MEMORANDUM

TO: File No. S7-07-16

FROM: Claire O'Sullivan
Special Counsel
Division of Trading and Markets
U.S. Securities and Exchange Commission

DATE: October 10, 2019

RE: Meeting with Bank Policy Institute, Sullivan & Cromwell LLP, Bank of America Corporation, the Goldman Sachs Group, Inc., JPMorgan Chase & Co., State Street Corporation, SunTrust Bank, U.S. Bank, and Citigroup Inc.

On October 10, 2019, staff from the Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (FRB), the Federal Deposit Insurance Corporation (FDIC), the Federal Housing Finance Agency (FHFA), the Securities and Exchange Commission (SEC), and the National Credit Union Administration (NCUA) met with representatives from the Bank Policy Institute, Sullivan & Cromwell LLP, Bank of America Corporation, the Goldman Sachs Group, Inc., JPMorgan Chase & Co., State Street Corporation, SunTrust Bank, U.S. Bank, and Citigroup Inc. The industry representatives shared their views on the proposed Incentive-Based Compensation Arrangements rule, and provided the attached materials.

Participants

OCC	Ted Dowd Melissa Lisenbee Marta Stewart-Bates Sarah Turney Alexandra Arney
FRB	Gillian Burgess Joe Maldonado Ryan Rossner
FDIC	Rae-Ann Miller Catherine Topping
FHFA	Richard Oettinger

SEC	Natasha (Vij) Greiner Jennifer Porter Jessica Shin Anand Das Claire O'Sullivan
NCUA	Gira Bose
Bank Policy Institute	Dafina Stewart
Sullivan & Cromwell LLP	Marc Trevino
Bank of America Corp.	Neil Barron
Goldman Sachs Group, Inc.	Alan Wilmit
JPMorgan Chase & Co.	Gina Palmisano
State Street Corporation	Betsy Oliphant
SunTrust Bank	Keith Thornton
U.S. Bank	Todd Shipman
Citigroup Inc.	William Lee

Incentive Compensation

October 10, 2019

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Introduction

- BPI and its member institutions strongly believe that incentive compensation arrangements are critical tools in the safe and sound management of financial institutions, allowing firms to attract talent, drive performance, deter imprudent risk-taking and maintain alignment of compensation expense and financial condition, each in a manner that is tailored to the size, complexity, business strategy, and risk tolerance of the firm.
  - It is best for the Agencies to have the tools that allow them flexibility to understand and address safety, soundness and risks at the institutions they oversee.
- Since the financial crisis, banking organizations have made substantial enhancements to incentive compensation arrangements to make them more risk-sensitive and improve governance processes. These enhancements have been reviewed by the Agencies.
- BPI supports the efforts of the Agencies to revisit the regulatory framework implementing section 956 of the Dodd-Frank Act.
- Statements from the heads of the OCC and SEC that they will propose a principles-based rule consistent with the 2010 Interagency Guidance on Sound Incentive Compensation Policies ("2010 Guidance"), are encouraging.
- BPI has long recommended that the Agencies not implement section 956 using a regulatory framework that imposes prescriptive or "one size fits all" requirements for the compensation structures of covered institutions.

Statutory Mandate

- Section 956 authorizes the Agencies to prohibit incentive-based payment arrangements that the Agencies determine either -
  - Encourage inappropriate risks by certain financial institutions by providing excessive compensation, or
  - Encourage inappropriate risks by certain financial institutions that could lead to material financial loss.
- Regulations and guidance are required to be comparable to the standards established under section 39 of the FDIA.
- The statutory language empowers the Agencies to prohibit arrangements or features that meet the statutory standard. Adoption of specific compensation structures would go well beyond the Congressional mandate.
- Interagency rules promulgated under section 956 should not be used to provide industry-wide standards that prescribe a general incentive compensation framework.

Drawbacks of Prescriptive Standards

- Other jurisdictions have implemented prescriptive standards, which have resulted in unintended consequences.
  - It is difficult to have a single set of standards that works for all markets and evolving products as the unintended consequences can prove quite negative.
- One size fits all standards are not effective. Creation of prescriptive standards that fits all companies and all situations is difficult, even within a single company.
- The 2010 Guidance specifically notes that the use of a single, formulaic approach to incentive compensation is likely to result in arrangements that are unbalanced at least with respect to some employees.
- Imposition of prescriptive standards would make it difficult for the Agencies to have the flexibility to emphasize important qualitative factors and to continue the back testing and refinements that were put in place after the crisis.
- Prescriptive standards make it difficult for banking organizations to attract and retain qualified individuals, which would harm – rather than help – safety and soundness.
  - As an example, financial services companies compete with unregulated technology firms for a variety of talent.

Drawbacks of Prescriptive Standards (cont'd)

- Prescriptive standards promulgated through the interagency rulemaking process would lag behind developments in the market and would make the standards much less adaptable to market conditions over time.
  - Standards may become outdated or produce unintended negative consequences, and would be difficult to amend.
- Implementation of changing supervisory expectations may also be constrained.
- The Agencies should instead implement principles-based incentive compensation standards and rely on the supervisory process to provide more detailed and specific standards to foster continued development of risk-based compensation practices.

Benefits of a Principles-based Approach

- Banking agencies noted in the 2010 Guidance that a principles-based approach is the most effective way to address compensation practices given differences in size and complexity of banking organizations and complexity, diversity, and range of use of incentive compensation arrangements.
- Principles-based standards ensure that the Agencies and firms are able to develop incentive compensation arrangements that account for risk and are tailored to the size, complexity, business strategy, and risk tolerance of each firm.
  - Permits firms to understand its workforce, risks, and stakeholders with respect to compensation practices and identify compensation practices that best enable firms to attract talent, drive performance and maintain alignment of compensation expense and financial condition.
  - Allows an institution to respond to changes in its businesses and activities, risk profile, law, and employee behavior to successfully identify and deter imprudent risk-taking on a real-time basis.
  - Allows market forces to work in tandem with principles-based rules to drive compensation best practices.

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Incentive Compensation Progress

- Since the financial crisis, banking organizations have implemented effective, risk-sensitive compensation by working with the Federal banking agencies and relying on the 2010 Guidance.
  - The United States was generally found to be compliant with all FSB compensation principles in the FSB's Sixth Progress Report on the Implementation of the FSB's Principles for Sound Compensation Practices. (Financial Stability Board, Implementing the FSB Principles for Sound Compensation Practices and their Implementation Standards, Sixth Progress Report, June 17, 2019).
- Consistent with the 2010 Guidance, in coordination with the regulators, the compensation arrangements banking organizations have adapted provide balanced incentives, reflect the diversity of financial organizations and maintain competitive balance with unregulated competitors.

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Incentive Compensation Progress (cont'd)

- Banking organizations have redesigned their incentive compensation programs in an effort to discourage inappropriate risk-taking by a combination of one or more of the following, as appropriate for the specific institution:
  - increasing the relative importance of assessing risk-balanced performance over the medium- and long-term in determining annual compensation;
  - limiting the amount of leverage used for performance-based awards and/or limiting the maximum amount that executives can earn for such awards;
  - establishing minimum percentages of incentive compensation awards that are subject to deferral;
  - making meaningful corporate governance changes related to the board of director's involvement in compensation practices and the risk-review of compensation;
  - implementing risk-adjustment policies with respect to incentive awards, including post-determination adjustment policies;
  - controlling the use of stock options and other incentive programs that use stock price as a key performance measure;
  - centralizing management oversight of sales incentive plans with effective, multi-tiered governance processes;
  - improving control group oversight of incentive compensation programs through cross-functional review of relevant risk-related events prior to award determination;
  - introducing "after-the-fact" monitoring to better inform the design of future incentive compensation arrangements; and
  - applying these policies in practice to reduce, clawback or cause the forfeiture of awards.

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Specific Recommendations

- Rules or standards should not differ based on asset size of the firm.
- The proposed rule should permit tailoring of applicability to certain senior executives.
  - Only those individuals that are material risk takers should be subject.
- The proposed rule should allow firms, in consultation with the Agencies, to develop appropriate governance models based on their compensation program and business model including engaging the Board or Compensation Committee as appropriate.
- Incentive compensation should be defined in the proposed rule as compensation tied to performance of the institution and/or employees over a defined period. The definition should exclude those arrangements that are not incentive-based.
- Scope of applicability
  - The proposed rule should apply on a consolidated basis
    - Application on an entity-by-entity basis would result in an unnecessary and duplicative standard under which numerous covered subsidiaries within one affiliated group would find themselves individually subject to provisions of the rule.
    - Firms have implemented/administered effective, risk-based compensation programs on a consolidated basis.
  - The proposed rule should permit covered institutions that are also subject to the requirements of supervisors of a non-US jurisdiction to coordinate requirements to avoid implementation of multiple compensation standards across a consolidated organization
    - A firm should be deemed to be in compliance with U.S. requirements if the incentive compensation regime in non-US jurisdiction satisfies the FSB Principles for Sound Compensation Practices. (Financial Stability Board, Principles for Sound Compensation Practices, April 2009, available at https://www.fsb.org/wp-content/uploads/r_090925c.pdf).

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Specific Recommendations (cont'd)

- Enforcement authority
  - The proposed rule should specify which agencies have authority to enforce the rules under section 956, particularly with respect to consolidated organizations.
- Firms should be permitted to continue to rely on supervisory guidance provided in relation to implementation of the standards outlined in the 2010 Guidance.
- Ensure proposed rule does not require violation of existing applicable regulations, such as
  - SEC's Regulation BI,
  - State laws on pay equity and diversity, and
  - EU regulations on pay disclosures.
- Disclosure and Reporting
  - Disclosure is available to stakeholders through the SEC's CD&A.
    - Additional disclosures would not necessarily contribute to safety and soundness or further assist stakeholders in identifying or monitoring inappropriate risk-taking.
  - Reporting requirements should consider time-sensitivity of incentive plans and avoid adversely impacting the privacy rights of employees.
  - The proposed rule's reporting requirements should permit sharing of agency reporting when an entity is under the jurisdiction of two or more regulators.

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