentive-based compensation programs and related processes should be required.

Section __.10(b)(1) of the Reproposed Rule requires the compensation committee to obtain input from both the audit and risk committees of a covered institution's board of directors. While compensation committees should of course be permitted to obtain input from all appropriate sources, in many cases input from either the audit and the risk committee should be adequate to apprise the compensation committee of relevant risks, and therefore requiring input from both committees is unnecessary to further the purposes of Section 956.

Sections __.10(b)(2) and __.10(b)(3) each require an annual written assessment be submitted to the compensation committee of a Level 1 or Level 2 covered institution of the effectiveness of its incentive-based compensation program and compliance and control processes "in providing risk-taking incentives that are consistent with the risk profile of the covered institution" – one to be prepared by the management of the covered institution based on input from, among others, the covered institution's audit and risk management functions and the other to be prepared by the internal audit or risk management function of the covered institution, developed independently of the covered institution's management. The requirement to prepare two separate reports is unnecessarily burdensome, especially as one will be prepared based on input from the other. It is to no one's benefit to have two essentially identical reports produced or to have two conflicting

[53] See Treas. Reg. § 1.409A-3(j)(4)(iii), which permits acceleration (i) for any Federal officer or employee in the executive branch to comply with an ethics agreement with the Federal government; and (ii) to the extent reasonably necessary to avoid the violation of an applicable Federal, state, local, or foreign ethics law or conflicts of interest law (including where such payment is reasonably necessary to permit the employee to participate in activities in the normal course of his or her position in which the employee would otherwise not be able to participate under an applicable rule). We believe a similar exception is appropriate in this context.

reports produced. If the latter were to happen, it would signal a breakdown in compliance and control that should not be surfaced through reliance on an annual report. If the Agencies feel that an "independent" report is required, it should require only the one report, in which case clarification should be provided regarding the role of management, because input from in-house compensation personnel or outside consultants hired by management might be required for data or other purposes.

M. Override Plan Design Requirements Where Adverse Accounting Consequences Would Follow

The Reproposed Rule should be revised to provide that its requirements concerning use of non-financial metrics, forfeiture and adjustment and clawback could be applied in a modified manner that is consistent with the purposes of Section 956 to the extent that outside auditors for a financial institution advise that modification would be necessary to permit the financial institution to use fixed share accounting in respect of deferred equity or equity-like awards.

There are two basic approaches to accounting for equity awards: fixed plan accounting and variable plan accounting. Under fixed plan accounting, generally, the grant date fair value of an equity award is treated as an expense and such value is amortized over the vesting period of the award. Under variable plan accounting, generally, the expense required to be recognized in respect of the award is reflected in the income statement over the life of the award (for as long as it is outstanding) and varies based on fluctuations in the value of the company stock. Generally, variable plan accounting is less favorable to the employer because it results in earnings volatility relative to fixed plan accounting. Such volatility could affect the safety and soundness of a financial institution, by affecting its ability to raise capital and in other ways. Variable plan accounting may be required if the determination of the number of shares, and other terms, of an equity award are not sufficiently fixed at the time that the award is granted.

VII. All Covered Institutions

We recommend that the requirements of Section __.4 apply only to incentive-based compensation arrangements in which covered persons, defined as recommended in Part II(A) above, participate. If that recommendation is not reflected in the Final Rule, then the requirements discussed below, relating to the use of non-financial metrics, record-keeping requirements and benchmarking, should be revised as stated below.

A. Financial and Non-Financial Performance Metrics

The ._4 requirements state that an incentive-based compensation arrangement would not be considered to balance risk and reward appropriately unless it complies with __.4(d). The __.4(d) requirements prohibit incentive-based compensation programs that have sole financial performance metrics. We would note, however, that the Final Interagency Guidance contains numerous ways to design a "balanced" incentive compensation program and many financial institutions have, in consultation with their regulators, developed balanced programs in reliance on such guidance and without the prescriptive features of _.4(d). We find it hard to believe that such programs would be considered unbalanced unless amended to comply with _.4(d).

In addition, Section __.4(d)(1) and (2) of the Reproposed Rule would require covered institutions to include financial and non-financial measures of performance (including considerations of risk-taking) even for employees who do not have the ability to cause the financial institution to take material risks, and to allow the non-financial measures of performance to override the financial measures. Pursuant to this requirement, a financial institution could not adopt a simple, and common, profit-sharing pool arrangement for lower-level employees in which the pool was formulaically divided among the participating employees. That result would not advance the purposes of Section 956, and the requirement therefore should not apply in respect of such broad-based plans.

B. Record-Keeping Requirements

Section __.4(f) of the Reproposed Rule would require covered institutions to create annually and maintain documents that demonstrate compliance with the requirements of Section __.4, memorialize the name of each employee who is subject to each such plan and describe how each such incentive-based compensation arrangement fits into a program that is compatible with effective risk management and controls, even for any such arrangement that covered only persons who were not Risk-Takers or senior executive officers. In addition, Section __.5(a)(4) of the Reproposed Rule would require Level 1 and Level 2 covered institutions to create annually and maintain documents that memorialize any material changes to the covered institution's incentive-based compensation arrangements and policies, even for any such that covered only persons who were not Risk-Takers or senior executive officers. These requirements would legislate best corporate governance practices and go well beyond the authority granted to the Agencies under Section 956 to prohibit particular, problematic incentive-based compensation arrangements. In addition, they would place a large burden on many covered institutions from an administrative and record-keeping perspective. They will be required to follow procedures far beyond what one could reasonably expect to be necessary from a risk-control perspective. At a minimum, if our recommendations concerning the definition of covered persons are not adopted, covered institutions should not be required to keep records of each employee who is subject to each such arrangement.

C. Benchmarking the Incentive-Based Compensation of All Employees

Section __.4(b)(1)(4) of the Reproposed Rule would require covered institutions to benchmark each incentive-based compensation arrangement for all of its employees against the compensation practices of other institutions for purposes of complying with the prohibition on excessive compensation. Similar to the record-keeping requirements discussed above, these requirements would legislate best corporate governance practices and go well beyond the authority granted to the Agencies under Section 956 to prohibit particular, problematic incentive-based compensation arrangements. Consistent with routine practices outside the financial services industry, many financial services companies maintain incentive, profit-sharing and merit-based arrangements that reach far down into the organization. These arrangements are usually intended to build a cohesive workforce and promote retention by giving even the lowest-level employees a stake in the company's performance. By sharing the profits arising from corporate activities, they provide an incentive for personal growth and a financial reward for good performance to even the lowest-level employees. It is hard to imagine any benefit that could arise from requiring financial institutions to focus resources and attention on whether these typically modest arrangements could result in excessive pay to clerical staff and other lower-level employees, who clearly have no involvement in risk-taking, relative to their peers at other financial institutions.

VIII. Issues Related to the Identification of Covered Institutions

A. "Average Total Consolidated Assets" Should Not Include Assets That Do Not Implicate Risk Concerns

The term "average total consolidated assets" should be revised to exclude double-counting of intercompany transactions, goodwill, leases and real property, assets of broker-dealers held for the exclusive benefit of customers and other assets held by financial institutions that do not implicate the risk concerns underlying Section 956, and additional clarifications for investment advisers should be made.

The measurement of average total consolidated assets should exclude the following:

1. Intercompany Obligations and Similar Transactions Should Be Excluded from Average Total Consolidated Assets

Without a clarification, an intercompany loan between affiliated entities could be double-counted, because the loan would be counted on the books of the lending entity and the cash or other property loaned would be an asset on the books of the borrowing entity. In order to avoid such double-counting, assets arising from intercompany loans and other similar transactions should be excluded from the measurement of "average total consolidated assets."

2. Goodwill Should Be Excluded from Average Total Consolidated Assets

Goodwill is an intangible asset that results from a premium price paid for a company and is not a reflection of the size of the company. Goodwill also does not contribute to or underpin risk-taking activities. Consequently, goodwill should be excluded from average total consolidated assets.[54]

3. Leases and Real Property Should Be Excluded from Average Total Consolidated Assets

Because, under the Reproposed Rules, balance sheet assets (modified as described above) would determine the Level of a covered institution, flexibility is appropriate when dealing with certain assets.

- For example, the value of headquarters or other buildings used for corporate purposes should not be taken into account for purposes of the average total consolidated asset test for a covered institution that does not conduct business in a way that gives rise to risk of loss attributable to the real estate (e.g., an investment adviser).

- Similarly, the value of a leasehold interest should not be taken into account for purposes of the average total consolidated asset test for a covered institution. Currently, when such interests are required to be reflected as a "right of use" asset, an offsetting liability for the lease obligation may also be required to be created. However, the average total consolidated asset test does not take into account the offsetting liability.

The Final Rule should authorize the exclusion for purposes of determining a covered institution's Level of assets that are not used in the covered institution's business in a way that could give rise to a risk of material loss. That determination should be made by the covered institution based on its particular situation, subject to the consent of the relevant Agencies based on safety and soundness considerations (for banking institutions) or other appropriate risk control standards (for other institutions).

4. "Locked Up" and Certain Other Assets of Broker-Dealers Should Be Excluded from Average Total Consolidated Assets

Assets held by broker-dealers in segregation for their customers within the meaning of Rule 15c3-3 under the Securities Exchange Act of 1934 ("Segregated Customer Assets") should be excluded from the measurement of "average total consolidated assets." These assets are (i) customer securities that the broker-dealer is not permitted to rehypothecate or otherwise make use of in the broker-dealer's business (i.e., fully paid securities and excess margin securities) and (ii) a special reserve account (i.e., a type of segregated account at a U.S. bank with U.S. dollar cash and U.S. Treasury securities) held primarily to provide protection for client cash balances and rehypothecated securities. Segregated Customer Assets cannot be used to satisfy the broker-dealer's other obligations, and they would not be available to creditors in the event of bankruptcy. Similar exclusions should also apply for cash or securities similarly required to be segregated for other

[54] The SEC's version of the Reproposed Rule requires investment advisers who file Forms ADV to refer to the measurement of assets in Question 1.O. of Part 1A of the form for purposes of determining whether they are covered institutions. There is, however, no authoritative guidance on whether goodwill should be included in the measurement of assets for that purpose.

regulatory purposes (e.g., Commodity Futures Trading Commission segregation rules). The rationale underlying the investment adviser exclusion of assets under management applies equally to broker-dealers.

Similarly, broker-dealers that are owned by affiliated advisers (or in certain cases by the funds they advise) and whose primary assets are assets used to facilitate clearing, settlement and financing on behalf of their clients ("Client Facilitation Assets") and whose other assets not related to the foregoing are de minimis should not be required to include Client Facilitation Assets when computing average total consolidated assets. These broker-dealers are not engaging in proprietary risk-taking but rather are engaged in activities on behalf of clients and such assets facilitate the smooth running of the market.

5. Market Value of Interests in Subsidiaries and Funds Should Be Used to Determine the Applicable Threshold of an Investment Adviser

Under Section 303.2 of the SEC's version of the Reproposed Rule, "average total consolidated assets" is defined for investment advisers to include the "regulated institution's total assets (exclusive of non-proprietary assets) shown on the balance sheet" for the most recent fiscal year. The Reproposed Rule also states that advisers are not required to consolidate their assets with subsidiaries.[55] We agree that this difference in treatment for advisers (other entities must consolidate assets) is appropriate. Because of some confusion on this point, however, the Final Rule should emphasize that when computing the total assets of an investment adviser the fair market value of investments (including investments in subsidiaries and investments in funds) should be used (and not the total value of assets at the subsidiary or fund).

6. Assets of Advisers Should Not Be Combined with Assets of Non-Covered Affiliates for Purposes of Determining Average Total Consolidated Assets of an Adviser

Combining the assets of an investment adviser with the assets of non-covered affiliates, even if those affiliates are not "operationally independent," would not further the goals of the Reproposed Rule. The assets of non-covered affiliates – i.e., the entities that are not investment advisers, banks or broker dealers – would pose no threat to the affiliated investment adviser from a risk standpoint, as the assets or equity could not be used for purposes of exposing the investment adviser to risk. Therefore, assets of non-covered affiliates should not be combined with the assets of the investment adviser for purposes of determining the Level of an investment adviser.

7. Only the Portion of the Assets of a Non-U.S. Adviser That Relate to U.S. Business Should Be Included in Average Total Consolidated Assets

As noted in Part V(F), when determining the average total consolidated assets of a non-U.S. adviser (including a relying adviser), only the portion of the assets that relate to the U.S. business should be counted.

B. Index the Level 1, Level 2 and Level 3 Thresholds for Inflation

Each of the dollar thresholds relevant to the determination of Level 1, Level 2 and Level 3 status, including the $1 billion threshold for Level 3 status, should be indexed for inflation.

C. Expansion of the Exclusion for DPC Subsidiaries

The exclusion in the Board's version of the Reproposed Rule for covered institutions acquired in the ordinary course of collecting a debt previously contracted should also be included in the other Agencies' versions of the rule.

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[55] 81 Fed. Reg. at 37,833.

The definition of subsidiary in the Board's version of the Reproposed Rule excludes "[a]ny company with respect to which the covered institution acquired ownership or control in the ordinary course of collecting a debt previously contracted in good faith" (the "DPC Subsidiaries").[56] This exclusion reflects the long-standing principle that a bank holding company or bank may acquire an otherwise impermissible investment for a limited period of time in connection with collecting on a debt previously contracted, including by acquiring a controlling investment in a company, without subjecting such company to regulation as a bank or bank holding company.[57] This exclusion should also be included in the other Agencies' versions of the rule. The same policy reasons that weigh in favor of permitting a Board-regulated institution to control a DPC Subsidiary for a limited period of time without applying the Original Proposal to the subsidiary's compensation programs also weigh in favor of permitting, for example, an OCC or FDIC-regulated depository institution to acquire control of a DPC Subsidiary for a limited period of time in a manner consistent with applicable law and regulation without application of the Original Proposal to the subsidiary.

IX. Specific Issues for Foreign Banking Organizations and Other Foreign Institutions

A. U.S. Commercial Subsidiaries of FBOs Should Be Excluded from the Definition of "Subsidiary" and from the Calculation of Consolidated Assets

The definition of "subsidiary" in the Board's version of the Reproposed Rule excludes merchant banking investments that are owned or controlled pursuant to Section 4(k)(4)(H) of the BHCA, and Subpart J of the Board's Regulation Y thereunder (the "Merchant Banking Rule" and such companies, "Merchant Banking Portfolio Companies").[58] We support this exclusion. Merchant Banking Portfolio Companies are typically commercial companies, they are not integrated into the operations of the financial holding company that controls them and a financial holding company's relationships with its Merchant Banking Portfolio Companies are subject to significant restrictions under the Merchant Banking Rule.[59] Thus, we agree that "[a]pplication of the proposed rule to these institutions directly would not further the purpose of the proposed rule."[60]

Similar considerations support the exclusion of U.S. commercial companies that an FBO controls under Section 2(h)(2) of the BHCA ("Section 2(h)(2) Companies")[61]. As with Merchant Banking Portfolio Companies, the U.S. operations of Section 2(h)(2) Companies are limited to commercial activities and are not integrated into the U.S. financial operations of the FBO that controls them. Moreover, Section 2(h)(2) Companies are excluded from the Board's requirement that certain large FBOs hold their U.S. subsidiaries under a U.S. intermediate holding company that is subject to enhanced prudential standards (the "IHC Rule").[62] Because Section 2(h)(2) Companies are not included for purposes of determining coverage under

[56] 81 Fed. Reg. at 37,809.

[57] See, e.g., 81 Fed. Reg. at 37,689; 12 C.F.R. §§ 1.7; 225.22(d)(1).

[58] 12 U.S.C. § 1843(k)(94)(H); 12 C.F.R. pt. 225, subpart J.

[59] See 12 C.F.R. 225.171 et seq.

[60] 81 Fed. Reg. at 37,689.

[61] Under BHCA Section 2(h)(2) and Section 211.23(f)(5) of the Board's Regulation K, qualifying foreign banking organizations ("QFBOs") are authorized to hold controlling investments in non-U.S. commercial companies that engage in activities in the United States through U.S. offices and subsidiaries, subject to extensive restrictions. These restrictions include requirements that the investing FBO qualify as a QFBO, limits on the nature and relative size of the target company's U.S. operations, prohibitions on engaging in financial activities in the United States, lending and cross-marketing restrictions, etc. See 12 U.S.C. § 1841(h)(2); 12 C.F.R. § 211.23(f)(5).

[62] See 12 C.F.R. § 252.153(b)(1) and (e); 77 Fed. Reg. 76628, 76638 (Dec. 28, 2012).

the IHC Rule, they also are not included as part of the U.S. assets as periodically reported by FBOs to the Board on Form FR Y-7Q.

- Given the similar aim of Section 165 to that of Section 956, we believe that the same approach should be taken and see no reason for the Board's departure from its treatment of Section 2(h)(2) Companies under the IHC Rule. Accordingly, we respectfully recommend that Section 2(h)(2) Companies should be excluded from the definition of "subsidiary" and from the calculation of average total consolidated assets for purposes of the Final Rule. As a result, it would not be necessary to prescribe any separate reporting requirement for Section 2(h)(2) Companies, and the determination of the average total consolidated assets of an FBO's U.S. operations can be based on information already reported on Form FR Y-7Q.

B. Substituted Compliance Should Be Permitted for Qualifying Foreign Institutions

The operations of Qualifying Foreign Institutions (defined below) will typically be subject to home country supervision. In order to avoid duplicative and conflicting regulation that would not only not advance the purposes of Section 956 but would also be overly burdensome to Qualifying Foreign Institutions insofar as they would be required to comply with parallel sets of compliance; therefore, we respectfully urge the adoption of an approach whereby the U.S. operations, subsidiaries, branches and agencies of financial institutions that are headquartered outside the United States are deemed to be in compliance with the Reproposed Rule to the extent that they are subject to supervision by a home country supervisory authority that has implemented incentive-based compensation regulation and/or supervision determined by the Agencies to be substantially equivalent to or otherwise substantially consistent with the purposes of Section 956 (a "Qualifying Foreign Institution").

While the Agencies may see a benefit to applying Section 956 to the U.S. operations of a global institution that is also subject to foreign regulations, those benefits are diminished or eliminated altogether if the foreign regulations are substantially equivalent to or are otherwise substantially consistent with the purposes of Section 956. Adopting our substituted compliance approach would address the following important concerns.

First and foremost, the substituted compliance approach would avoid either duplicative requirements or direct conflicts that the Reproposed Rule could raise under home country laws, which are especially problematic given frequent movement of employees between the United States and home country jurisdictions.

Second, this approach would address issues that might otherwise be raised in the context of a controlled group with multiple covered institutions whose incentive based compensation arrangements are centrally managed within a framework prescribed by applicable home country requirements and standards. Under a "top down" approach, these home country-prescribed compensation arrangements would typically extend to a Qualifying Foreign Institution's U.S. subsidiaries and branches. Permitting the Qualifying Foreign Institution's home country regulator to review compensation arrangements as a whole under one regime would ensure greater coordination and alignment of incentive compensation arrangements group wide.

Third, as recognized by the Agencies, many non-U.S. financial institutions have undertaken extensive review and revision of their compensation programs under home country supervision as well as adopted rigorous processes for identification of individuals with positions which permit them to take risks that could lead to material financial loss to the institution. Requiring such institutions to engage in additional costly and time-consuming procedures with respect solely to their U.S. entities – both in regard to program review and

Risk-Taker identification – would be unduly burdensome and unnecessary. For any non-U.S. financial institution subject to regulation and supervision that is substantially equivalent to or is otherwise substantially consistent with the purposes of Section 956, we believe that those institutions should not be required to duplicate such efforts.

X. Cost/Benefit Considerations

Before proceeding with the Reproposed Rule, the Agencies should conduct – and provide to the public – an analysis of relevant costs and benefits and appropriate quantitative impact assessments of the Reproposed Rule.

The Reproposed Rule would significantly expand compliance costs and administrative burdens on covered institutions beyond those associated with the Original Proposal and the Final Interagency Guidance. Among other changes, the Reproposed Rule applies to a significantly larger universe of employees at covered financial institutions and adds a comprehensive framework of plan design requirements, as discussed above. These costs have not been sufficiently addressed in the preamble to the Reproposed Rule, or weighed against the claimed benefits of the Reproposed Rule or against other, potentially less burdensome, approaches.

Of the six Agencies collaborating on the Reproposed Rule, only the SEC has sought to provide an analysis comparing the Reproposed Rule's expected costs and burdens to its claimed benefits, and only with respect to a limited set of covered institutions (and the SEC has admitted that it does not have adequate data with respect to most of the covered institutions within its jurisdiction).[63] In light of the issues discussed above, it is important that each Agency gather the necessary data to fully analyze the costs it would impose on the covered institutions within its jurisdiction and to weigh those costs against the claimed benefits of the Reproposed Rule and other less burdensome and less prescriptive approaches. The resulting analysis, and its underlying data and assumptions, should be released for comment to enable the public a meaningful opportunity to evaluate and provide input on the analysis.

We recognize that the other Agencies participating in the rulemaking are not subject to the same legal requirements to conduct explicit cost-benefit analysis in their regulations that apply to the SEC. Nevertheless, we believe that the Reproposed Rule does not adequately reflect the legal requirements that do apply to the other Agencies, nor does it reflect the general U.S. government policy that federal agencies, including independent agencies such as those participating in the Reproposed Rule, should analyze the costs and benefits of proposed regulations and consider less burdensome alternatives.

For example, the Riegle Community Development and Regulatory Improvement Act (the "Riegle Act") requires each of the OCC, FDIC and Board, "in determining the effective date and administrative compliance requirements for new regulations that impose additional reporting, disclosure, or other requirements on insured depository institutions," to "consider, consistent with principles of safety and soundness and the public interest— (1) any administrative burdens that such regulations would place on depository institutions . . . and (2) the benefits of such regulations."[64] Despite this mandate, the Federal Banking Agencies make no attempt to estimate or address in a comprehensive way the administrative burdens that would be placed on insured depository institutions by the Reproposed Rule. Instead, they simply state that "comment on these matters has been solicited in the discussions of Section __.1 and __.3 in Part II of

[63] See 81 Fed. Reg. at 37,754. The SEC, which only addresses investment advisers and broker-dealers in its analysis, estimates that 806 institutions will be covered by its version of the Reproposed Rule. The Federal Banking Agencies, by contrast, estimate that they collectively oversee 1,411 covered institutions that would be affected by the proposed rule; however, this likely understates the true number because they assume that affiliated covered institutions will always act in concert, rather than implementing independent compliance programs. 81 Fed. Reg. at 37,753.

[64] 12 U.S.C. § 4802(a) (Emphasis added).

the Supplementary Information[, which discusses effective dates and timing issues], as well as other sections of the preamble, and that the requirements of [the Riegle Act] will be considered as part of the overall rulemaking process."[65]

In addition, it is the stated policy of the U.S. government that federal agencies, including independent regulatory agencies, should consider the costs and benefits during the rulemaking process. In January 2011, the Obama Administration issued Executive Order 13,563, instructing executive departments to use "the best available techniques to quantify anticipated present and future benefits and costs as accurately as possible."[66] In June 2011, the Obama Administration issued Executive Order 13,579, requesting that independent regulatory agencies abide by the same principles.[67] At the same time, President Obama released a statement requesting independent regulatory agencies "to follow . . . key cost-saving, burden-reducing principles," including undertaking cost-benefit analysis consistent with principles applicable to executive departments.[68] The Office of Management and Budget further emphasized to the independent regulatory agencies the "importance of . . . careful analysis of consequences, including both costs and benefits. Analysis of costs and benefits, undertaken in advance, can be a helpful way of assessing alternatives and of ensuring that regulation is justified."[69]

Although these Executive Orders do not bind independent regulatory agencies, the Federal Banking Agencies have nevertheless expressed their intent to follow the same principles. For example, the Board has "for many years tried to abide by the principles described" in Executive Order 13,579 to "minimize regulatory burden" through analysis of costs and benefits.[70] In addition, the FDIC considers "evaluation of regulatory costs and benefits including consideration of alternatives" as one of the few "important rulemaking processes and procedures."[71]

Therefore, before proceeding with the Reproposed Rule, the Agencies should conduct – and provide to the public, with an opportunity to review and comment – an analysis of relevant costs and benefits and appropriate quantitative impact assessments. A thorough analysis of the costs and benefits of the Reproposed Rule is especially important in light of the increased costs that will arise from the need to compete for talent and the significantly expanded compliance costs and administrative burdens that would be

[65] 81 Fed. Reg. at 37,757.

[66] Executive Order No. 13563, Improving Regulation and Regulatory Review, 76 Fed. Reg. 3821 (Jan. 21, 2011).

[67] Executive Order No. 13579, Regulation and Independent Regulatory Agencies, 76 Fed. Reg. 41587 (July 14, 2011) ("To the extent permitted by law, independent regulatory agencies should comply with" the general requirements directed to executive agencies in Executive Order 13563.).

[68] Press Release, Memorandum—Regulation and Independent Regulatory Agencies (July 11, 2011), https://www.whitehouse.gov/the-press-office/2011/07/11/memorandum-regulation-and-independent-regulatory-agencies.

[69] Memorandum from Cass R. Sunstein, Administrator, Office of Information and Regulatory Affairs, to the Heads of Independent Regulatory Agencies (July 22, 2011), https://www.whitehouse.gov/sites/default/files/omb/memoranda/2011/m11-28.pdf.

[70] Letter from Ben S. Bernanke, Chairman, Board of Governors of the Federal Reserve System, to Cass R. Sunstein, Administrator, Office of Information and Regulatory Affairs 1 (Nov. 8, 2011), https://www.federalreserve.gov/foia/files/regulatory-burden-reduction-111115.pdf.

[71] Statement of Policy on the Development and Review of Regulations and Policies, 78 Fed. Reg. 22,771, 22,772 (Apr. 17, 2013).

imposed by the Reproposed Rule in comparison to previous guidance and regulations addressing the compensation practices of financial institutions.

XI. Issue a Further Proposed Rule and Provide Public Opportunity to Comment Prior to Issuing the Final Rule

SIFMA strongly urges the Agencies to adopt a Final Rule that reflects a balance of principles and appropriately focused prescriptive rules that will allow the Agencies and each financial institution to prudently tailor its application to particular business circumstances. The overly prescriptive approach and overbroad scope of the Reproposed Rule raise extensive and interrelated concerns that will seriously impact the ability of financial institutions to operate and risk manage their businesses. Given the radical change from the 2011 Proposed Rule and the significant consequences and concerns discussed throughout our comment letter, it is critical that the Agencies repropose – and provide to the public an opportunity to review and comment – a revised version of the Reproposed Rule.

* * *

We thank you for the opportunity to submit this comment letter. We would be happy to discuss with you any of the comments described above or any other matters you feel would be helpful in your evaluation of the Reproposed Rule and the comments you receive. Please do not hesitate to contact Peter Matheson at [redacted] if you would like to discuss these matters further.

Sincerely,

Kenneth E. Bentsen, Jr.
President & CEO

Appendix A

RESPONSES TO REQUEST FOR COMMENTS

1.1. The Agencies invite comment on whether this timing would be sufficient to allow covered institutions to implement any changes necessary for compliance with the proposed rule, particularly the development and implementation of policies and procedures. Is the length of time too long or too short and why? What specific changes would be required to bring existing policies and procedures into compliance with the rule? What constraints exist on the ability of covered institutions to meet the proposed deadline?

Response: Given the complexity and breadth of the rules, SIFMA recommends that the Agencies lengthen the compliance date to ensure that institutions have no less than two years to comply with the new requirements. SIFMA proposes that compliance be required no earlier than the beginning of the first calendar quarter that begins at least 730 days after a Final Rule is published in the Federal Register.

In practice, compensation plans are amended well before the year in which they will be implemented begins. Significant time in advance of these amendments will be needed to digest the Final Rule, identify covered employees, re-design incentive-based compensation plans, adopt new review processes, implement governance and record-keeping requirements, and provide related training of personnel. Certain required changes may necessitate amendments to plan documentation requiring shareholder approval, in which case the changes and approvals would have to be completed by April or May of the year prior to the performance year for calendar year companies.

1.2. The Agencies invite comment on whether the compliance date should instead be the beginning of the first performance period that starts at least 365 days after the final rule is published in the Federal Register *in order to have the proposed rule's policies, procedures, risk management, and governance requirements begin when the requirements applicable to incentive compensation plans and arrangements begin. Why or why not?*

Response: Addressed in our response to Question 1.1.

2.1 The Agencies invite comment on whether other financial institutions should be included in the definition of "covered institution" and why.

Response: SIFMA would not recommend expanding the definition of "covered institution." We also note our recommendation that certain institutions be excluded from the definition of "covered institution," as further discussed in Parts V(F), VIII(C) and IX of our comment letter.

2.2. The Agencies invite comment on whether any additional financial institutions should be included in the proposed rule's definition of subsidiary and why.

Response: SIFMA would not recommend expanding the definition of "subsidiary."

2.3. The Agencies invite comment on whether any additional financial institutions (such as registered investment companies) should be excluded from the proposed rule's definition of subsidiary and why.

Response: Addressed in Parts V(B)(2), V(C), VIII(C) and IX(A) of our comment letter.

2.4. The Agencies invite comment on the definition of average total consolidated assets.

Response: Addressed in Part VIII(A) of our comment letter.

2.5. The Agencies invite comment on the proposed rule's approach to consolidation. Are there any additional advantages to the approach? For example, the Agencies invite comment on the advantages of the proposed rule's approach for reinforcing the ability of an institution to establish and maintain effective risk management and controls for the entire consolidated organization and enabling holding company structures to more effectively manage human resources. Are there advantages to the approach of the proposed rule in helping to reduce the possibility of evasion of the more specific standards applicable to certain individuals at Level 1 or Level 2 covered institutions? Are there any disadvantages to the proposed rule's approach to consolidation? For example, the Agencies invite comment on any disadvantages smaller subsidiaries of a larger covered institution may have by applying the more specific provisions of the proposed rule to these smaller institutions that would not otherwise apply to them but for being a subsidiary of a larger institution. Is there another approach that the proposed rule should take? The Agencies invite comment on any advantages and disadvantages of the SEC's proposal to not consolidate subsidiaries of broker-dealers and investment advisers that are not themselves subsidiaries of depository institution holding companies. Are the operations, services, and products of broker-dealers and investment advisers not typically effected through subsidiaries? Should the SEC adopt an express requirement to treat two or more affiliated investment advisers or broker-dealers that are separate legal entities (e.g., investment advisers that are operationally integrated) as a single investment adviser or broker-dealer for purposes of the proposed rule's thresholds?

Response: Addressed in Part V of our comment letter.

2.6. The Agencies invite comment on whether the three-level structure would be a workable approach for categorizing covered institutions by asset size and why.

Response: As addressed in Parts V and VIII(B) of our comment letter, we believe that certain modifications are necessary to the Reproposed Rule's methodology for categorization in order to improve the workability of this approach.

2.7. The Agencies invite comment on whether the asset thresholds used in these definitions would divide covered institutions into appropriate groups based on how they view the competitive marketplace. If asset thresholds are not the appropriate methodology for determining which requirements apply, which other alternative methodologies would be appropriate and why?

Response: As addressed in Parts V, VIII(A) and VIII(B) of our comment letter, we believe that certain modifications are necessary to the Reproposed Rule's methodology with respect to the calculation of asset thresholds in order to improve the workability of this approach.

2.8. Are there instances where it may be appropriate to modify the requirements of the proposed rule where there are multiple covered institutions subsidiaries within a single parent organization based upon the relative size, complexity, risk profile, or business model, and use of incentive-based compensation of the covered institution subsidiaries within the consolidated organization? In what situations would that be appropriate and why?

Response: Addressed in Part V of our comment letter.

2.9. Is the Agencies' assumption that incentive-based compensation programs are generally designed and administered at the holding company level for the organization as a whole correct? Why or why not? To what extent do broker-dealers or investment advisers within a holding company structure apply the same compensation standards as other subsidiaries in the parent company?

Response: As discussed in Part V(A) of our comment letter, the Agencies' assumption is generally correct, but there are numerous exceptions to the general rule. Our suggested approach to consolidation in Part V of our comment letter is intended to help address these issues.

2.10. Bearing in mind that section 956 by its terms seeks to address incentive-based compensation arrangements that could lead to material financial loss to a covered institution, commenters are asked to provide comments on the proposed method of *determining asset size for investment advisers. Are there instances where it may be appropriate to determine asset size differently, by for example, including client assets under management for investment advisers? In what situations would that be appropriate and why?*

Response: Addressed in Parts V(E) and VIII(A) of our comment letter.

2.11. *Should the determination of average total consolidated assets for investment advisers exclude non-proprietary assets that are included on a balance sheet under accounting rules, such as certain types of client assets under management required to be included on an investment adviser's balance sheet? Why or why not?*

Response: Addressed in Parts V(E) and VIII(A) of our comment letter.

2.12. *Should the determination of average total consolidated assets be further tailored for certain types of investment advisers, such as charitable advisers, non-U.S.-domiciled advisers, or insurance companies and, if so, why and in what manner?*

Response: SIFMA recommends that unregistered investment advisers and certain registered non-U.S. investment advisers be excluded from the Final Rule, as addressed in Part V(F) of our comment letter. We also note our recommendations regarding the calculation of assets in Parts V(E) and VIII(A) of our comment letter.

2.13. *The Agencies invite comment on the methods for determining whether foreign banking organizations and Federal branches and agencies are Level 1, Level 2, or Level 3 covered institutions. Should the same method be used for both foreign banking organizations and Federal branches and agencies? Why or why not?*

Response: Addressed in Part IX of our comment letter.

2.14. *The Agencies invite comment on whether the definition of "principal shareholder" reflects a common understanding of who would be a principal shareholder of a covered institution.*

Response: The Final Rule should expressly confirm that principal shareholders that do not receive incentive-based compensation from a covered institution should be excluded. For example, principal shareholders that receive compensation from a non-covered institution parent of a covered institution should not be covered. Principal shareholders should be limited to direct shareholders of the covered institution, not including individuals who have 10% of a class of voting stock in an entity several levels above the covered institution in the ownership structure.

2.15. *The Agencies invite comment on whether the types of positions identified in the proposed definition of senior executive officer are appropriate, whether additional positions should be included, whether any positions should be removed, and why.*

Response: Addressed in Part III(B)(1) of our comment letter.

2.16. *The Agencies invite comment on whether the term "major business line" provides enough information to allow a covered institution to identify individuals who are heads of major business lines. Should the proposed rule refer instead to a "core business line," as defined in FDIC and FRB rules relating to resolution planning (12 C.F.R. § 381.2(d)), to a "principal business unit, division or function," as described in SEC definitions of the term "executive officer" (17 C.F.R. § 240.3b-7), or to business lines that contribute greater than a specified amount to the covered institution's total annual revenues or profit? Why?*

Response: Addressed in Part III(B)(1) of our comment letter.

2.17. *Should the Agencies include the chief technology officer (the "CTO"), chief information security officer, or similar titles as positions explicitly listed in the definition of "senior executive officer"? Why or why not? Individuals in these* *positions play a significant role in information technology management. The CTO is generally responsible for the development and implementation of the information technology strategy to support the institution's business strategy in line with its appetite for risk. In addition, these positions are generally responsible for implementing information technology architecture, security, and business resilience.*

Response: Addressed in Part III(B)(1) of our comment letter.

2.18. For purposes of a designation under paragraph (2) of the definition of significant risk-taker, should the Agencies provide a specific standard for what would constitute "material financial loss" and/or "overall risk tolerance"? If so, how should these terms be defined and why?

Response: SIFMA urges the Agencies to adopt the approach taken by the Federal Banking Agencies under the Final Interagency Guidance, as addressed in Part III(B)(2) of our comment letter.

2.19. The Agencies specifically invite comment on the one-third threshold in the proposed rule. Is one-third of the total of annual base salary and incentive-based compensation an appropriate threshold level of incentive-based compensation that would be sufficient to influence risk-taking behavior? Is using compensation from the last calendar year that ended at least 180 days before the beginning of the performance period for calculating the one-third threshold appropriate?

Response: Addressed in Part III(B)(2)(b) of our comment letter.

2.20. The Agencies specifically invite comment on the percentages of employees proposed to be covered under the relative compensation test. Are 5 percent and 2 percent reasonable levels? Why or why not? Would 5 percent and 2 percent include all of the significant risk-takers or include too many covered persons who are not significant risk-takers?

Response: Addressed in Part III(B)(2) of our comment letter.

2.21. The Agencies specifically invite comment on the time frame needed to identify significant risk-takers under the relative compensation test. Is using compensation from the last calendar year that ended at least 180 days before the beginning of the performance period appropriate? The Agencies invite comment on whether there is another measure of total compensation that would be possible to measure closer in time to the performance period for which a covered person would be identified as a significant risk-taker.

Response: While that time frame is appropriate within the context of the Reproposed Rule, we have a number of concerns with the relative compensation test more generally, as addressed in Part III(B)(2) of our comment letter.

2.22. The Agencies invite comment on all aspects of the exposure test, including potential costs and benefits, the appropriate exposure threshold and capital equivalent, efficacy at identifying those non-senior executive officers who have the authority to place the capital of a covered institution at risk, and whether an exposure test is a useful complement to the relative compensation test. If so, what specific types of activities or transactions, and at what level of exposure, should the exposure test cover? The Agencies also invite comment on whether the exposure test is workable and why. What, if any, additional details would need to be specified in order to make the exposure test workable, such as further explanation of the meanings of "commit" or "expose"? In addition to committees, should the exposure test apply to groups of persons, such as traders on a desk? If so, how should it be applied?

Response: SIFMA urges the Agencies to eliminate the exposure test and proposes an alternative solution in Part III(B)(2) of our comment letter.

2.23. With respect to the exposure test, the Agencies specifically invite comment on the proposed capital commitment levels. Is 0.5 percent of capital of a covered institution a reasonable proxy for material financial loss, or are there alternative levels or dollar thresholds that would better achieve the statutory objectives? If alternative methods would better achieve the statutory *objectives, what are the advantages and disadvantages of those alternatives compared to the proposed level? For depository institution holding company organizations with multiple covered institutions, should the capital commitment level be consistent across all such institutions or should it vary depending on specified factors and why? For example, should the levels for covered institutions that are subsidiaries of a parent who is also a covered institution vary depending on: (1) the size of those subsidiaries relative to the parent; and/or (2) whether the entity would be subject to comparable restrictions if it were not affiliated with the parent? What are the advantages and disadvantages of any such variation, and what would be the appropriate levels? The Agencies recognize that certain covered institutions under the Board's, the OCC's, the FDIC's, and the SEC's proposed rules, such as Federal and state branches and agencies of foreign banks and investment advisers that are not also depository institution holding companies, banks, or broker-dealers or subsidiaries of those institutions, are not otherwise required to calculate common equity tier 1 capital or tentative net capital, as applicable. How should the capital commitment level be determined under the Board's, the OCC's, the FDIC's, and the SEC's proposed rules for those covered institutions? Is there a capital or other measure that the Agencies should consider for those covered institutions that would achieve similar objectives to common equity tier 1 capital or tentative net capital? If so, what are the advantages and disadvantages of such a capital or other measure?*

Response: SIFMA urges the Agencies to eliminate the exposure test and proposes an alternative solution in Part III(B)(2) of our comment letter.

2.24. The Agencies invite comment on whether it is appropriate to limit the exposure test to market risk and credit risk and why. What other types of risk should be included, if any and how would such exposures be measured? Should the Agencies prescribe a method for measurement of market risk and credit risk? Should exposures be measured as notional amounts or is there a more appropriate measure? If so, what would it be? Should the exposure test take into account hedging? How should the exposure test be applied to an individual in a situation where a firm calculates an exposure limit for a trading desk comprised of a group of people? Should a de minimis threshold be introduced for any transaction counted toward the 0.5 percent annual exposure test?

Response: SIFMA urges the Agencies to eliminate the exposure test and proposes an alternative solution in Part III(B)(2) of our comment letter.

2.25. Should the exposure test consider the authority of a covered person to initiate or structure proposed product offerings, even if the covered person does not have final decision-making authority over such product offerings? Why or why not? If so, are there specific types of products with respect to which this approach would be appropriate and why?

Response: SIFMA urges the Agencies to eliminate the exposure test and proposes an alternative solution in Part III(B)(2) of our comment letter.

2.26. Should the exposure test measure a covered person's authority to commit or expose (a) through one transaction or (b) as currently proposed, through multiple transactions in the aggregate over a period of time? What would be the benefits and disadvantages of applying the test on a per-transaction versus aggregate basis over a period of time? If measured on an aggregate basis, what period of time is appropriate and why? For example, should paragraph (1)(iii) of the definition of significant risk-taker read: "A covered person of a covered institution who had the authority to commit or expose in any single transaction during the previous calendar year 0.5 percent or more of the capital of the covered institution or of any section 956 affiliate of the covered institution, whether or not the individual is a covered person of that specific legal entity"? Why or why not?

Response: SIFMA urges the Agencies to eliminate the exposure test and proposes an alternative solution in Part III(B)(2) of our comment letter.

2.27. If the exposure test were based on a single transaction, would 0.5 percent of capital be the appropriate threshold for significant risk-taker status? Why or why not? If not, what would be the appropriate percentage of capital to include in the exposure test and why?

Response: SIFMA urges the Agencies to eliminate the exposure test and proposes an alternative solution in Part III(B)(2) of our comment letter.

2.28. Should the Agencies introduce an absolute exposure threshold in addition to a percentage of capital test if a per-transaction test was introduced instead of the annual exposure test? Why or why not? For example, would a threshold formulated as "the lesser of 0.5 percent of capital or $100 million" help to level the playing field across Level 1 covered institutions and the smallest Level 2 covered institutions and better ensure that the right set of activities is being considered by all institutions? The Agencies' supervisory experience indicates that many large institutions, for example, require additional scrutiny of significant transactions, which helps to ensure that the potential risks posed by large transactions are adequately considered before such transactions are approved. Would $100 million be the appropriate level at which additional approval procedures are required before a transaction is approved, or would a lower threshold be appropriate if an absolute dollar threshold were combined with the capital equivalent threshold?

Response: SIFMA urges the Agencies to eliminate the exposure test and proposes an alternative solution in Part III(B)(2) of our comment letter.

2.29. Should the exposure test measure exposures or commitments actually made, or should the authority to make an exposure or commitment be sufficient to meet the test and why? For example, should paragraph (1)(iii) of the definition of significant risk-taker read: "A covered person of a covered institution who committed or exposed in the aggregate during the previous calendar year 0.5 percent or more of the common equity tier 1 capital, or in the case of a registered securities broker or dealer, 0.5 percent or more of the tentative net capital, of the covered institution or of any section 956 affiliate of the covered institution, whether or not the individual is a covered person of that specific legal entity"?

Response: SIFMA urges the Agencies to eliminate the exposure test and proposes an alternative solution in Part III(B)(2) of our comment letter.

2.30. Would a dollar threshold test, as described above, achieve the statutory objectives better than the relative compensation test? Why or why not? If using a dollar threshold test, and assuming a mechanism for inflation adjustment, would $1 million be the right threshold or should it be higher or lower? For example, would a threshold of $2 million dollars be more appropriate? Why or why not? How should the threshold be adjusted for inflation? Are there other adjustments that should be made to ensure the threshold remains appropriate? What are the advantages and disadvantages of a dollar threshold test compared to the proposed relative compensation test?

Response: SIFMA's recommended approach to the identification of significant risk-takers is addressed in Part III(B)(2) of our comment letter.

2.31. The Agencies specifically invite comment on replacement of the relative compensation test in paragraphs (1)(i) and (ii) of the definition of significant risk-taker with a dollar threshold test, as follows: "a covered person of a Level 1 or Level 2 covered institution who receives annual base salary and incentive-based compensation of $1 million or more in the last calendar year that ended at least 180 days before the beginning of the performance period." Under this alternative, the remaining language in the definition of "significant risk- taker" would be unchanged.

Response: SIFMA's recommended approach to the identification of significant risk-takers is addressed in Part III(B)(2) of our comment letter.

2.32. The Agencies invite comment on all aspects of a dollar threshold test, including potential costs and benefits, the appropriate amount, efficacy at identifying those non-senior executive officers who have the ability to place the institution at risk, time frame needed to identify significant risk-takers, and comparison to a relative compensation test such as the one proposed. Is the last calendar year that ended at least 180 days before the beginning of the performance period an appropriate time frame or for the dollar threshold test or would using compensation from the performance period that ended in the most recent calendar year be appropriate? The Agencies specifically invite comment on whether to use an exposure test if a dollar threshold test replaces the relative compensation test and why.

Response: SIFMA's recommended approach to the identification of significant risk-takers is addressed in Part III(B)(2) of our comment letter.

2.33. The Agencies invite comment on all aspects of the definition of "significant risk-taker." The Agencies specifically invite comment on whether the definition should rely solely on the relative compensation test, solely on the exposure test, or on both tests, as proposed. What are the advantages and disadvantages of each of these options?

Response: SIFMA's recommended approach to the identification of significant risk-takers is addressed in Part III(B)(2) of our comment letter.

2.34. In addition to the tests outlined above, are there alternative tests of, or proxies for, significant risk-taking that would better achieve the statutory objectives? What are the advantages and disadvantages of alternative approaches? What are the implementation burdens of any of the approaches, and how could they be addressed?

Response: SIFMA's recommended approach to the identification of significant risk-takers is addressed in Part III(B)(2) of our comment letter.

2.35. How many covered persons would likely be identified as significant risk-takers under the proposed rule? How many covered persons would likely be identified under only the relative compensation test with the one-third threshold? How many covered persons would likely be identified under only the exposure test as measured on an annual basis with the one-third threshold? How many covered persons would be identified under only an exposure test formulated on a per transaction basis with the one-third threshold? How many covered persons would be identified under only the dollar threshold test, assuming the dollar threshold is $1 million, with the one-third threshold? How many covered persons would be identified under each test individually without a one-third threshold?

Response: SIFMA has not had an opportunity to comprehensively compile such data given the limited timeframe available to comment on the Reproposed Rule. However, our concerns with the scope of the definition of "covered persons" are addressed in Part III of our comment letter.

2.36. The Agencies invite comment on whether the proposed rule's definition of "to award" should include language on when incentive-based compensation is awarded for purposes of the proposed rule. Specifically, the Agencies invite comment on whether the definition should read: "To award incentive-based compensation means to make a final determination, conveyed to a covered person, at the end of the performance period, of the amount of incentive-based compensation payable to the covered person for performance over that performance period." Why or why not?

Response: SIFMA agrees that the Final Rule should define "to award" in substantially the manner set forth above.

2.37. The Agencies invite comment on whether and in what circumstances, the proposed definition of "control function" should include additional individuals and organizational units that (a) do not engage in activities designed to generate revenue or reduce expenses; (b) provide operational support or servicing to any organizational unit or function; or (c) provide technology services.

Response: Addressed in Parts III(A) and III(B)(1) of our comment letter.

2.38. To the extent covered institutions are already deferring incentive-based compensation, does the proposed definition of deferral reflect current practice? If not, in what way does it differ?

Response: Addressed in Parts VI(A), VI(B), VI(C), VI(D), VI(E) and VI(F) of our comment letter.

2.39. Are there any financial instruments that are used for incentive-based compensation and have a value that is dependent on the performance of a covered institution's shares, but are not captured by the definition of "equity-like instrument"? If so, what are they, and should such instruments be added to the definition? Why or why not?

Response: SIFMA has no comment in respect of Question 2.39.

2.40. The Agencies invite comment on the proposed definition of incentive-based compensation. Should the definition be modified to include additional or fewer forms of compensation and in what way? Is the definition sufficiently broad to capture all forms of incentive-based compensation currently used by covered institutions? Why or why not? If not, what forms of incentive-based compensation should be included in the definition?

Response: Addressed in Part IV of our comment letter.

2.41. The Agencies do not expect that most pensions would meet the proposed rule's definition of "incentive-based compensation" because pensions generally are not conditioned on performance achievement. However, it may be possible to design a pension that would meet the proposed rule's definition of "incentive-based compensation." The Agencies invite comment on whether the proposed rule should contain express provisions addressing the status of pensions in relation to the definition of "incentive-based compensation." Why or why not?

Response: SIFMA requests that the Agencies clarify that incentive-based compensation does not include any employer contributions to retirement plans qualified under Section 401(a) of the Internal Revenue Code and regulated under associated U.S. Treasury Department regulations as addressed in Part IV(F) of our comment letter.

2.42. The Agencies invite comment on whether the proposed definition of "long-term incentive plan" is appropriate for purposes of the proposed rule. Are there incentive-based compensation arrangements commonly used by financial institutions that would not be included within the definition of "long-term incentive plan" under the proposed rule but that, given the scope and purposes of section 956, should be included in such definition? If so, what are the features of such incentive-based compensation arrangements, why should the definition include such arrangements, and how should the definition be modified to include such arrangements?

Response: SIFMA is concerned with the prescriptive requirements that are applied to long-term incentive plans under the Reproposed Rule. Furthermore, certain types of compensation currently picked up by the broad definition of "incentive-based compensation" would not be easily classified as short- or long-term, e.g., carried interest plans or plans that combine as one award both short-term and long-term performance criteria, regardless of the definition used. These concerns, and our recommended solutions, are addressed in Part IV of our comment letter.

2.43. Does the proposed rule's definition of "performance period" meet the goal of providing covered institutions with flexibility in determining the length and start and end dates of performance periods? Why or why not? Would a prescribed performance period, for example, periods that correspond to calendar years, be preferable? Why or why not?

Response: SIFMA believes that each covered institution is best placed to determine the performance period in respect of which compensation is determined and that the proposed definition maintains the necessary flexibility.

2.44. The Agencies invite comment generally on the proposed rule's definitions.

Response: Our concerns with the applicable definitional language in the Reproposed Rule are addressed throughout our comment letter, generally organized by substantive topic.

2.45. Is the interplay of the award date, vesting date, performance period, and deferral period clear? If not, why not?

Response: As addressed in Part VI(J) of our comment letter, SIFMA requests further clarification on the use of the term "vest" in respect of service-based conditions.

2.46. Have the Agencies made clear the distinction between the proposed definitions of clawback, forfeiture, and downward adjustment? Do these definitions align with current industry practice? If not, in what way do they differ and what are the implications of such differences for both the operations of covered institutions and the effective supervision of compensation practices?

Response: Addressed in Parts IV(A), VI(I) and VI(J).

3.1. The Agencies invite comment on whether a covered institution's average total consolidated assets (a rolling average) is appropriate for determining a covered institution's level when its total consolidated assets increase. Why or why not? Will 540 days provide covered institutions with adequate time to adjust incentive-based compensation programs to comply with different requirements? If not, why not? In the alternative, is 540 days too long to give covered institutions time to comply with the requirements of the proposed rule? Why or why not?

Response: As discussed in our response to Question 1.1, given the complexity and breadth of the Reproposed Rule, SIFMA recommends that the Agencies lengthen the compliance date to ensure that institutions have no less than two years to comply with the Final Rule or in the event that an institution moves from Level 3 to Level 2 or Level 1.

3.2. The Agencies invite comment on whether the date described in section __.3(a)(2) should instead be the beginning of the first performance period that begins at least 365 days after the date on which the regulated institution becomes a Level 1, Level 2, or Level 3 covered institution in order to have the date on which the proposed rule's corporate governance, policies, and procedures requirements begin coincide with the date on which the requirements applicable to plans begin. Why or why not?

Response: As recommended in our response to Question 3.1., a two-year compliance period has the added benefit of permitting the alignment of the beginning of the Final Rule's policies, procedures, risk management and governance requirements with the beginning of the requirements applicable to incentive compensation plans.

3.3. The Agencies invite comment on whether four consecutive quarters is an appropriate period for determining a covered institution's level when its total consolidated assets decrease. Why or why not?

Response: SIFMA agrees that four consecutive quarters is an appropriate period.

3.4. Should the determination of total consolidated assets for covered institutions that are investment advisers be by reference to a periodic report or similar concept? Why or why not? Should there be a concept of a rolling average for asset size for covered institutions that are investment advisers and, if so, how should this be structured?

Response: SIFMA believes that, to the extent an investment adviser's balance sheet is the basis for the asset determination, a rolling quarterly average is appropriate. However, Parts V(E) and VIII(A) of our comment letter address certain items that we believe should not be included within this asset determination.

3.5. Should the transition period for an institution that changes levels or becomes a covered institution due to a merger or acquisition be different than an institution that changes levels or becomes a covered institution without a change in corporate structure? If so, why? If so, what transition period would be appropriate and why?

Response: SIFMA believes in both cases a two-year transition period would be appropriate for compliance with the newly applicable rules.

3.6. The Agencies invite comment on whether covered institutions transitioning from Level 1 to Level 2 or Level 2 to Level 3 should be permitted to modify incentive-based compensation plans with performance periods that began prior to their transition in level in such a way that would cause the plans not to meet the requirements of the proposed rule that were applicable to the covered institution at the time when the performance periods for the plans commenced. Why or why not?

Response: SIFMA recommends that such modification be permitted given that the regulatory trigger and rationale for the requirements would no longer exist during the remainder of the performance period and thereafter.

4.1. The Agencies invite comment on the requirements for performance measures contained in section __.4(d) of the proposed rule. Are these measures sufficiently tailored to allow for incentive-based compensation arrangements to appropriately balance risk and reward? If not, why?

Response: Addressed in Part VII(A) of our comment letter.

4.2. The Agencies invite comment on whether the terms "financial measures of performance" and "non-financial measures of performance" should be defined. If so, what should be included in the defined terms?

Response: Addressed in Part VII(A) of our comment letter.

4.3. Would preparation of annual records be appropriate or should another method be used? Would covered institutions find a more specific list of topics and quantitative information for the content of required records helpful? Should covered institutions be required to maintain an inventory of all such records and to maintain such records in a particular format? If so, why? How would such specific requirements increase or decrease burden?

Response: Addressed in Parts V(D) and VII(B) of our comment letter.

4.4. Should covered institutions only be required to create new records when incentive-based compensation arrangements or policies change? Should the records be updated more frequently, such as promptly upon a material change? What should be considered a "material change"?

Response: Addressed in Part VII(B) of our comment letter.

4.5. Is seven years a sufficient time to maintain the records required under section __.4(f) of the proposed rule? Why or why not?

Response: SIFMA believes that the duration of time to maintain records should match the time span between the grant of an award and the end of the clawback period (as modified as described in Part VI(J)).

4.6. Do covered institutions generally maintain records on incentive-based compensation arrangements and programs? If so, what types of records and related information are maintained and in what format? What are the legal or institutional policy requirements for maintaining such records?

Response: As addressed in Part VII(B) of our comment letter, the recordkeeping already required and/or maintained varies widely among covered institutions depending on their size and complexity. SIFMA suggests that this is another example of why a principles-based approach that reflects the diversity of financial institutions is so important.

4.7. For covered institutions that are investment advisers or broker-dealers, is there particular information that would assist the SEC in administering the proposed rule? For example, should the SEC require its reporting entities to report whether they utilize incentive-based compensation or whether they are Level 1, Level 2 or Level 3 covered institutions?

Response: SIFMA believes that since virtually all covered institutions utilize incentive-based compensation, and in light of the information already provided to the SEC in FOCUS reports and Forms ADV, no such additional reporting is necessary.

5.1. Should the level of detail in records created and maintained by Level 1 and Level 2 covered institutions vary among institutions regulated by different Agencies? If so, how? Or would it be helpful to use a template with a standardized information list?

Response: As addressed in Parts III and IV of our comment letter, we believe that the scope of covered employees and covered compensation is too broad, and that the recordkeeping requirements should apply to a narrower category of employees and compensation arrangements. In terms of the content of the recordkeeping requirements, as discussed in our response to Question 4.6 and in Part VII(B) of our comment letter, the recordkeeping already required and/or maintained varies widely among covered institutions depending on their size and complexity, and the Reproposed Rule imposes requirements far beyond what one could reasonably expect to be necessary from a risk-control perspective.

5.2. In addition to the proposed records, what types of information should Level 1 and Level 2 covered institutions be required to create and maintain related to deferral and to forfeiture, downward adjustment, and clawback reviews?

Response: SIFMA does not believe that additional recordkeeping in this regard would help to advance the purposes of Section 956.

6.1. The Agencies invite general comment on the reservation of authority in section __.6 of the proposed rule.

Response: Addressed in Part V(C) of our comment letter.

6.2. The Agencies based the $10 billion dollar floor of the reservation of authority on existing similar reservations of authority that have been drawn at that level. Did the Agencies set the correct threshold or should the floor be set lower or higher than $10 billion? If so, at what level and why?

Response: Our recommendations concerning the appropriate reservation of authority are addressed in Part V(C)(1) of our comment letter.

6.3. Are there certain provisions in section __.5 and sections __.7 through __.11 of the proposed rule that would not be appropriate to apply to a covered institution with total consolidated assets of $10 billion or more and less than $50 billion regardless of its complexity of operations or compensation practices? If so, which provisions and why?

Response: SIFMA believes that each Agency should have the authority to waive the application of some or all of its requirements to particular employees or particular businesses in appropriate circumstances as addressed in Part V(C) of our comment letter.

6.4. The Agencies invite comment on the types of notice and response procedures the Agencies should use in determining that the reservation of authority should be used. The SEC invites comment on whether notice and response procedures based on the procedures for a proceeding initiated upon the SEC's own motion under Advisers Act rule 0-5 would be appropriate for this purpose.

Response: SIFMA believes that any procedures utilized in this regard should give affected covered institutions a reasonable opportunity to discuss the proposed exercise of authority with the applicable Agency prior to its effectiveness.

6.5. What specific features of incentive-based compensation programs or arrangements at a Level 3 covered institution should the Agencies consider in determining such institution should comply with some or all of the more rigorous requirements within the rule and why? What process should be followed in removing such institution from the more rigorous requirements?

Response: Addressed in Part V(C)(3) of our comment letter.

7.1 The Agencies invite comment on the proposed requirements in sections __.7(a)(1) and (a)(2).

Response: Addressed in Parts VI(A), VI(B) and VI(C) of our comment letter.

7.2 Are minimum required deferral periods and percentages appropriate? If not, why not? Should Level 1 and Level 2 covered institutions be subject to different deferral requirements, as in the proposed rule, or should they be treated more similarly for this purpose and why? Should the minimum required deferral period be extended to, for example, five years or longer in certain cases and why?

Response: Addressed in Parts VI(A), VI(B) and VI(C) of our comment letter.

7.3 Is a deferral requirement for senior executive officers and significant risk-takers at Level 1 and Level 2 covered institutions appropriate to promote the alignment of employees' incentives with the risk undertaken by such covered persons? If not, why not? For example, comment is invited on whether deferral is generally an appropriate method for achieving incentive-based compensation arrangements that appropriately balance risk and reward for each type of senior executive officer and significant risk-taker at these institutions or whether there are alternative or more effective ways to achieve such balance.

Response: Addressed in Parts VI(A) and VI(B) of our comment letter.

7.4 Commenters are also invited to address the possible impact that the required minimum deferral provisions for senior executive officers and significant risk-takers may have on larger covered institutions and whether any deferral requirements should apply to senior executive officers at Level 3 institutions.

Response: Addressed in Parts V, VI(A) and VI(B) of our comment letter.

7.5 A number of commenters to the 2011 Proposed Rule suggested that applying a prescriptive deferral requirement, together with other requirements under that proposal, would make it more difficult for covered institutions to attract and retain key employees in comparison to the ability of organizations not subject to such requirements to recruit and retain the same employees. What implications does the proposed rule have on "level playing fields" between covered institutions and non-covered institutions in setting forth minimum deferral requirements under the rule?

Response: Our "level playing field" concerns are significant in the context of the Reproposed Rule, and are addressed in Parts I and II of our comment letter.

7.6 The Agencies invite comment on whether longer performance periods can provide risk balancing benefits similar to those provided by deferral, such that the shorter deferral periods for incentive-based compensation awarded under long-term incentive plans in the proposed rule would be appropriate.

Response: Addressed in Part VI(B) of our comment letter.

7.7 Would the proposed distinction between the deferral requirements for qualifying incentive- based compensation and incentive-based compensation awarded under a long-term incentive plan pose practical difficulties for covered institutions or increase compliance burdens? Why or why not?

Response: The extent of any practical difficulties or compliance burden relating to these deferral requirements will depend in large part on the size and complexity of the covered institution, its employee population and its incentive-based compensation arrangements, which is another reason why we believe a principles-based approach is appropriate.

7.8 Would the requirement in the proposed rule that amounts awarded under long-term incentive plans be deferred result in covered institutions offering fewer long-term incentive plans? If so, why and what other compensation plans will be used in place of long-term incentive plans and what negative or positive consequences might result?

Response: As discussed in Part VI of our comment letter, these requirements, as well as others discussed in Part VI of our comment letter, would likely result in an increase in the relative amount of fixed, compared to variable, compensation.

7.9 Are there additional considerations, such as tax or accounting considerations, that may affect the ability of Level 1 or Level 2 covered institutions to comply with the proposed deferral requirement or that the Agencies should consider in connection with this provision in the final rule? Commenters on the 2011 Proposed Rule noted that employees of an investment adviser to a private fund hold partnership interests and that any incentive allocations paid to them are typically taxed at the time of allocation, regardless of whether these allocations have been distributed, and consequently, employees of an investment adviser to a private fund that would have been subject to the deferral requirement in the 2011 Proposed Rule would have been required to pay taxes relating to incentive allocations that they were required to defer. Should the determination of required deferral amounts under the proposed rule be adjusted in the context of investment advisers to private funds and, if so, how? Could the tax liabilities immediately payable on deferred amounts be paid from the compensation that is not deferred?

Response: Addressed in our response to Question 7.11 and Part VI(J) and VI(L) of our comment letter.

7.10 The Agencies invite comment on the circumstances under which acceleration of payment should be permitted. Should accelerated vesting be allowed in cases where employees are terminated without cause or cases where there is a change in control and the covered institution ceases to exist and why? Are there other situations for which acceleration should be allowed? If so, how can such situations be limited to those of necessity?

Response: Addressed in Part VI(J) of our comment letter.

7.11 The Agencies received comment on the 2011 Proposed Rule that stated it was common practice for some private fund adviser personnel to receive payments in order to enable the recipients to make tax payments on unrealized income as they became due. Should this type of practice to satisfy tax liabilities, including tax liabilities payable on unrealized amounts of incentive-based compensation, be permissible under the proposed rule, including, for example, as a permissible acceleration of vesting under the proposed rule? Why or why not? Is this a common industry practice?

Response: As discussed in Part IV(B) of our comment letter, our view is that portfolio management compensation arrangements, such as carried interest arrangements, are a common industry practice that should be excluded from the definition of "incentive-based compensation." If they are not so excluded, then an exception to permit satisfaction of tax liabilities as described above should be provided in order to avoid inappropriately burdening employees receiving such compensation arrangements by requiring them to fund such tax liabilities through other available liquid assets.

7.12 The Agencies invite comment on the requirement in section __.7(a)(3).

Response: Addressed in Part VI(D) of our comment letter.

7.13 The Agencies invite comment on the composition requirement set out in section __.7(a)(4)(i) of the proposed rule.

Response: Addressed in Part VI(D) of our comment letter.

7.14 In order to allow Level 1 and Level 2 covered institutions sufficient flexibility in designing their incentive-based compensation arrangements, the Agencies are not proposing a specific definition of "substantial" for the purposes of this section. Should the Agencies more precisely define the term "substantial" (for example, one-third or 40 percent) and if so, should the definition vary among covered institutions and why? Should the term "substantial" be interpreted differently for different types of senior executive officers or significant risk-takers and why? What other considerations should the Agencies factor into level of deferred cash and deferred equity required? Are there particular tax or accounting implications attached to use of particular forms of incentive-based compensation, such as those related to debt or equity?

Response: Addressed in Part VI(D) of our comment letter.

7.15 The Agencies invite comment on whether the use of certain forms of incentive-based compensation in addition to, or as a replacement for, deferred cash or deferred equity-like instruments would strengthen the alignment between incentive-based compensation and prudent risk-taking.

Response: Addressed in Part VI(D) of our comment letter.

7.16 The Agencies invite commenters' views on whether the proposed rule should include a requirement that a certain portion of incentive-based compensation be structured with debt-like attributes. Do debt instruments (as opposed to equity-like instruments or deferred cash) meaningfully influence the behavior of senior executive officers and significant risk-takers? If so, how? How could the specific attributes of deferred cash be structured, if at all, to limit the amount of interest that can be paid? How should such an interest rate be determined, and how should such instruments be priced? Which attributes would most closely align use of a debt-like instrument with the interest of debt holders and promote risk-taking that is not likely to lead to material financial loss?

Response: Addressed in Part VI(D) of our comment letter.

7.17 The Agencies invite comment on the restrictions on the use of options in incentive-based compensation in the proposed rule. Should the percent limit be higher or lower and if so, why? Should options be permitted to be used to meet the deferral requirements of the rule? Why or why not? Does the use of options by covered institutions create, reduce, or have no effect on the institution's risk of material financial loss?

Response: Addressed in Part VI(F) of our comment letter.

7.18 Does the proposed 15 percent limit appropriately balance the benefits of using options (such as aligning the recipient's interests with that of shareholders) and drawbacks of using options (such as their emphasis on upside gains)? Why or why not? Is the proposed 15 percent limit the appropriate limit, or should it be higher or lower? If it should be higher or lower, what should the limit be, and why?

Response: Addressed in our response to Question 7.17 and Part VI(F) of our comment letter.

7.19 Are there alternative means of addressing the concerns raised by options as a form of incentive-based compensation other than those proposed?

Response: Addressed in Part VI(F) of our comment letter.

7.20 The Agencies invite comment on the forfeiture and downward adjustment requirements of the proposed rule.

Response: Addressed in Parts IV(A), VI(C) and VI(J) of our comment letter.

7.21 Should the rule limit the events that require a Level 1 or Level 2 covered institution to consider forfeiture and downward adjustment to adverse outcomes that occurred within a certain time period? If so, why and what would be an appropriate time period? For example, should the events triggering forfeiture and downward adjustment reviews be limited to those events that occurred within the previous seven years?

Response: SIFMA believes that the events triggering forfeiture and downward adjustment reviews should be limited to those events that occurred within the applicable performance and deferral periods. The Reproposed Rule as drafted will promote unease among employees given the broad nature of the triggers and the uncertainty as to the time frame.

7.22 Should the rule limit forfeiture and downward adjustment reviews to reducing only the incentive- based compensation that is related to the performance period in which the triggering event(s) occurred? Why or why not? Is it appropriate to subject unvested or unawarded incentive-based compensation to the risk of forfeiture or downward adjustment, respectively, if the incentive- based compensation does not specifically relate to the performance in the period in which the relevant event occurred or manifested? Why or why not?

Response: Addressed in our response to Question 7.21.

7.23 Should the rule place all unvested deferred incentive-based compensation, including amounts voluntarily deferred by Level 1 and Level 2 covered institutions or senior executive officers or significant risk-takers, at risk of forfeiture? Should only that unvested deferred incentive-based compensation that is required to be deferred under section .7(a) be at risk of forfeiture? Why or why not?

Response: Addressed in Part VI(C) of our comment letter.

7.24 Are the events triggering a review that are identified in section __.7(b)(2) comprehensive and appropriate? If not, why not? Should the Agencies add "repeated supervisory actions" as a forfeiture or downward adjustment review trigger and why? Should the Agencies add "final enforcement or legal action" instead of the proposed "enforcement or legal action" and why?

Response: The events triggering a review as currently defined in the Reproposed Rule are too broad and, SIFMA believes, if retained, will have a significant (and potentially detrimental) impact on the senior executive officers and significant risk-takers of Level 1 and Level 2 covered institutions in the performance of their duties. Not all risk-taking is inappropriate. SIFMA believes that narrowing these events is warranted, starting with substituting "enforcement or legal action" with "final enforcement or legal action."

7.25 Is the list of factors that a Level 1 or Level 2 covered institution must consider, at a minimum, in determining the amount of incentive-based compensation to be forfeited or downward adjusted by a covered institution appropriate? If not, why not? Are any of the factors proposed unnecessary? Should additional factors be included?

Response: Insofar as supervisory capacity is concerned (i.e., not direct participation), the Agencies should recognize and the Final Rule should reflect a realistic understanding of reporting structures, and that senior executive officers and significant risk-takers should not be penalized if there is no actual awareness of the underlying circumstances leading to an event triggering review under Section ___.7(b)(2) (absent willful ignorance). This point is important because to impose upon a senior executive officer or significant risk-taker an imperative to closely monitor each and every activity of the employees who may report to him or her will detract from the more material responsibilities of his or her job.

7.26 Are the proposed parameters for forfeiture and downward adjustment review sufficient to provide an appropriate governance framework for making forfeiture decisions while still permitting adequate discretion for covered institutions to take into account specific facts and circumstances when making determinations related to a wide variety of possible outcomes? Why or why not?

Response: SIFMA believes that in order for the proposed parameters for forfeiture and downward adjustment review to permit adequate discretion for covered institutions to take into account specific facts and circumstances when making determinations related to a wide variety of possible outcomes, they should not mandate consideration at minimum of the enumerated factors. For instance, while in retrospect it may seem obvious that there were actions that could have been taken to prevent the triggering event from happening, in some cases hindsight bias may prove to be especially influential where there were many uncertain or unknown factors that only later became clear or known as a result of the triggering event. Likewise, there may be cases where the impact of the triggering event is largely out of one's control and both unpredictable and unpredicted.

7.27 Should the rule include a presumption of some amount of forfeiture for particularly severe adverse outcomes and why? If so, what should be the amount and what would those outcomes be?

Response: SIFMA does not believe that the Final Rule should include a presumption of forfeiture for particularly severe adverse outcomes. As the Agencies have recognized, covered institutions must be able "to take into account specific facts and circumstances when making determinations related to a wide variety of possible outcomes," and such a presumption may not be appropriate in a wide variety of possible outcomes.

7.28 What protections should covered institutions employ when making forfeiture and downward adjustment determinations?

Response: SIFMA believes that specific, prescriptive protections would be inappropriate in this context, given the very fact-specific nature of any forfeiture or downward adjustment determination.

7.29 In order to determine when forfeiture and downward adjustment should occur, should Level 1 and Level 2 covered institutions be required to establish a formal process that both looks for the occurrence of trigger events and fulfills the requirements of the forfeiture and downward adjustment reviews under the proposed rule? If not, why not? Should covered institutions be required as part of the forfeiture and downward adjustment review process to establish formal review committees including representatives of control functions and a specific timetable for such reviews? Should the answer to this question depend on the size of the institution considered?

Response: SIFMA does not believe that covered institutions should be required to establish a formal process that both looks for the occurrence of trigger events and fulfills the requirements of the forfeiture and downward adjustment reviews, or formal review committees, as the compliance burden would be too high. Each review is likely to be highly fact-specific and may not lend itself to a formal review process and/or a specific timetable – each institution should be able to determine the appropriate method to handle these matters in the context of its corporate governance practices and procedures.

7.30 The Agencies invite comment on the clawback requirements of the proposed rule.

Response: Addressed in Part VI(I) of our comment letter.

7.31 Is a clawback requirement appropriate in achieving the goals of section 956? If not, why not?

Response: Addressed in Part VI(I) of our comment letter.

7.32 Is the seven-year period appropriate? Why or why not?

Response: Addressed in Part VI(I)(a) of our comment letter.

7.33 Are there state contract or employment law requirements that would conflict with this proposed requirement? Are there challenges that would be posed by overlapping Federal clawback regimes? Why or why not?

Response: Addressed in Part VI(I)(b) of our comment letter.

7.34 Do the triggers discussed above effectively achieve the goals of section 956? Should the triggers be based on those contained in section 954 of the Dodd-Frank Act?

Response: SIFMA believes that the Agencies should ensure consistency in the approach to clawbacks under Sections 956 and 954.

7.35 Should the Agencies provide additional guidance on the types of behavior that would constitute misconduct for purposes of section __.7(c)(1)?

Response: SIFMA does not recommend that the Agencies provide additional guidance, as the types of behavior that could have such a result may vary between businesses, much less institutions, and should be determined by each covered institution based upon its own facts and circumstances.

7.36 Should the rule include a presumption of some amount of clawback for particularly severe adverse outcomes? Why or why not? If so, what should be the amount and what would those outcomes be?

Response: SIFMA does not recommend that the Final Rule include a presumption of clawback for particularly severe adverse outcomes, as each situation should be judged upon its own unique circumstances.

8.1. The Agencies invite comment on whether this restriction on Level 1 and Level 2 covered institutions prohibiting the purchase of a hedging instrument or similar instrument on behalf of covered persons is appropriate to implement section 956 of the Dodd-Frank Act.

Response: SIFMA has no comment in respect of the proposed anti-hedging provision.

8.2. Are there additional requirements that should be imposed on covered institutions with respect to hedging of the exposure of covered persons under incentive-based compensation arrangements?

Response: SIFMA does not believe that additional requirements should be imposed on covered institutions with respect to hedging of the exposure of covered employees.

8.3. Should the proposed rule include a prohibition on the purchase of a hedging instrument or similar instrument on behalf of covered persons at Level 3 institutions?

Response: SIFMA has no comment in respect of the proposed anti-hedging provision.

8.4. The Agencies invite comment on whether the proposed rule should establish different limitations for senior executive officers and significant risk-takers, or whether the proposed rule should impose the same percentage limitation on senior executive officers and significant risk-takers.

Response: Addressed in Part VI(G) of our comment letter.

8.5. The Agencies also seek comment on whether setting a limit on the amount that compensation can grow from the time the target is established until an award occurs would achieve the goals of section 956.

Response: Addressed in Part VI(G) of our comment letter.

8.6. The Agencies invite comment on the appropriateness of the limitation, i.e., 125 percent and 150 percent for senior executive officers and significant risk-takers, respectively. Should the limitations be set higher or lower and, if so, why?

Response: Addressed in Part VI(G) of our comment letter.

8.7. Should the proposed rule apply this limitation on maximum incentive-based compensation opportunity to Level 3 institutions?

Response: Addressed in Part V of our comment letter.

8.8. The Agencies invite comment on whether the restricting on the use of relative performance measures for covered persons at Level 1 and Level 2 covered institutions in section __.8(d) of the proposed rule is appropriate in deterring behavior that could put the covered institution at risk of material financial loss. Should this restriction be limited to a specific group of covered persons and why? What are the relative performance measures being used in industry?

Response: Addressed in Appendix E of our comment letter.

8.9. Should the proposed rule apply this restriction on the use of relative performance measures to Level 3 institutions?

Response: Addressed in Appendix E of our comment letter.

8.10. The Agencies invite comment on whether there are circumstances under which consideration of transaction or revenue volume as a sole performance measure goal, without consideration of risk, can be appropriate in incentive-based compensation arrangements for Level 1 or Level 2 covered institutions.

Response: Addressed in Appendix E of our comment letter.

8.11. Should the proposed rule apply this restriction on the use of volume-driven incentive-based compensation arrangements to Level 3 institutions?

Response: Addressed in Appendix E of our comment letter.

9.1 Some Level 1 and Level 2 covered institutions are subject to separate risk management and controls requirements under other statutory or regulatory regimes. For example, OCC- supervised Level 1 and Level 2 covered institution are subject to the OCC's Heightened Standards. Is it clear to commenters how the risk management and controls requirements under the proposed rule would interact, if at all, with requirements under other statutory or regulatory regimes?

Response: SIFMA requests clarity from the Agencies regarding how the risk management and controls requirements of the Reproposed Rule would interact with requirements under other statutory and regulatory regimes, including those outside the U.S., particularly if a prescriptive approach is taken.

10.1. The Agencies invite comment on this provision generally and whether the written assessments required under sections __.10(b)(2) and __.10(b)(3) of the proposed rule should be provided to the compensation committee on an annual basis or at more or less frequent intervals?

Response: Addressed in Part VI(K) of our comment letter.

10.2. Are both reports required under § __.10(b)(2) and (3) necessary to aid the compensation committee in carrying out its responsibilities under the proposed rule? Would one or the other be more helpful? Why or why not?

Response: Addressed in Part VI(K) of our comment letter.

11.1. The Agencies invite general comment on the proposed policies and procedures requirements for Level 1 and Level 2 covered institutions under section __.11 of the proposed rule.

Response: SIFMA believes that such policies and procedures requirements pose an undue compliance burden on covered institutions.

12.1. Commenters are invited to address all aspects of section __.12, including any examples of other indirect actions that the Agencies should consider.

Response: Addressed in Part V(E) of our comment letter.

13.1. The Agencies invite comment on all aspects of section __.13.

Response: SIFMA is concerned about enforcement in the context of the overlapping and inconsistent regulatory oversight and guidance that is likely to result from the approach of the Reproposed Rule, as generally addressed in Part V of our comment letter.

14.1. Commenters are invited to address all aspects of section __.14 of the proposed rule.

Response: SIFMA has no comment in respect of Section __.14.

Appendix B

PRINCIPLES-BASED STANDARD UNDER SECTION 39 OF THE FDIA AND 956 OF DODD-FRANK

The legislative and regulatory history relevant to Section 956 clearly illustrate that the Section 956 guidance should primarily consist of principles that should guide compensation practices at diverse financial institutions, rather than prescriptive rules that apply underlying principles in a uniform manner across those institutions.

(a) Section 39 and the Safety and Soundness Guidelines. Section 39 of the FDIA requires the Agencies to establish certain safety and soundness standards for all insured depository institutions. In language that is mirrored by Section 956(b), Section 39(c) of the FDIA provides that the appropriate regulators shall for specified institutions prescribe "standards prohibiting as an unsafe and unsound practice any . . . compensation or benefit agreement . . . that -- (A) would provide any executive officer, employee, director, or principal shareholder of the institution with excessive compensation, fees or benefits; or (B) could lead to material financial loss to the institution."

Pursuant to the mandate of Section 39, guidance adopted in 1995 and remaining currently in effect imposes safety and soundness standards in respect of financial institution compensation. The Safety and Soundness Guidelines do not require <u>any</u> compensation plans for <u>any</u> employees of <u>any</u> financial institutions to have <u>any</u> specific plan design features. As discussed below, neither does Section 956(b).

The approach of the Safety and Soundness Guidelines in respect of the regulation of compensation plans that could lead to material financial loss to an institution was quite intentional, and clearly does not reflect any omission or oversight. Paragraph iii of the Introduction to the Safety and Soundness Guidelines expressly refers to the requirements of Section 39(c), including clause (B) thereof. Paragraph vi of the Introduction to the Safety and Soundness Guidelines specifically explains that "the agencies believe that the standards adopted in these Guidelines" are in response to the requirement of Section 39(c) and "serve this end without dictating how institutions must be managed and operated."

Part III of the Safety and Soundness Guidelines addresses the two concerns referred to in Section 39 relevant to compensation: compensation that is excessive and compensation that could lead to material financial loss. As to the second concern, Section B of Part III of the Safety and Soundness Guidelines provides that "compensation that could lead to material financial loss to an institution is prohibited as an unsafe and unsound practice." Section 956 requires the Agencies to prescribe regulations or guidelines that implement standards "comparable" to that standard.

(b) 2009 Proposed Guidance on Sound Incentive Compensation Policies. In October 2009, the Board issued the Proposed Interagency Guidance on sound incentive compensation policies.[72] The Proposed Interagency Guidance was based on three principles:

Incentive compensation arrangements at a banking organization should:

- Provide employees incentives that do not encourage excessive risk-taking beyond the organization's ability to effectively identify and manage risk;
- Be compatible with effective controls and risk management; and

[72] 74 Fed. Reg. 55,227 (Oct. 27, 2009). The proposed guidance issued by the Board was, in 2010, issued in final form by all of the Agencies. 75 Fed. Reg. 36,395 (June 25, 2010).

- Be supported by strong corporate governance, including active and effective oversight by the organization's board of directors.

The Proposed Interagency Guidance discusses in detail "these principles, and the types of policies, procedures and systems that banking organizations should have to help insure compliance with these principles," in the context of both large and small banking organizations.[73] The Proposed Interagency Guidance further stated that "the principles and the guidance are consistent with" guidance and implementation standards issued by the Financial Stability Board[74] earlier in 2009.

Consistent with the Safety and Soundness Guidelines, the Proposed Interagency Guidance did not propose to require that any compensation plans for any employees of any financial institutions have any specific plan design features.[75] It did seek comments on whether such requirements should be included in the final form of those rules, including specifically requesting comments on whether "formulaic limits" should be adopted for some or all banking organizations. As an example, the Proposed Interagency Guidance asked whether the rules should require that at least 60% of all incentive compensation received by senior executives of all large complex banking organizations be deferred and paid in the form of stock.

(c) 2010 Final Interagency Guidance on Sound Incentive Compensation Policies. In June 2010, the Federal Banking Agencies adopted a revised version of the Proposed Interagency Guidance in final form. The preamble to the Final Interagency Guidance discusses at length the risks that can be posed by improper compensation plan design. The preamble also notes that the Proposed Interagency Guidance specifically requested comment on whether "formulaic limits on incentive compensation would likely promote the safety and soundness of banking organizations, whether applied generally or to specific types of employees or banking organizations." As discussed in Section I(3) above, the Final Interagency Guidance reflects the conclusion that a principles-based approach to the regulation of financial industry compensation is more effective than a prescriptive one.

(d) The 2011 Proposed Rule Under Section 956. In March 2011, the Agencies issued the Original Proposal under Section 956.[76] The Original Proposal adopted an approach that was essentially principles-based, and therefore largely consistent with the standard established under Section 39 of the FDIA, except that it included two specific requirements related to the design of incentive-based compensation programs. Those requirements applied to compensation paid to senior executives only (not significant risk-takers) and only to institutions with more than $50 billion of capital.

The preamble to the Original Proposal noted that "Section 956 requires the Agencies to ensure that any compensation standards established under Section 956 are comparable to those established under Section 39 of the FDIA." As to the issue of excessive compensation, the Reproposed Rule adopted standards that were essentially identical to the principles-based rules included in the Safety and Soundness Guidelines.

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[73] The Proposed Interagency Guidance included specific discussion of the application of the principles addressed therein to senior executives and other employees who, either individually or as part of a group, may expose the relevant banking organization to material amounts of risk. It included specific discussions concerning the application of the principles to "large complex banking organizations" and other banking organizations.

[74] The Financial Stability Board was established in April 2009 by the Heads of State and Government of the Group of Twenty with an objective and mandate to promote the reform of international financial regulation.

[75] See also, regulations dated June 4, 2002, by the Federal Housing Finance Agency concerning compensation of board members, executive officers, and employees of the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation, at 12 C.F.R. 1710.13.

[76] 76 Fed. Reg. 21170 (Apr. 14, 2011).

However, with respect to compensation that could give rise to material financial loss, the preamble of the Reproposed Rule states that "Section 39 of the FDIA does not include standards" related to determinations of inappropriate risks. [77]

As shown above, we respectfully submit that the Safety and Soundness Guidelines do provide a standard under Section 39 for determining whether compensation arrangements may encourage inappropriate risks. That standard envisions a flexible approach coupled with close supervisory oversight that takes into account the particular circumstances of each financial institution, employee and compensation arrangement.

(e) The Reproposed Rule under Section 956. The preamble to the Reproposed Rule also notes the mandate of Section 956(c) and states that "as explained in greater detail below, the standards established by the proposed rule are comparable to the standards established under section 39 of the FDIA." That sentence seems to constitute a recognition that there are, in fact, standards established under Section 39. Nevertheless, a few pages later the preamble to the Reproposed Rule reverts to the view that "section 39 of the FDIA does not include standards," notwithstanding that it acknowledges the Congressional presumption inherent in Section 956(c)(1) that it does.

Based on the conclusion that no standard was established under Section 39, the preamble to the Reproposed Rule states that the Agencies filled in the presumed statutory gap by considering various unidentified sources.[78] The preamble in addition notes that a comment was received in response to the Original Proposal concerning the comparability of the proposed standards to those established under Section 39. The commenter argued that the standards were not comparable, because the Original Proposal included more "detailed and prescriptive" rules than are in the Safety and Soundness Principles established under Section 39.

The Agencies replied with a statement that they "intend that the requirements of the proposed rule implementing Section 956(b)(2) of the Act would be comparable to the standards established under Section 39 of the FDIA." (emphasis added). That formulation is unclear, because the Reproposed Rule is precisely the implementing rule that is supposed to be comparable. In any case, notwithstanding any such intent, the preamble makes no attempt to show that the Reproposed Rule establishes, or would establish, standards that are in fact comparable to those established under Section 39, as discussed above. Such a showing could not be made because of the stark difference between the approach of the Reproposed Rule compared to the Safety and Soundness Guidelines and warrants consideration by the Agencies of a significant shift in their approach to a principles-based model.

[77] Based on the conclusion that no standard was established under Section 39, the preamble to the Reproposed Rule indicates that the Agencies considered the language and purpose of Section 956, existing supervisory guidance that addresses incentive-based compensation arrangements that may encourage excessive risk-taking, the Principles for Sound Compensation Practices and the related Implementation Standards adopted by the Financial Stability Board, and other relevant material in considering how to implement this aspect of Section 956.

[78] "Accordingly, as in the 2011 Proposed Rule, the Agencies have considered the language and purpose of Section 956, existing supervisory guidance that addresses incentive-based compensation arrangements that may encourage inappropriate risk-taking, the FSB Principles and Implementation Standards, and other relevant material in considering how to implement this aspect of Section 956."

Appendix C

FINAL INTERAGENCY GUIDANCE: EXAMPLES OF INEFFECTIVE OR IMPRUDENT PRESCRIPTIVE RULES

The Final Interagency Guidance provided numerous specific examples of prescriptive rules that would not be effective or prudent to apply uniformly to diverse financial institutions, and the reasons therefore, as follows:

- "Where reliable risk measures exist, risk adjustment of awards may be more effective than deferral of payment in reducing incentives for imprudent risk-taking. This is because risk adjustment potentially can take account of the full range and time horizon of risks, rather than just those risk outcomes that occur or become more evident during the deferral period." That is, mandating both risk adjustment of awards and deferral of payment, as the Reproposed Rule would do, will likely provide no additional benefit in regard to risk mitigation in these circumstances and rather, as posited in Part I above, may lead to increased risks at financial institutions, such as difficulty in recruiting and retaining key employees and increased fixed costs.[79]

- "Deferral of payment may be more effective than risk adjustment in mitigating incentives to take hard-to-measure risks (such as the risks of new activities or products, or certain risks such as reputational or operational risk that may be difficult to measure with respect to particular activities), especially if such risks are likely to be realized during the deferral period." As in the circumstance above, mandating both risk adjustment of awards and deferral of payment, as the Reproposed Rule would do, will likely provide no additional benefit in regard to risk mitigation in these circumstances and may instead increase risks at financial institutions.

- "Activities, risks, and incentive compensation practices may differ materially among banking organizations based on, among other things, the scope or complexity of activities conducted and the business strategies pursued by the organizations. These differences mean that methods for achieving balanced compensation arrangements at one organization may not be effective in restraining incentives to engage in imprudent risk-taking at another organization." Nevertheless, because the Reproposed Rule includes prescriptive requirements applicable to every covered institution, the Reproposed Rule would require many financial institutions to implement ineffective methods to manage their specific risks.

- "The payment of deferred incentive compensation in equity (such as restricted stock of the organization) or equity-based instruments (such as options to acquire the organization's stock) may be helpful in restraining the risk-taking incentives of senior executives and other covered employees whose activities may have a material effect on the overall financial performance of the organization. However, equity-related deferred compensation may not be as effective in restraining the incentives of lower-level covered employees (particularly at large organizations) to take risks because such employees are unlikely to believe that their actions will materially affect the organization's stock price." However, under the prescriptive approach of the Reproposed Rule, equity would be required to be used for <u>all</u> employees subject to mandatory deferrals, even for employees for whom it is unlikely to be effective.

[79] As noted in the Final Interagency Guidance, "in some cases two or more methods may be needed in combination for an incentive compensation arrangement to be balanced." However, by clear implication two or more methods will not be required in many cases. A principles-based approach coupled with close supervisory oversight will permit the design to fit the situation. The prescriptive approach of the Reproposed Rule will not, but will instead impose unnecessary costs.

Appendix D

FINANCIAL INSTITUTION INCENTIVE COMPENSATION CHANGES SINCE THE FINANCIAL CRISIS

The most recent FSB Progress Report on the implementation of the FSB Principles for Sound Compensation Practices and their Implementation Standards[80] noted the following changes in effective implementation made by banks during the period of 2011-2014, as cited collectively by national regulators:

Improvements in Governance, including:

- Boards are more actively involved in the design of compensation policies and in reviewing their implementation.
- Boards have created a dedicated committee to govern compensation arrangements.
- Greater board involvement in conduct and ethics issues.
- Greater involvement of the CRO/ risk management/other control functions in the approval process of performance/risk measurement indicators and in the performance assessment process.
- Compensation systems are subject to robust controls and periodic reviews to ensure integrity, alignment with regulations and consistency of outcomes with intentions.
- Revised reporting structure and performance goals of control function staff to increase independence.
- Alignment of compensation policies at different group levels and better monitoring at group level.
- Periodic internal audits and compensation systems' performance assessments based on relevant risk indicators; formal monitoring and validation programs for compensation programs and outcomes.
- Introduction of 360-degree review process involving independent control functions, peers and direct reports.

Improvements in risk alignment, including:

- Greater use of deferred pay and increase in deferral periods and non-cash components.
- Introduction of malus and clawback clauses and increased use of malus.
- Increased use of risk-based performance metrics; risk taken into account in the calculation of the bonus pool; improved consistency with indicators used for risk management and Risk Appetite Framework purposes.

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[80] FSB, "Implementing the FSB Principles for Sound Compensation Practices and their Implementation Standards - Fourth Progress Report" at 37-38 (Nov. 10, 2015), available at http://www.fsb.org/wp-content/uploads/FSB-Fourth-progress-report-on-compensation-practices.pdf.

- Improvements in a mix of quantitative and qualitative methods in making ex-ante risk adjustments; increased use of qualitative risk measures, e.g. related to Internal Audit, compliance etc. Greater focus on compliance risk.

- Improvements in KPIs and performance management systems to reduce number of KPIs, simplify performance management and make the link between compensation and performance more transparent.

- Gate conditions and malus clauses progressively refined, increasing their "potential impact" on variable compensations.

- Well established and progressively sounder processes for identification of MRTs; more clarity on the classification of MRTs.

- Constant evaluation of metrics and methodology. Risk objectives and regular "risk reviews" are now commonplace.

Improvements in stakeholder engagement, including:

- Increased and improved public disclosure of compensation policies, including on compensation governance and risk alignment; banks' public disclosures have strengthened in line with the Basel Committee's Pillar 3 guidance.

- Growing clarity and completeness of the information disclosed to the public on compensation payout amounts, deferrals and ratio between variable and fixed components of the remuneration for identified staff, including data regarding directors, managers and other key management personnel categories.

- The remuneration policies are approved by the shareholders' meeting, and are brought to the attention of the market. Overall, an increasing role of proxy advisors and shareholders involvement is observed.

- Shareholders are able to play an increasingly important role within firms. In the EU, the role of shareholders has been made more important with the need for approval of 2:1 variable fixed compensation arrangements.

Appendix E

REQUIREMENTS OF THE REPROPOSED RULE APPLICABLE TO ALL EMPLOYEES OF COVERED INSTITUTIONS

The following discusses and provides examples of requirements in the Reproposed Rule that are likely to give rise to unnecessary costs and burdens unless the definition of "covered persons" in the Reproposed Rule is appropriately narrowed.

(a) Board of Directors Approval. Section __.4(e)(1) of the Reproposed Rule would require the boards of directors of each covered institution to conduct oversight of the covered institution's incentive-based compensation arrangements for employees who do not have the ability to expose the financial institution to material amounts of risk. This requirement would divert the time and attention of boards of directors from other oversight and strategic considerations that would actually contribute to the safety and soundness of covered institutions.

(b) Pro Rata Vesting of Deferred Compensation. Section __.7(a)(1)(iii)(A) of the Reproposed Rule appears to require vesting on a basis that is no faster than pro rata for all employees of Level 1 and Level 2 institutions, including those who do not have the ability to expose the financial institution to material amounts of risk, for any of their compensation that is deferred (including voluntarily) under an annual incentive-based compensation arrangement.[81] The same issue arises under __.7(a)(2)(iii)(A) in respect of long-term incentive plans. The Reproposed Rule would impose such requirements notwithstanding that (by assumption) faster vesting could not incentivize participants to expose the financial institution to material amounts of risk.

(c) Relative Performance Measures. Section __.8(c) of the Reproposed Rule would prohibit a Level 1 or Level 2 covered institution from using incentive-based compensation performance measures that are based solely on industry peer performance comparisons. Accordingly, a Level 1 or Level 2 covered institution could not promise a $1,000 bonus to each of its bank tellers in a particular geographic region in which the covered institution scores highest among its peers on a customer satisfaction survey. It is difficult to understand how this requirement is necessary to mitigate material risk at covered financial institutions.

(d) Volume Driven Incentive-Based Compensation. Section __.8(d) of the Reproposed Rule would prohibit a Level 1 or Level 2 covered institution from providing incentive-based compensation to any employee, including any employee who does not have the ability to expose the financial institution to material amounts of risk, without regard to transaction quality or compliance with sound risk management policies. Accordingly, a Level 1 or Level 2 covered institution could not maintain a routine commission program for employees whose functions do not subject the institution to material amounts of risk, such as securities brokers.

(e) Independent Monitoring. __.9(c) of the Reproposed Rule would require independent monitoring by Level 1 and Level 2 institutions of all incentive-based compensation arrangements, including those covering only employees who do not have the ability to expose the financial institution to material amounts of risk. The Reproposed Rule would require that a methodology be developed for assessing whether each such arrangement appropriately balances risk and reward, notwithstanding that (by assumption) the arrangement could not incentivize participants to expose the financial institution to material amounts of risk.

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[81] Compare the formulation in __.7(a)(iii)(A) with that in __.7(a)(1)(iii)(B) ("that is required to be deferred under this part").