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Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F. Street, NE
Washington, DC 20549-1090

Re: Proposed Rules on Incentive-Based Compensation Arrangements Release No. 34–64140; File No. S7-12-11

Dear Ms. Murphy:

The U.S. Chamber of Commerce is the world's largest business federation, representing more than 3 million businesses and organizations of every size, sector, and region. The Chamber created the Center for Capital Markets Competitiveness ("CCMC") to promote a modern and effective regulatory structure for capital markets to fully function in a 21st century economy. To achieve this objective it is an important priority of the CCMC to advance an effective and transparent incentive-based compensation structure. The CCMC welcomes this opportunity to comment on the Proposed Rules on Incentive-Based Compensation Arrangements ("proposed rules") proposed by the U.S. Securities and Exchange Commission ("SEC").

The CCMC believes that strong corporate governance is a cornerstone of fundamental business practices and capital formation needed for economic growth and job creation. In evaluating rules and legislative proposals regarding corporate governance and executive compensation, the CCMC uses the following principles:

- **Corporate governance policies must promote long-term shareholder value and profitability but should not constrain reasonable risk-taking and innovation.**

- **Long-term strategic planning should be the foundation of managerial decision-making.**

- **Corporate executives' compensation should be premised on a balance of individual accomplishment, corporate performance, adherence to risk management and compliance with laws and regulations, with a focus on shareholder value.**

- **Management needs to be robust and transparent in communicating with shareholders.**

The proposed rules are issued pursuant to Section 956 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act"). Using the forgoing principles to evaluate the proposed rules, the CCMC has several serious concerns including:

- One-Size-Fits-All Approach;
- Retention and Acquisition of Talent;
- SEC Economic Analysis;
- "Excessive Compensation" and "Inappropriate Risk";
- Calculation of "Total Consolidated Assets";
- "Covered Financial Institution";
- Defining "Incentive-Based Compensation";
- Reporting Requirements;
- Timing of Annual Reports;
- The Role of the Director and Shareholder; and
- the Effects on Efficiency, Competition and Capital Formation.

Accordingly, in compliance with Section 956, the CCMC recommends that the SEC issue guidance, rather than rules, following a period of evaluation and correction to address these defects in the proposed rules.

A detailed discussion of our concerns is provided below.

A. Background

Section 956 of the Act requires the SEC, as well as the OCC, Board of Governors of the Federal Reserve System ("Board"), FDIC, OTS, NCUA, and FHFA (together "the Agencies") to jointly prescribe regulations or guidelines with respect to incentive-based compensation practices at covered financial institutions. Specifically, Section 956 requires that the Agencies prohibit incentive-based payment arrangements, or any feature of any such arrangement, at a covered financial institution that the Agencies determine encourages inappropriate risks by a financial institution by providing excessive compensation or that could lead to material financial loss. Under the Act, a covered financial institution also must disclose to its appropriate Federal regulator the structure of its incentive-based compensation arrangements sufficient to determine whether the structure provides "excessive compensation, fees, or benefits" or "could lead to material financial loss" to the institution.

B. Discussion of Concerns Regarding the Proposed Rules

I. One-Size-Fits All Approach

This joint agency rulemaking—based on the *Guidance on Sound Incentive Compensation Policies* ("Banking Guidance") adopted by the OCC, Board, FDIC, and OTS, which itself is relatively new and its impact on competition largely unknown—attempts to impose a one-size-fits-all approach to financial regulation.[1] Given that various forms of financial market participants each operate in a unique fashion, it is inappropriate to regulate them as if they were all the same. For instance, such basic risk factors as liquidity and diversification are wholly different for managers of mutual funds, private equity funds, hedge funds, investment banks and broker-dealers, yet each of these broad categories of institutions would be subject to the same proposed rules. It is unrealistic to expect one set of rules to be equally applicable to all types of financial institutions that would be swept under these proposed rules. Guidelines could, perhaps, be generally applicable, but the Agencies have proposed rules, which require a more tailored approach that reflects these distinctions.

[1] It would seem on its face that the Banking Guidance provides a basis of regulatory compliance with Section 956. That being said, it would seem prudent to first evaluate and test the impacts of the Banking Guidance before moving forward with an expansion of compensation policies by the financial regulators.

Because the issues involved are complex, far-reaching, and introduce a number of unknowns into the compensation decision making process, we believe it would be appropriate to convene a series of working groups comprised of investors and institutions representing each of the industries affected by these proposed rules to gain a fuller understanding of the true impact that these rules would have on the ability of covered institutions in each covered industry to raise capital and compete globally. We further recommend that such working groups address each of the issues discussed below.

Informed by the recommendations of these working groups, the SEC should carefully consider revisiting the mandates of Section 956 as guidelines rather than rules. The SEC may very well determine that guidelines are preferable if the working groups recommend significantly different approaches for the different industries involved. It also may need to consider whether a second comment period is necessary to explore any issues raised by the working groups that have not been sufficiently considered during the current comment process.

II. Retention and Acquisition of Talent

Human capital is the operating infrastructure of a financial institution. The quality of the workforce and ability to attract talent are long-term indicators of the financial institutions ability to be successful and secure profitability. Appropriate compensation practices that allow employees to engage in reasonable risk taking and long-term decision making are of great importance. Narrow compensation policies and practices will drive away talent and degrade the foundation and long-term profitability viability of a firm.

Actions have consequences and the competition for talent is fierce. Employees can be lured away by direct competitors, global firms, or different industries. Such an exodus of skill, intelligence and experience can quickly denude a financial institution of its talent base and impact its prospects.

Accordingly, while the proposed rules suggest an appropriate balance between risk taking and compensation, there has not been enough of a discussion or development of guidance to address the competition of talent or the impacts of a

brain drain from a financial institution. An exit of talent can be as devastating as excessive risk, yet the proposed rules largely remain silent on the issue.

III. SEC Economic Analysis

At the outset, we note that the SEC's economic analysis focuses primarily and inadequately on the proposed rules' potential costs in terms of administrative burdens on covered financial institutions. The proposed rules' true costs to covered institutions cannot be estimated without due consideration of the competitive burden that the rules will impose on covered institutions, relative to their domestic and foreign competitors that will not be covered by the rules.

Accordingly, the SEC should provide much more robust estimates of the costs and benefits associated with implementation of these rules. Specifically, the SEC should conduct a thorough review of the proposed costs and benefits of the proposed rules, specifically addressing each the following issues in detail:

A. The quantitative methodologies the agency uses to evaluate the costs and benefits of proposed rules and the effects those rules could have on job creation and economic growth. In the "SEC Economic Analysis" section of the release, the SEC notes that its internal cost estimates for proposed § 248.205 ("Report of Incentive-Based Compensation Arrangements") are based on burden estimates provided in the Paperwork Reduction Act ("PRA") section of the release. The PRA section, in turn, refers to the SEC's previous estimates in connection with the adoption of Item 402 of Regulation S-K to conclude that the internal cost burden for covered broker-dealers and investment advisers would be 100 hours (rounded up from 95). We are concerned that no attempt has been made to apply a coherent quantitative methodology to evaluate the likely costs of these proposed rules and the effect these rules could have on job creation and economic growth. Rather, they focus narrowly on certain costs, while giving only cursory attention to the broader and likely much more substantial negative effect that these rules are likely to have on covered institutions' ability to compete in a competitive marketplace for business and for talent. Furthermore, we do not believe that reference in the PRA section to cost estimates used in previous rulemakings as described above—particularly without an attempt to verify the accuracy of those previous estimates—is a viable substitute for rigorous quantitative analysis of the costs and benefits of these proposed rules.

B. The qualitative methods the agency uses to categorize or rank the effects of proposed rules. The SEC's economic analysis does not appear to attempt to categorize or rank the intended effects of the proposed rules on job creation and economic growth. Rather, where potential benefits are discussed, such discussion fails to tie effects to principles intended to be promoted by these rules.

C. The extent to which the agency considers alternative approaches to its proposed rules. It is noted in the release that the Agencies chose to propose rules rather than guidelines and that the decision, in the SEC's estimation, will benefit broker-dealers and investment advisers because "greater predictability would facilitate broker-dealers' and investment advisers' ability to design compliance policies and procedures." However, as discussed in detail throughout this letter, the CCMC believes these rules, as proposed, are likely to inject uncertainty into covered broker-dealer and investment advisers' risk and compensation determinations.

D. The extent to which the agency examines the costs, benefits, and economic impact of reasonable alternatives to its proposed rules. We note that these proposed rules are based on the *Guidance on Sound Incentive Compensation Policies* ("*Banking Agency Guidance*") adopted by the OCC, Board, FDIC, and OTS, which only became effective on June 25, 2010, less than one year prior to the proposal of these rules. We do not believe that the SEC has adequately explained its reasons for moving forward with rules rather than guidelines or other less burdensome alternatives to the proposed rules. This is particularly troubling in absence of any analysis of the costs and benefits actually incurred or realized by institutions that have been subject to the *Banking Agency Guidance*. This analysis should include a discussion of the similarities and differences between banks subject to the *Banking Agency Guidance* and broker-dealers and investment advisers subject to these rules, and how such similarities and differences impact the costs of these rules. .

E. The extent to which the agency seeks public input and expertise in evaluating the costs, benefits, and economic impact of its proposed rules, and the extent to which the agency incorporates the public input into its rule proposals. As discussed above, we believe the SEC should convene a series of working groups comprised of investors and institutions representing each of the industries affected by these proposed rules to gain a fuller understanding of the true impact that these rules would have on the ability of covered institutions in each covered industry to raise capital and compete globally. We believe

the findings of these working groups will further evidence the view that these rules should be revisited as general guidelines that provide enough flexibility to permit the broad array of covered institutions to comply with the principles of these proposed rules without unnecessarily burdening their ability to compete in a competitive marketplace. Additionally, in the entire discussion of proposed benefits of these proposed rules, there is only one instance in which the SEC attempts to substantiate its discussion of proposed benefits with empirical evidence or citation to outside sources. This lack of citations to outside sources suggests both that the SEC's review of the costs and benefits of these proposed rules were cursory at best and that external views were inadequately considered.

F. *The extent to which the economic analysis performed by the agency with respect to its proposed rulemakings is transparent and the results are reproducible.* As noted in paragraph A, above, we do not believe the SEC has performed an economic analysis that would lend itself to a discussion of transparency and reproducibility.

Upon a more thorough analysis of the costs and benefits of these rules, we believe the SEC may appropriately determine that the mandates of Section 956 should be revisited as guidelines rather than rules, as is explicitly authorized by the Act. This conclusion is supported both by the fact that the true costs of implementation of these rules have not been accounted for and because the proposed rules' one-size-fits-all approach to regulation of covered broker-dealers and investment advisers fails to account for the significant differences among institutions that fit within those broad categories, as discussed in greater detail above.

IV. "Excessive Compensation" and "Inappropriate Risk"

A. "Excessive Compensation"

Competition for Talent. Covered financial institutions face intense competition for talent. Employees can be lured away by direct competitors, global firms, or different industries. Accordingly, a flight of talent from covered financial institutions to other industries or institutions that are not subject to these rules may create a brain drain that can be destructive to the covered institutions. Such an exodus of skill, intelligence, and experience can quickly erode an institution's talent base and impede its ability to compete.

This competitive environment must be factored into any analysis of covered financial institutions' incentive compensation arrangements. A covered financial institution may appropriately put in place incentive compensation arrangements that differ from those of comparable covered financial institutions because it believes that such differing arrangements are necessary to attract and retain the best talent in a competitive environment. Accordingly, we request that the SEC also consider competition for talent as a factor that appropriately affects whether a compensation arrangement is "excessive," particularly in light of the fact that covered institutions must compete with one another as well as with firms that are not "covered financial institutions" subject to these proposed rules.

Comparable Compensation Practices at Comparable Institutions. In determining whether an incentive-based arrangement provides "excessive compensation," the proposed rules provide a number of enumerated factors for the SEC to consider, including "comparable compensation practices at comparable covered financial institutions, based upon such factors as asset size, geographic location, and the complexity of the covered financial institution's operations and assets." The fact that compensation practices fall within the range of compensation practices at comparable institutions strongly suggests that such compensation practices are not excessive. At the same time, compensation practices that differ from those of comparable covered financial institutions should not be presumed to be excessive, because compensation is company specific. In such cases, additional analysis may be required to determine why an institution's compensation practices appear to diverge from those of comparable institutions.

The Financial Condition of the Covered Financial Institution. In determining whether an incentive-based arrangement provides "excessive compensation," the proposed rules provide that "the financial condition of the covered financial institution" is a factor for the SEC to consider. With respect to this factor, we note that high performing employees of high performing institutions would naturally be expected to share in the institutions' success, provided that adequate measures are taken to manage pay riskiness. Additionally, institutions that have experienced financial difficulty may need flexibility to set compensation arrangements that attract and retain personnel who will be key to improving performance, provided that adequate measures are taken to manage pay riskiness.

B. *"Inappropriate Risk"*

The prohibition against incentive-based compensation arrangements that encourage "inappropriate risk" provides that an arrangement will not be in compliance unless it: (i) balances risk and financial rewards, for example by using deferral of payments, risk adjustment of awards, reduced sensitivity to short-term performance, or longer performance periods; (ii) is compatible with effective controls and risk management; and (iii) is supported by strong corporate governance, including active and effective oversight by the covered financial institution's board of directors or a committee thereof.

Risk-taking is at the core of the free enterprise system, and is the essential factor distinguishing it from other types of financial systems. We agree that there is a distinction to be made between appropriate and inappropriate risk-taking, but the distinction is a facts and circumstances one that calls for a good degree of experience and judgment as applied to individual cases. Whether appropriate or inappropriate, there is no escaping the reality that risk can result in losses as well as in gains.

While the proposal provides several pages describing each of the above mentioned standards of "inappropriate risk" in greater length, these lengthier descriptions are in some respects circular and provide little practical insight to guide institutions' efforts to achieve compliance with this prohibition. For example, "inappropriate risks" are described as those that "may encourage inappropriate risks that could lead to material financial loss" or "may encourage excessive risk-taking." As is implicit in the rules' use of "inappropriate," not all risks would lead to a violation. All financial institutions take risks, including some that may expose the firm to a material financial loss. Accordingly, it will be crucial for these firms to be able to clearly distinguish between "appropriate" and "inappropriate" risks in order to comply with the proposed rules.

Under the "Compatibility with Effective Controls and Risk Management" heading, it is noted that covered financial institutions must ensure that risk-management personnel "have an appropriate role in the institution's processes for designing incentive-based compensation arrangements, monitoring their use, and assessing whether they achieve balance." We believe that a full understanding of the risks associated with a particular institution's activities requires intimate familiarity

with the particular institution, and believe the SEC should allow a reasonable amount of deference to the well-informed judgment of personnel who are familiar with the institution, including what role, if any, would productively be played by risk-management personnel. The determination of the "appropriate" role of risk-management personnel in designing incentive-based compensation arrangements, monitoring their use, and assessing whether they achieve balance, should be left to the institutions' reasonable judgment.

V. Calculation of Total Consolidated Assets

The proposed rules apply to covered financial institutions that have total consolidated assets of $1 billion or more, with additional requirements for covered financial institutions that have total consolidated assets of $50 billion or more. For broker-dealers registered with the SEC, asset size would be determined by the total consolidated assets reported in the firm's most recent year-end audited Consolidated Statement of Financial Condition filed pursuant to Rule 17a-5 under the Securities Exchange Act of 1934. For investment advisers, asset size would be determined by the adviser's total assets shown on the balance sheet for the adviser's most recent fiscal year end.

Indexing for Inflation. We believe that the $1 billion and $50 billion asset thresholds should be indexed for inflation so that, in the future, only those institutions whose assets, in real terms, are equivalent to $1 billion and $50 billion today will be swept into the coverage of these rules. This would help ensure that the asset thresholds remain constant in real terms in the future and that smaller institutions, which are currently intended to be outside the scope of this rule, are not unintentionally brought within its scope in the future merely because of inflation.

Balance Sheet Assets. We note that there is currently some uncertainty with respect to requirements under US GAAP regarding the circumstances in which the assets of certain funds managed by an investment adviser should be included in the balance sheet of the investment adviser. Third party non-proprietary assets invested in funds managed by the adviser should be excluded from the adviser's total assets, even if those funds are required to be consolidated under GAAP.

Exclude Deferred Compensation and Bonuses Payable. Deferral of some compensation is required for firms above the $50 billion threshold, and is a factor of pay riskiness for covered firms below the $50 billion threshold. Assets set aside as deferred compensation and bonuses payable should be excluded from firms' assets because the inclusion of these assets—which have been earned or accrued by employees but not yet paid—for purposes of calculating the firm's total consolidated assets both overstate the firm's assets and provide a disincentive for firms to voluntarily defer employee compensation.

VI. Covered Financial Institution

Many firms are complex, multi-level organizations comprised of numerous subsidiaries and affiliates, some of which may meet the definition of a covered financial institution while others do not. It is essential that the definition of "covered financial institution" is clear and unambiguous in the final rule. We believe that the covered financial institution should be defined as the entity identified in Section 956(e)-(f), and should not be expanded to include affiliated companies such as subsidiaries and parent companies that do not themselves qualify as covered financial institutions.

We further believe that any covered financial institution (a "parent CFI") should be permitted to comply with these rules on its own behalf and on behalf of any subsidiary that is itself a covered financial institution (a "subsidiary CFI") by adopting procedures and by making reports to the parent CFI's primary regulator that cover both the parent CFI and any subsidiary CFIs. Firms should be permitted the flexibility – but not required – to comply separately. Some firms may decide that it would be more appropriate to treat subsidiary CFIs as separate and distinct covered financial institutions, with separate policies and procedures and separate reporting obligations to a different regulator. Others may prefer to take a more holistic approach with respect to their policies and reports.

VII. Defining Incentive-Based Compensation

The proposed rules define "incentive-based compensation" to mean any variable compensation that serves as an incentive for performance. The notice further indicates that the definition is broad and principles-based in order to address

the objectives of Section 956 in a manner that provides for flexibility as forms of compensation evolve.

The notice also indicates that certain types of compensation would not fall within the scope of the definition, including salary, payments for achieving or maintaining professional certification, company 401(k) contributions, and dividends paid and appreciation realized on stock or other equity instruments that are owned outright by a covered person and not subject to any vesting or deferral arrangement.

In addition to the above excluded categories, we request that the final rule explicitly exclude employees' partnership and limited liability company interests when such interests are not subject to any vesting or deferral arrangement, together with distributions and appreciation. We believe these interests should be excluded because they are similar to other equity instruments that are owned outright.

We also believe that it would be appropriate to exclude additional categories of equity interests that provide inherent protection against excessive risk taking, whether or not subject to vesting, such as general partner interests and other interests with unlimited liability. Such exclusion is appropriate because these types of interests necessarily expose their holders to losses that might be associated with "excessive risk," and, consistent with the purpose of these rules, would therefore tend to encourage less risky behavior. Even if the final rules do not explicitly exclude categories of equity interests with unlimited liability, we believe it would be appropriate to recognize that interests with unlimited liability tend to reduce pay riskiness.

Further, to the extent that equity subject to vesting is treated as "incentive compensation," the rules should be clarified so that equity subject to vesting is treated as and valued for "incentive-based compensation" purposes at the time of grant, and that dividends and appreciation of such equity between grant and vesting would be excluded, because it is the grant-date value that is considered when compensation decisions are made. The final rules should also make clear that, consistent with a plain reading of the rules, grants of equity with multi-year vesting periods would not be considered "annual incentive-based compensation" that is subject to the deferral rules for larger financial institutions.

VIII. Reporting Requirements

The proposed rules would require that a covered financial institution submit a report annually to its appropriate regulator or supervisor in a format specified by its appropriate Federal regulator. Such report would be required to describe the structure of the covered financial institution's incentive-based compensation arrangements for covered persons. The Agencies note that they have intentionally chosen phrases like "clear narrative description" and "succinct description" to describe the disclosures being sought.

We applaud the SEC's decision to keep its instructions broad and to clarify that reports should be "succinct". In light of the general trend towards increased disclosures rather than improved disclosures, it is appropriate that the proposed rules seek to elicit such information through broad requirements that enable covered financial institutions to tailor their reports to their own situations in a succinct manner.

In addition, we note that the proposed rules apply to incentive compensation arrangements "established or maintained" by the institution. We request that the SEC clarify that the requirements of proposed §248.205 be applied prospectively, and not retroactively to compensation that has been previously awarded but not paid, or to compensation subject to existing employment agreements.

IX. Timing of Annual Reports

With respect to the timing of reports, we are concerned that the requirement that total consolidated assets be determined based on a single date snapshot may inadvertently capture firms that only meet the $1 billion threshold on that particular date. In order to avoid inadvertently covering firms that would ordinarily fall below the $1 billion or $50 billion threshold, financial institutions should be permitted, where appropriate, to elect to measure assets by reference to another date that is more indicative of its true situation, or instead use a median or average of a period of months or consecutive reporting periods (similar to the approach adopted by the OCC, Board, FDIC, OTS and NCUA), provided that the methodology used to select the reference date is applied consistently year-over-year.

Such flexibility regarding the annual filing date may also be important to permit firms to select a reference date that coincides with their annual compensation review. This would minimize uncertainty likely to result from a reference date that differs from the date on which compensation decisions are finalized.

X. The Role of the Director and Shareholder

It goes without saying that the SEC's role in the safety and soundness of covered financial institutions is paramount. However, it must not be forgotten that directors and shareholders, where that structure exists, share a unique and vital responsibility in the management of a financial institution.

A one-size-fits-all approach may emasculate the ability of directors and shareholders to perform their legally obligated management duties. This is clearly the case if a formulistic approach where ever to be used. However, a heavy handed use of the proposed rules could have the same effect.

Shareholders and directors can, within the regulatory framework, choose the governance and compensation structures that work best for that financial institution. This will lead to a diversity of structures and practices that can best suit the financial institution. While this may provide firms with a competitive edge, it also creates a dynamic capital markets system. A one-size-fits-all approach will destroy that diversity and inhibit the efficiency of our capital markets, adversely impacting the economy overall. Accordingly, in its reviews, the SEC should work closely with directors and shareholders to evaluate and strengthen the managerial aspects of that relationship. The SEC should be sensitive not to undercut the director-shareholder dialogue and tailor the proposed rules and its implementation to reinforce it.

XI. Effect on Efficiency, Competition and Capital Formation

The Commission is required by law to consider its rules' effects on efficiency, competition, and capital formation.[2] We believe that our concerns listed above reflect a failure to determine the full impacts upon efficiency, competition and capital

[2] 15 U.S.C. Sections 78 c(f), 78w(a)(2), 80a-2(c).

formation. Earlier this year, the CCMC issued a report[3] demonstrating the various forms of capital and liquidity that are needed by businesses to operate and expand. On the one hand, the rule may impact the forms of capital that may be available to public companies, potentially impacting the return for their investors. On the other hand, the rule, particularly its one-size-fits-all approach, will impact the ability of different forms of capital (i.e. Private Equity, Hedge Funds, Broker-Dealers, etc) to be competitive domestically and globally.

The CCMC believes that the SEC has not appropriately and properly taken into account how the proposed rules' effect on efficiency, competition and capital formation and by failing to do so may promulgate a rule without achieving a standard necessitated by law.

Conclusion

The CCMC once again would like to thank the SEC for the opportunity to comment on the proposed rules. Without question, financial institutions should avoid excesses that imperil the long-term viability of the firm. However, the CCMC has serious concerns regarding the nature of the one-size-fits-all approach of the proposed rules, as well as a failure to understand the impacts upon capital formation and markets efficiency. These rules will not only impact financial institutions, but also the credit that they provide to businesses and ultimately their investors.

While excess should be avoided, we must also remember that a free enterprise system needs to allow businesses to engage in appropriate risk taking. Carefully calibrated guidance would be better suited to recognize and manage the significant differences between market participants, allowing for the effective operation of capital markets. An improper set of rules and enforcement can create underperformance values that will harm economic growth and job creation.

Sincerely,

Tom Quaadman

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[3] ***Sources of Capital and Economic Growth: Interconnected and Diverse Markets Driving U.S. Competitiveness,*** by Anjan Thankor, John E. Simon Professor, Finance and Director, PhD Program, Washington University in St. Louis and European Corporate Governance Institute.