American Bankers Association
Building Success. Together.

Phoebe Papageorgiou
Senior Counsel
Center for Securities, Trust and Investments
202-663-5053
phoebep@aba.com

VIA ELECTRONIC MAIL

November 18, 2010

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

Re: File Number S7-31-10, Shareholder Approval of Executive Compensation and Golden Parachute Compensation, 75 Federal Register 66590 (Thursday, October 28, 2010).

Dear Ms. Murphy:

The American Bankers Association[1] appreciates this opportunity to comment on the Securities and Exchange Commission's (Commission) proposed rule implementing Section 951 in the Dodd-Frank Wall Street Reform and Consumer Financial Protection Act (Act). Many of our members are publicly-traded bank holding companies, including many community banks and their holding companies that would be affected disproportionately by the proposal.

Among other things, the proposal would require publicly-traded companies subject to the Commission's proxy rules to include a separate resolution subject to shareholder advisory vote to approve the compensation of its named executive officers, as disclosed pursuant to Item 402 of Regulation S-K (say on pay vote). In addition, the proposal requires issuers to include an advisory shareholder vote on the frequency of the say on pay vote, either every one, two, or three years. The proposal would also require issuers to allow a shareholder advisory vote on compensation agreements for named executive officers that are based on mergers, acquisitions, or other dispositions of all or substantially all of the issuer's assets. Lastly, the proposal would require issuers to describe in their Compensation Discussion and Analysis (CD&A) in proxy statements and Form 10-Ks whether and, if so, how the issuer addressed the results of shareholder advisory votes on executive compensation.

The Disproportionate Burden on Community Banks

Recognizing that not all issuers should necessarily be treated the same, Congress specifically gave the Commission authority to exempt an issuer or class of issuers from the say on pay vote requirements,

---

[1] ABA represents banks of all sizes and charters and is the voice for the nation's $13 trillion banking industry and its two million employees. ABA's extensive resources enhance the success of the nation's banks and strengthen America's economy and communities.

and in particular directed the Commission to take into account whether the requirements disproportionately burden "small issuers." ABA strongly urges the Commission to exercise this exemptive authority in a meaningful way and provide relief for publicly traded banking organizations, specifically community banks. The proposal does provide some minor relief to "smaller reporting companies" (i.e., companies with a public float of less than $75 million as of the last day of their most recently completed second fiscal quarter), by not requiring them to describe whether and, if so, how it addressed the previous say on pay vote in a CD&A. This relief from one small part of the proposed regulation is not sufficient to address Congress' mandate to consider the disproportionate burden on small issuers inasmuch as it would still leave major new burdens that would weigh disproportionately upon community banks.[2]

The test for mandatory registration of securities under section 12(g) of the Securities Exchange Act of 1934 requires a company to register if it has at least $10 million in assets and 500 shareholders (criteria that have not been updated in decades even while the economy and the investment community have grown dramatically). Given the nature of the banking business where loans are considered assets, virtually all community banks that have more than 500 shareholders must register their securities with the Commission.[3] However, thousands of community banks that are considerably larger than $10 million in assets nevertheless are considered "small" for purposes of bank regulation. To give some perspective, the banking regulators define a small bank for purposes of the Community Reinvestment Act as an institution with less than $1 billion in assets. On average, these community banks have less than 60 full-time employees and less than $10 million in revenues. And community banks with less than $500 million in assets have on average fewer than 45 full-time employees and less than $5 million in revenues.[4]

Community banks, unlike other types of issuers, often have local shareholders who do not necessarily rely on Commission required reports to make their investment decisions. And unlike institutional investors, these individual investors often do not have the resources to compare the compensation information of the bank with other comparable banks, potentially making this new information in the proxy misleading or confusing. In our informal study of community banks, we have found that the household location of several community banks' shareholders highlighted the local nature of the banks' shareholder base.[5] In addition, we found that between 70% and 95% of the surveyed banks' shareholders reside in the same state as the banking organization's headquarters. Often they are bank customers and have the ability to make first hand observations regarding the health and operations of the institution and its value to the shareholders and the community.

---

[2] In addition, market capitalization as a threshold for becoming a "smaller reporting company" is not a good indication of what is a smaller issuer, because share prices can fluctuate at any time – there is no way to plan for potentially more reporting obligations. An asset-based threshold for relief would be a more stable and appropriate indicator of small issuers, such as community banks.

[3] Second quarter of 2010 data show that less than 1% of banks -- 50 banks out of approximately 7,800 – have less than $10 million in total assets.

[4] FDIC Call Report Statistics, Second Quarter 2010.

[5] The banks surveyed by ABA had a total number of shareholders that ranged from 410 to 6,500.

As many have documented, the costs of being a public company, including the additional incremental costs of new rules, are disproportionately borne by smaller public companies.[6] The burden of this proposal, as well as others, will be felt acutely by community banks because, unlike other registered companies, community banks' resources are already strained to the breaking point by the crushing, cumulative burden of bank regulation.[7] This burden is especially great for smaller corporations that do not have large corporate communications staffs. Given the particular characteristics of community banks, we urge the Commission to exempt them as a class of issuer from the rule's requirements.

Banking Organizations and Safety and Soundness

Investors in publicly-traded community banks would not suffer as a result of exempting these banks from the proposed new requirements. Publicly traded banking organizations are a unique type of issuer in that they are subject to a complex framework of federal and state banking laws and regulations, some of which specifically address the compensation of executive officers. Some of these laws and regulations include the following:

- In June 2010, the Federal Reserve Board (FRB), the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of Currency (OCC), and the Office of Thrift Supervision (OTS) jointly issued guidance on sound incentive compensation policies of banking organizations whether publicly traded or privately held. The guidance requires regulated entities—
  - (1) to provide employees, including executive officers, incentives that appropriately balance risk and reward;
  - (2) to make incentive compensation plans compatible with effective controls and risk-management; and
  - (3) to have strong corporate governance, including active and effective oversight by the organization's board of directors.[8]

[6] See generally, Foley & Lardner, The Cost of Being Public in the Era of Sarbanes-Oxley (August 2, 2007), *available at* http:/www.foley.com/publications/pub_detail.aspx?pubid=4487; Exposure Draft of Final Report of Advisory Committee on Smaller Public Companies, SEC Release No. 33-8666 (March 3, 2006) [71 FR 11090].

[7] In just the two years preceding enactment of the Dodd-Frank Act, over 50 new rules and other guidance documents were issued by the banking agencies. Estimates of rules coming out of DFA vary but all suggest that several hundred new rules will be adopted.

[8] Interagency Guidance on Sound Incentive Compensation Policies, 75 Federal Register 36395 (June 25, 2010) (Interagency Guidance).

- Section 39(c) of the Federal Deposit Insurance Act, 12 USC 1831p-1(c), requires all the federal banking agencies to establish standards prohibiting as an unsafe and unsound practice any compensatory arrangement that would provide any executive officer, employee, director, or principal shareholder of the institution with excessive compensation, fees or benefits and any compensatory arrangement that could lead to material financial loss to an institution. Section 39(c) also requires that the agencies establish standards that specify when compensation is excessive.[9]
- Section 956 of the Act further requires Federal regulators (including the Commission and the banking agencies) jointly to prescribe regulation or guidelines that prohibit any type of incentive-based payment arrangement that the regulators determine encourages inappropriate risks.
- Whether publicly traded or privately held, banks with assets of over a billion dollars are required to have independent audit committees, and bank examiners review board minutes to evaluate board actions, including decisions regarding executive officer compensation.

All of these requirements are focused on avoiding compensation that is based on misaligned incentives or that is otherwise unsafe or unsound.

Moreover, banking policy has recognized that a tension might sometimes arise between the interests of shareholders and the interest of ensuring that a bank operates in a safe and sound manner. The rationale for the banking agencies' requirements described above is to protect the long-term health of the institution, in part because shareholder interests are not always fully aligned with the safety and soundness of the institution. The safety and soundness standards are intended to provide an elevated level of protection against unsound practices. As stated in the Interagency Guidance,

> Aligning the interests of shareholders and employees, however, is not always sufficient to protect the safety and soundness of a banking organization. Because banking organizations benefit directly or indirectly from the protections offered by the Federal safety net (including the ability of insured depository institutions to raise insured deposits and access the Federal Reserve's discount window and payment services), *shareholders of a banking organization in some cases may be willing to tolerate a degree of risk that is inconsistent with the organization's safety and soundness*. Thus, a review of incentive compensation arrangements and related corporate governance practices to ensure that they are effective from the standpoint of shareholders is not sufficient to ensure they adequately protect the safety and soundness of the organization. [Emphasis added] [10]

In other words, unlike other classes of issuers, the regulatory agencies that govern their activities have found that, particularly in the short term, individual shareholder influence may not be fully

---

[9] See, e.g., 12 CFR Part 30 (OCC).

[10] Interagency Guidance at 36396.

aligned with the safety and soundness of the institution. We urge the Commission to consider the inherent potential conflicts in regulatory regimes when drafting the final rule.

Conclusion

ABA appreciates this opportunity to comment on this significant new requirement in Section 951 of the Act. We urge the Commission to consider the particular circumstances that govern banking organizations, as well as the characteristics of community banks that are publicly-traded companies. If you wish to discuss our comments further, please feel free to write or call the undersigned.

Sincerely,

Phoebe A. Papageorgiou

Phoebe A. Papageorgiou
Senior Counsel