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July 21, 2016

Office of the Comptroller of the Currency
400 7th Street SW, Suite 3E-218
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Attention: Legislative and Regulatory Activities Division

Mr. Robert deV. Frierson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Mr. Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

Mr. Alfred M. Pollard
General Counsel
Federal Housing Finance Agency
400 7th Street SW, Eighth Floor
Washington, DC 20219

Mr. Gerard S. Poliquin
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

Mr. Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 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 No. 3064-AD86; FHFA RIN No. 2590-AA42; SEC File Number S7-07-16)

Dear Mr. deV. Frierson, Mr. Feldman, Mr. Pollard, Mr. Poliquin, Mr. Fields, and Whom it May Concern at the Office of the Comptroller of the Currency:

The U.S. Chamber of Commerce, the world's largest business federation representing the interests of more than three million businesses of all sizes, sectors, and regions, and dedicated to promoting, protecting, and defending America's free

enterprise system, 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. CCMC welcomes the opportunity to comment on the Re-proposed Rule on Incentive-Based Compensation (the "Reproposal"). Since its inception, the CCMC has advocated for a system of corporate governance that incentivizes prudent risk taking and innovation and that promotes the long-term interest of the firm's shareholders.

Section 956 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") requires the Office of the Comptroller of the Currency ("OCC"), the Board of Governors of the Federal Reserve System (the "Federal Reserve"), the Federal Deposit Insurance Corporation ("FDIC," and, together with the OCC and Federal Reserve, the "Federal Banking Agencies"), the Securities and Exchange Commission ("SEC"), the National Credit Union Administration ("NCUA"), and the Federal Housing Finance Authority (collectively "the Agencies") to jointly prescribe regulations on incentive-based compensation arrangements for financial services firms.[1] The Agencies issued a proposal in 2011 but it was never finalized.[2] These six agencies recently re-proposed a rule to implement Section 956 of the Dodd-Frank Act.[3]

The Reproposal in its current form goes beyond the scope of the Dodd-Frank Act and will harm the financial services industry making it more difficult for non-financial businesses to access the capital needed to grow and create jobs. Our concerns, as expressed in more detail herein, include but are not limited to:

I. The Federal Banking Agencies have failed to provide statutorily required economic analysis of the Reproposal, which has impeded the public's

[1] The Office of Thrift Supervision, which also is to participate in this rulemaking, was consolidated into the OCC following enactment of the Dodd-Frank Act.
[2] Incentive-Based Compensation Arrangements, 76 Fed. Reg. 21,170 (proposed Apr. 14, 2011).
[3] Incentive-Based Compensation Arrangements, 81 Fed. Reg. 37,670 (proposed June 10, 2016).

right to notice and ability to comment and has resulted in a flawed rulemaking process;

II. **The agencies have failed to reconcile the comment periods harming the ability of commenters to provide informed commentary;**

III. **The Reproposal goes beyond the boundaries of the Dodd-Frank Act by requiring what must be in a compensation plan rather than prohibiting what may not be in a plan;**

IV. **The Agencies should prefer a principles-based approach over a highly prescriptive, one-size-fits-all approach to regulating the diverse financial services industry;**

V. **The Reproposal's "Significant Risk-Taker" and "Senior Executive Officer" definitions are simultaneously over-broad and under-inclusive from the perspective of the Agencies' desired regulatory outcome;**

VI. **The Reproposal would create artificial talent acquisition and retention arbitrage among geographies, industries, and firms of different sizes;**

VII. **The Reproposal's definition of incentive-based compensation should be narrowed;**

VIII. **The Reproposal's definition of "Average Total Consolidated Assets" is over-inclusive;**

IX. **The Reproposal's deferral rules are unnecessarily prescriptive and onerous;**

X. The Agencies should pare back the downward adjustment, forfeiture, and clawback rules;

XI. The additional restrictions on incentive-based compensation plans are unnecessary; and

XII. The Reproposal interferes with the duties of boards of directors by requiring their review of compensation plans and requires recordkeeping that goes beyond the requirements of the Dodd-Frank Act.

DISCUSSION

For decades, our American system of bifurcated corporate responsibilities between boards of directors, who owe a fiduciary duty to shareholders, and management, which runs the company's daily operations, has contributed to the collective success of an economy that has been, and today remains, the envy of the world. Thousands of innovators, entrepreneurs, Main Street businesses, and multinational companies have benefitted from the ability to tailor corporate decision-making to the particular needs of their respective firms, taking into account the unique competitive pressures of the industries and geographies in which they operate.

Across our diverse American business community, human capital is the foundational cornerstone of growth and organizational success. Every day, businesses in the financial services industry compete fiercely in an increasingly globalized market to attract and retain the services of talented professionals through the use of incentive-based compensation arrangements that are designed to align organizational and individual incentives. These compensation plans are uniquely designed by boards of directors and management and are tailored for the employees of a particular institution. The Reproposal itself correctly acknowledges that "incentive-based compensation arrangements are critical tools in the management of financial institutions."

It is therefore essential that any regulator charged with writing compensation rules (or any corporate governance rules, for that matter) comprehensively study all relevant issues and data and analyze the likely effects of its regulations on the highly competitive market for talent. If they don't, and if the costs of a rule outweigh its benefits, professionals may flee covered businesses in favor of others financial firms, other industries or seek opportunities in jurisdictions whose regulators more appropriately balance the putative governmental interest in regulating compensation plans with management's ability—and, under prevailing corporation law, its statutory duty—to make business judgments for the benefit of the firm's owners. This result could actually have the effect of undermining the regulator's goals by discouraging the most talented individuals—those most capable of preventing or managing the types of losses the regulator is trying to proscribe—from working in the financial services sector. It might also chill the kind of risk-taking—lending, financing, investing—that spurs economic growth and job creation, resulting in a "freezing in place" or corporate stagnation.

We have serious concerns with the substance of the Reproposal, emanating not only from within the four corners of the document itself but also from its even more prescriptive approach to the rulemaking than the Agencies' initial 2011 proposal and its deviation from congressional intent.[4] Legislative forerunners to section 956 would have applied to the incentive compensation plans of *all* employees in *all* financial services firms. The Chamber opposed those onerous measures, which would have had catastrophic consequences for lending and financing, especially transactions between community financial institutions and small businesses. Congress significantly narrowed the text to what it is today. Nevertheless, the Reproposal would mandate recordkeeping for *all* incentive-based compensation plans at covered firms with more than $1 billion in assets—an outcome we believe the legislative history shows that Congress specifically rejected.

[4] Our comments on the Agencies' 2011 proposal highlighted many of the same points we make herein.

We note that the Reproposal would subject a broad diversity of financial firms to a prescriptive uniform regulation. In a comment letter we submitted on July 13, 2011 on the Agencies initial proposal, we drew the Agencies' attention to a paper entitled *Sources of Capital and Economic Growth: Interconnectedness and Diverse Markets Driving U.S. Competitiveness*. We noted that a central theme of that paper is that "our modern economy requires a rich diversity of financing sources to provide businesses of all sizes and industries with financing that suits their individual needs." That remains true today. While we have tried to highlight some of our major concerns with the Reproposal, these comments are not exhaustive of every particular issue that might arise if these proposed rules were to apply in their current form to specific types of organizations, including insurance companies, broker-dealers, and banks.

I. The Federal Banking Agencies have failed to provide statutorily required economic analysis of the Reproposal, which has impeded the public's right to notice and ability to comment and has resulted in a flawed rulemaking process.

An economic analysis of the costs and benefits of a proposed regulation on those affected by it is a critical tool in a regulator's tool box.[5] Cost-benefit analysis provides discipline to rulemaking so that rules are narrowly tailored to the problem they are designed to address. It also encourages the consideration of less costly alternative approaches. Financial regulators should welcome the public's cooperation in such analysis to guarantee they consider a diversity of data and viewpoints germane to a specific rulemaking before it is finalized and implemented across a market.

But an agency's failure to undertake economic analysis is more than a missed opportunity. The lack of adherence to express congressional instructions to consider certain costs and benefits is itself a violation of the Administrative Procedure Act, and

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[5] *See* PAUL ROSE AND CHRISTOPHER J. WALKER, U.S. CHAMBER OF COMMERCE, THE IMPORTANCE OF COST-BENEFIT ANALYSIS IN FINANCIAL REGULATION (2013).

it increases the possibility that the resulting rule will arbitrary and capricious.[6] For example, in 1996, Congress amended the Securities Exchange Act to require the SEC to consider a proposed rule's economic impact on efficiency, competition, and capital formation, in addition to its preexisting duty to consider the impact on investor protection.[7] In the years that followed, the SEC failed to take that mandate seriously, often claiming in a perfunctory way that it had "considered" the costs and benefits of a proposed rule and thus satisfied the statute even though it did not publish its analysis. It was not until a series of decisions by the United States Court of Appeals for the District of Columbia that the SEC began to undertake and publish its economic analysis when it proposes a rule.[8] Today, the public now has over 100 pages of economic analysis from the SEC in connection with the Re-proposal.

In stark contrast, we currently have zero pages of economic analysis concerning the Reproposal from the Federal Banking Agencies despite the clear language of the Riegle Community Development and Regulatory Improvement Act of 1994 (the "Riegle Act"). Like the SEC, the Federal Banking Agencies are *required* to consider the costs and benefits of their proposed rules, albeit with respect to different metrics. Section 302 of the Riegle Act provides:

> [i]n determining the effective date and administrative compliance requirements for new regulations that impose additional reporting, disclosure, or other requirements on insured depository institutions, each Federal banking

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[6] *See* 5 U.S.C. § 706(2).
[7] 15 U.S.C. § 77b(b) ("Whenever pursuant to this subchapter the Commission is engaged in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation."); *accord* 15 U.S.C. § 78c(f) (same); 15 U.S.C. § 80a-2(c) (same); 15 U.S.C. § 80b-2(c) (same).
[8] *See Bus. Roundtable v. SEC*, 647 F.3d 1144, 1148 (D.C. Cir. 2011) (chastising the SEC "for having failed once again—as it did most recently in *American Equity Investment* . . . and before that in *Chamber of Commerce*—adequately to assess the economic effects of a new rule"); *Am. Equity Inv. Life Ins. Co. v. SEC*, 613 F.3d 166 (D.C. Cir. 2010); *Chamber of Commerce v. SEC*, 412 F.3d 133 (D.C. Cir. 2005).

> agency shall consider, consistent with the principles of safety and soundness and the public interest: (1) any administrative burdens that such regulations would place on depository institutions, including small depository institutions and customers of depository institutions; and (2) the benefits of such regulations.[9]

This statute is designed to enforce the commonsense principle that the benefits of a proposed regulation should outweigh the administrative and compliance burdens the Federal Banking Agencies place upon insured depository institutions. The requirement to perform and allow public comment on a cost-benefit analysis is not optional. Congress very expressly mandated it.

Nevertheless, the analysis the Riegle Act requires is completely missing from the Re-proposal. The text of Section D of Part V simply states, "[t]he Federal Banking Agencies note that comment on [matters covered by the Riegle Act] has been solicited" in other sections of the text.[10] Those sections, however, are lacking in any analysis on the administrative burdens that the proposal would place on depository institutions or the benefits of the proposal.[11] What expenses will firms covered by the proposed rule incur in changing their incentive-based compensation arrangements? How will customers of depository institutions be affected? What are the benefits of this rule and how do regulators assess them in light of regulations promulgated over the last five years pursuant to the Dodd-Frank Act?[12] What alternative were considered?

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[9] 12 U.S.C. § 4802.

[10] Proposed Rule on Incentive-based Compensation Arrangements 351, https://www.federalreserve.gov/newsevents/press/bcreg/bcreg20160516a1.pdf.

[11] *See id.* at 55-59, 149-61.

[12] We note that the Dodd-Frank Act is replete with provisions that are each designed to reduce systemic risk. We would assume that the analysis accompanying each successive regulation would take into account the regulatory work that has preceded it. In this case, for example, we question the marginal benefit of the proposal on reducing systemic risk when regulators have already issued rules concerning a firm's capital reserves, liquidity management, ability to resolve quickly

As the line of D.C. Court of Appeals cases involving the SEC demonstrates, it is not enough for an agency simply to punt the responsibility for undertaking cost-benefit analysis to the public during the comment period. Quite the opposite, an agency must "apprise itself—and hence the public and Congress—of the economic consequences of a proposed regulation *before* it decides whether to adopt the measure."[13] Commenters are entitled to see an agency's analysis at the time a rule is proposed, to critique its data and methods, and to present new data and analysis. Presumably, the Federal Banking Agencies put a great deal of thought and analysis into these questions over the five years since they first proposed an incentive-based compensation rule, but they have declined to share it.

Moreover, the failure to perform economic analysis would also run counter to President Obama's Executive Order 13579, which requires that "to the extent permitted by law, independent regulatory agencies should comply with" the provisions of Executive Order 13563.[14] That order directs covered agencies to propose or adopt a regulation "only upon a reasoned determination that its benefits justify its costs."[15] At least one of the Federal Banking Agencies, the Board of Governors of the Federal Reserve System (the "Fed"), has committed itself to undertaking such an analysis.[16] But despite this public commitment, the Fed's version of the Reproposal contains no such cost-benefit analysis. Neither does the Reproposal contain any explanation for why the Federal Banking Agencies appear to be disregarding this Administration's openness and transparency directives.

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without posing a material threat to the financial system, and other similar regulations. At a minimum, commenters are entitled to understand how the Federal Banking Agencies analyzed how this proposal will work in conjunction with other regulations.

[13] *Chamber of Commerce v. SEC*, 412 F.3d at 144 (emphasis added).

[14] *See* Exec. Order No. 13,579, 76 Fed. Reg. 41585 (July 14, 2011).

[15] Exec. Order No. 13,563, 76 Fed. Reg. 3821 (Jan. 18, 2011).

[16] Letter from Chairman Ben Bernanke to Cass Sunstein, Administrator, Office of Information and Regulatory Affairs, Nov. 8, 2011 (stating that the Board of Governors of the Federal Reserve System "continues to believe that [its] regulatory efforts should be designed to minimize regulatory burden consistent with the effective implementation of [its] statutory responsibilities").

Whether by statute or executive order, the rulemaking process is designed to invite and take account of public input, but the public cannot provide meaningful input when regulators do not publish their data and analysis. Understanding the costs and benefits that regulators considered in relation to the Reproposal and the burdens they believe it will impose is critical to the public's ability to respond to it. We request that the Federal Banking Agencies withdraw the Reproposal until they are prepared to fulfill their statutory duty to publish economic analysis for notice and comment.

II. The agencies have failed to reconcile the comment periods harming the ability of commenters to provide informed commentary;

The fragmented adoption of the proposed rule by the agencies has yielded comment periods of different lengths. The NCUA, the first agency to act, set the deadline for public comment at July 22, 2016, which as of the date of proposal gave a 90-day comment period. As the other agencies subsequently adopted the proposed rule they also used the July 22 deadline, resulting in comment periods of less than 90 days. Despite their adoption of nearly identical text, the Agencies nowhere explain their divergent views on how long the public should have to comment on the proposed rule.

The reality is that the public comment period could not have begun in earnest until all of the Agencies had proposed the proposed rule. As a legal matter, the statute requires them to act jointly. And as a practical matter, the public has to see all parts of the rule, as proposed by each of the six Agencies, before it can begin to analyze it comprehensively. The fact that NCUA, the first to propose, gave a 90-day public comment period is therefore irrelevant.

III. The Reproposal runs afoul of its enabling statute by prescribing what must be in a compensation plan rather than prohibiting what may not be in a plan.

Section 956 of the Dodd-Frank Act confers upon the Agencies the limited authority to *prohibit* incentive-based compensation plans that provide "an executive officer, employee, director, or principal shareholder" of a covered institution with "excessive compensation, fees, or benefits," or that "could lead to material financial loss" to the institution. The statute does not authorize the Agencies to *prescribe* terms and features of government-approved compensation plans. Yet that is exactly what the Agencies have done. The Reproposal would impose a highly prescriptive set of affirmative guidelines on compensation plans across a diversity of financial services firms, violating the plain text of the enabling statute. The Agencies should withdraw the Reproposal or, at a minimum, amend it to more faithfully reflect congressional intent.

IV. The Agencies should prefer a principles-based approach over a highly prescriptive, one-size-fits-all approach to regulating the diverse financial services industry.

The Reproposal would regulate the compensation of hundreds of thousands of diverse employees working at thousands of firms in very diverse sectors of the financial services economy using the exact same set of prescriptive rules. Imposing uniform, inflexible regulation on such a diverse population of covered businesses would be counterproductive to the regulatory goals of section 956 and would have significant negative consequences in the sector of our economy that finances economic growth.

Instead, the Agencies should consider the effectiveness of existing principles-based frameworks for regulating incentive-based compensation arrangements. These include the 1995 Interagency Guidance on Sound Incentive Compensation Policies,

which the Federal Banking Agencies adopted pursuant to section 39 of the Federal Deposit Insurance Act (to which regulators, under section 956, as to give deference), and the 2010 final interagency Guidance on Sound Incentive Compensation Policies. Both of these frameworks are *principles-based*, and quite intentionally so. The preamble to the 2010 guidance specifically notes that the Agencies, just six years ago, considered and affirmatively rejected a rules-based approach:

> 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.

In contrast to the prescriptive regulation of deferred incentive compensation that prevails in some other jurisdictions like the United Kingdom and European Union, the 2010 guidance has enabled the Federal Banking Agencies' to achieve their regulatory goals in their supervision of the banking industry over the last six years without significantly impeding competition for talent. Under our domestic guidance, businesses have worked cooperatively with regulators to identify material risk-takers in their organizations and implement compensation arrangements with regulatory approval. We thus have serious questions about what has prompted the Agencies to publish the Reproposal at all, but especially in a highly prescriptive form that breaks sharply from—and in some ways, is plainly incompatible with—the existing guidelines for regulating incentive-based compensation. There appears to be no reason why the 2010 interagency guidance could not suffice to fulfill the Agencies' section 956 statutory duties and no justification for discarding what is working.

We believe that highly prescriptive regulation is appropriate when the scope of the regulated industry, activity, or group of employees is relatively uniform and when the economic benefits of ease of compliance (such as checking off "yes" or "no" on a questionnaire) outweigh the costs that the regulation imposes. For example, we support uniform speed limits for all cars driving on the highway because each car generally looks the same and is operated by drivers who have obtained a standard license. But when a regulator—or all the more, a group of six regulators—seeks to regulate an industry as diverse and complex as the American financial services industry, a monolithic prescriptive approach threatens to impose costs on firms, their employees, and customers indiscriminately and in a manner that likely will undermine the ultimate regulatory objective. Like the ocean transforms jagged rocks into smooth stones over time, a one-size-fits-all prescriptive approach to the regulation of incentive-based compensation would reshape diverse markets and eliminate their unique contributions to our economy as they are forced to conform to new standardized regulations.

In contrast, a principles-based approach, which clearly is permissible under section 956's requirement that the Agencies prescribe "regulations *or guidelines*," accounts for the differences among regulated entities and gives regulators the flexibility and tools they need to tailor their approach for a particular industry or business in light of its unique risks, compensation culture, complexity, and other appropriate characteristics.[17] It forces the corporation to think critically about its activities and how and whether they comport with regulators' expectations. Principles-based regulation fosters a cooperative relationship between the regulator and the covered entity, which reduces regulatory friction and increases regulatory efficiency. Compared to existing guidance, the Reproposal would be implemented by

[17] In section 956, Congress intentionally authorized the Agencies to prescribe "regulations or guidelines" governing incentive-based compensation arrangements—a clear indication of legislative intent that the Agencies have wide latitude to devise a principles-based guideline approach rather than a prescriptive rules-based approach. This choice of words is in contrast to other Dodd-Frank provisions that require any of a variety of regulators to prescribe only "rules," and not guidelines, on a given subject.

even more regulators across an even more diverse set of businesses, making a principles-based approach to the present rulemaking all the more desirable.

In addition to providing the Agencies more flexibility to tailor their regulation of unique industries and businesses, a principles-based approach would let the Agencies take into account the impact of new, recent regulations on the financial services industry. Since 2010, the firms whose compensation arrangements would be covered by the Reproposal have begun to comply with a variety of rules, including capital and liquidity ratios, annual stress tests, the submission of "living wills," and rules applicable to designated SIFI nonbanks regulated by the Fed, to name a few. Each of these regulatory measures (as well as those that are yet to come) has made the risk of material financial loss at a firm less likely, either because losses themselves are less likely or because the materiality of any loss would be diminished. Yet these regulations are diverse and apply differently to the many different types of firms that the Reproposal would cover. A principles-based approach would allow the Agencies to take into account the existing, unique regulatory programs presently applicable to each type of covered business and fashion tailored incentive-based compensation regulation most appropriate to each particular type of firm.

V. The Reproposal's "Significant Risk-Taker" and "Senior Executive Officer" definitions are simultaneously over-broad and under-inclusive from the perspective of the Agencies' desired regulatory outcome.

Since 2010, covered institutions subject to the 2010 guidance have worked cooperatively with their respective regulators to identify material risk takers at their organizations. This approach has worked well, in large part because it accommodates diversity among institutions' business lines, sizes, and other unique characteristics and fosters a cooperative approach toward achieving regulatory goals. In contrast, the Reproposal introduces the term "significant risk-taker" and defines it using bright-line tests that poorly approximate actual risk-taking activities and that will be difficult to implement without significantly impairing a firm's ability to attract and retain talent.

The Agencies should further develop and publish their rationale for breaking with the more flexible approach to identifying risk-takers.

It is almost by logical necessity that a prescriptive definition applied across diverse businesses in the financial services industry to regulate subjective behavior like "risk-taking" will, in error, simultaneously cover some employees whose actions pose little to no risk of material financial loss and possibly not cover other employees whose activities actually could subject a firm to material financial loss. At a minimum, the result will be to discourage employees from seeking to be hired into those over-included positions that carry out low-risk or risk-mitigating functions. Meanwhile, other employees may flock to positions the Reproposal's bright-line test possibly "misses," thereby exploiting a regulatory deficiency. In either case, the result is a distorted marketplace for talent that stifles economic growth and impedes desired regulatory outcomes.

For example, the Reproposal would subject the compensation plans of some employees in control functions that are designed to *mitigate* risk at Level 1 and Level 2 institutions to the regulation's deferral, adjustment, forfeiture, and clawback rules. The Agencies, whose statutory concern is with material financial loss, should want to see the most talented individual in those control functions, yet the Reproposal's prescriptive compensation rules might end up discouraging the most talented individual from taking that job. The Reproposal's Significant Risk-Taker definition would also pick up financial advisors whose responsibilities are limited to handling client funds, including the retirement accounts of millions of retail investors who had nothing to do with the 2008 financial crisis, rather than the firm's capital.

Moreover, the use of compensation percentiles to determine who is a significant risk-taker is highly impracticable because it necessarily depends upon the compensation of others in the firm—one doesn't know whether she is in the top 2% of earners, and therefore a significant risk-taker in future years, until the year is over and incentive compensation for everyone in the firm is tallied. How are businesses

supposed to recruit talented individuals to work for them when they can offer very little certainty about whether the prospective employee's pay can be clawed back or downwardly adjusted for the next 11 years?

The problems with a bright-line approach should counsel the Agencies to abandon it in favor of the existing, more flexible material risk taker framework. If, however, the Agencies maintain a bright-line approach, they should select a metric other than compensation percentile to permit employers to offer more certainty to prospective employees. Regardless of the metric selected, the exposure test prong of the rule should be removed, as it presents fundamental issues that make it very difficult to correctly calculate and apply. It also represents an inappropriate measure of an individual's ability to expose the business to the risk of material financial loss. Finally, the Agencies should permit a business to identify Senior Executive Officers on a consolidated basis and not at an entity-level basis. A subsidiary CFO should not, for example, be subject to the same restrictions as a parent company CFO, especially if she is not even a Significant Risk Taker.

VI. The Reproposal would create artificial talent acquisition and retention arbitrage among geographies, industries, and firms of different sizes

American businesses compete fiercely on a daily basis to attract and retain talented individuals to produce goods and services, serve customers, and grow the business. One of the primary methods of attracting top talent is through an incentive-based compensation arrangement whereby the employee gets paid according to his or her successes. Given the choice between working at a company that pays a flat salary no matter how well the worker performs compared to his peers, and a company that pays for success, most employees would choose the meritocratic firm.

a. The Reproposal's "Levels" Will Create Non-Market-Based Competition for Talent Within an Industry Based on Firm Size

In addition to creating global and inter-industry competitive disadvantages for covered institutions, the Reproposal's use of "levels" would also create artificial incentives for individuals within the same industry to seek employment at the firm where they are least likely to be a significant risk-taker—a form of regulatory arbitrage. For example, an individual who is a significant risk taker by virtue of her compensation at a Level 2 firm (under the relative compensation test) may be incented to seek employment at a Level 1 firm in the same industry if her compensation arrangement at the larger firm would put her below the 5% cut-off. Conversely, an individual at a Level 1 firm who is just within the 5% cutoff may seek opportunities at a Level 2 institution where his compensation will put him just outside of the 2% cutoff. Employees at Level 3 institutions would be treated as employees at Level 1 or Level 2 institutions if their employers were part of a larger consolidated group. The Reproposal's distortion of market-based incentives is yet another reason why the Agencies should abandon a prescriptive approach in favor of a principles-based approach, like the one presently proposed for Level 3 institutions, for all covered institutions.

b. Talent and Innovation May Flee Covered Institutions for Non-Covered Institutions

In addition to considering the impact of a rule under section 956 on the global competitiveness of American firms, the Agencies should closely consider whether the type of talent incentive-based compensation arrangements are designed to attract will be likely to leave covered industries in favor of non-covered industries. The Reproposal foreshadows the possibility that even chief technology and/or chief information security officers may be covered in a final rule. Will a CTO hired by a financial institution to oversee development of a new customer-friendly mobile interface leave the bank in favor of a pure tech company so as not to be subject to

deferral and clawback? While it is true that the respective jurisdictional scopes of the Agencies' are limited, the Agencies should consider the impact of the Reproposal on the broader economy, including whether it is likely to cause artificial disparities in different industries' ability to attract and retain talent. Moreover, if the Agencies believe the Reproposal mitigates the risk of material financial loss to covered firms, they should consider whether the Reproposal, if it results in professionals leaving covered industries in favor of non-covered industries, would have the practical effect of simply shifting excessive risk-taking to other corners of the financial system.

c. The Reproposal May Cause "Brain Drain" and Make Our Economy Less Competitive

The American economy is the strongest, most diverse, and most innovative economy in the world. We benefit from having well-regulated capital markets as the foundation of our free enterprise system. Our economy is built to *encourage* prudent risk-taking, entrepreneurship, and opportunity, which yield positive externalities like job creation, productivity, and financial stability. That is why many foreign nationals, especially those with backgrounds in the STEM fields, seek attractive employment opportunities in the United States. Other nations' economies have different ontologies and social purposes and thus are regulated quite differently.

The Reproposal puts American economic growth and job creation in serious jeopardy. The Agencies should consider the impact of the Reproposal on the competitiveness of American businesses vis-à-vis their international competitors. The Agencies should start their analysis from the baseline of the status quo and develop their rule based on how the Reproposal is likely to shift competitive advantages and disadvantages on a global basis, not on whether the Reproposal is likely to bring our regulatory framework "more in line" with other countries with different economic cultures. They should further consider whether now, with potential dislocation of talent from the United Kingdom and European Union as a result of "Brexit," is an

appropriate time to make employment in the United States less attractive compared to other jurisdictions competing for the same talent.

VII. The Reproposal's definition of incentive-based compensation should be narrowed.

The Reproposal defines "incentive-based compensation" to mean "any variable compensation, fees, or benefits that serve as an incentive or reward for performance." It excludes some types of compensation, such as 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, the Agencies should 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 excluded 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 statutory purpose of section 956, would therefore tend to discourage excessive risk-taking. 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 such excessive risk-taking.

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 are excluded, because it is the grant-date value that is considered when compensation decisions are made. The final rule 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. The Reproposal's definition of "Average Total Consolidated Assets" is over-inclusive.

The Agencies have improved the manner in which Average Total Consolidated Assets is calculated since the 2011 proposal, but more work is needed. The Agencies should expressly exclude intercompany obligations and goodwill. As described in detail below, the calculation should also exclude assets held for the account of customers, including the non-proprietary assets of broker-dealers.

For broker-dealers registered under section 15 of the Securities Exchange Act of 1934 (the "Exchange Act"), assets are determined by reference to the FOCUS Report. Broker-dealers report information from their financial statements in the FOCUS Report. Accounting rules require broker-dealers to include un-invested customer cash balances as assets on their balance sheets even though those assets are segregated and held solely for the benefit of customers under the Customer Protection Rule.[18] As a result, the Reproposal would incorrectly treat customer assets

[18] Un-invested customer cash balances are regulated under the Customer Protection Rule (Rule 15c3-3) under the Exchange Act, which requires broker-dealers to segregate them in an account entitled "Special Reserve Bank Account for the Exclusive Benefit of Customers" (the "Customer Reserve Account"). These balances are referred to as "locked up" assets because they must be separated from all of the broker-dealer's other bank accounts. The Customer Reserve Account cannot be used to satisfy the broker dealer's other obligations, and the assets would not be available to creditors in the event of bankruptcy. Moreover, the cash can only be invested in the highest credit quality assets. For example,

as if they were subject to potential "inappropriate risk" and could result in "material financial loss" for the broker-dealer notwithstanding the fact that existing SEC rules prevent that from happening.

In the Reproposal, the SEC has already excluded other non-proprietary assets that may be included in a covered institution's balance sheet solely as a result of accounting rules rather than its economic ownership. For example, client assets under management are excluded from the definition of "average total consolidated assets" for investment advisers, even if such assets appear on an investment adviser's balance sheet. The same policy should apply to funds held in the Customer Reserve Account that are included on the FOCUS Report solely for accounting purposes.

Additionally, while the Reproposal does acknowledge that large financial institutions typically manage their businesses on a consolidated basis, it applies a number of its requirements on an entity-by-entity basis. Applying the Reproposal's rules on an entity-by-entity basis in this manner would create a result where hundreds of covered subsidiaries within one affiliated group would find themselves individually subject to the Reproposal (and, in some cases, to the jurisdictions of different regulators). Covered institutions should be afforded flexibility to apply any final rule on a consolidated basis for portions of their business.

Finally, the Agencies should clarify that non-majority owned subsidiaries should not be subject to the rule. The Reproposal would use the Bank Holding Company Act definition of "control" (25% or more), which in some circumstances would result in a firm's being required to implement compensation rules at, for example, a foreign-owned and foreign-located joint venture, where it doesn't have the ability to enforce these requirements.

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investments are limited to FDIC-insured bank deposits, Treasury securities, or certain other government-guaranteed securities.

IX. The Reproposal's deferral rules are unnecessarily prescriptive and onerous.

The Reproposal would require Level 1 and Level 2 covered institutions to defer specific percentage of a Senior Executive Officer and Significant Risk-Taker's incentive-based compensation for a minimum specified number of years. The stated purpose of this rule is to appropriately balance risk and reward—a function traditionally performed not by government but by managers, boards of directors, and shareholders.

The deferral percentages and periods in the Reproposal are onerous, particularly in light of the breadth of affected individuals, and unsupported by any quantitative analysis. Any such prescriptions should be established only after a careful review of whether they will meaningfully contribute to risk mitigation. The Agencies have proposed a four-year deferral of 60% of a senior executive officer's "Other Incentive-Based Compensation" and 50% of a significant risk-taker's "Other Incentive-Based Compensation" at a Level 1 institution; they have proposed slightly less burdensome prescriptions to apply to Level 2 institutions. Nowhere in the Reproposal do the Agencies explain how these percentages have been derived, why they are different for Level 1 and Level 2 institutions, or, most importantly, why they—and not alternative percentages—most appropriately balance risk and reward. Neither do the Agencies appear to consider how these rules would impact the personal liquidity of the employees that would be subject to them. These strict requirements for SEOs and SRTs represent a departure from the flexibility of the 2010 guidance, which specifically acknowledges that "[d]eferral of a substantial portion of an employee's incentive compensation *may not be workable* for employees at lower pay scales because of their more limited financial resources."

Finally, the Agencies should allow events beyond death and disability to permit acceleration of deferred compensation. These events should include: entering government service, retirement, demonstrable financial hardship, acceleration to meet

tax obligations associated with deferred compensation, change of control, and involuntary termination of employment.

X. The Agencies should pare back the downward adjustment, forfeiture, and clawback rules

In addition to prescribing deferral rules, the Reproposal would also require Level 1 and Level 2 covered institutions to use downward adjustment, forfeiture, and clawback provisions to reduce incentive-based compensation *ex post* for certain events. Naturally, downward adjustment and forfeiture features of compensation plans, as applied to a large number of affected individuals, will discourage prospective employees from joining the firm and will deter existing employees from taking even the most prudent risks (every loan has *some* chance of default). These features will have a direct negative impact on a firm's lending, financing, and investing behaviors; these penalties will, in the aggregate, make financing less available in the capital markets. While we believe it is appropriate for compensation plans to use a broad range of tools to promote an institution's long-term goals, we believe that the Reproposal's downward adjustment and forfeiture provisions should have a relatively short look-back period. We further submit that the triggers for downward adjustment or forfeiture should be limited to activities that have a tight nexus to the events that yielded the compensation.

The Reproposal further requires Level 1 and Level 2 covered institutions to include provisions that permit the institution to claw back all vested incentive-based compensation for a period of seven years after the vesting date. As an initial matter, this period is unnecessarily long: an employee will not have certainty about the ownership of deferred compensation subject to clawback for more than a decade. This is much longer than a traditional business cycle, and much longer than is likely necessary to detect the manifestations of the type of conduct the rule is designed to discourage. At a minimum, the clawback period should run from the date the compensation is granted, not when it vests.

XI. The additional restrictions on incentive-based compensation plans are unnecessary.

On top of the required provisions that allow a company to take pay away from covered individuals, the Reproposal would cap the amount of incentive-based compensation that may be paid to senior executive officer and significant risk takers. While the Agencies state that the point of this proposal is to curb the use of excessive "leverage" in designing incentive-based plans, we fail to see what marginal benefit a cap on incentive-based pay would provide. What is the harm in uncapped upside potential earning if all of that earning could be reduced, forfeited, or clawed back altogether? We further question how the Agencies arrived at their conclusion that the percentage caps used in the Reproposal—125% for senior executive officers and 150% for significant risk-takers—are consistent with industry practice.

Neither do we see any marginal benefit obtained in prohibiting covered institutions from using volume-driven or relative performance measures alone to determine compensation. There should be a presumption in favor of a firm's ability to use whatever mix of benchmarks it believes are appropriate for its industry, size, and for different types of employees. Relative performance, even as a sole benchmark, is generally accepted (and endorsed by a prominent proxy advisory firm) in measuring an employee's success among his or her peers. Similarly, compensation plans that use volume-driven measures of success as the sole benchmark may be appropriate in some circumstances. Nevertheless, the Reproposal would prohibit such compensation plans for *all* employees (not just senior executive officers and significant risk-takers) at Level 1 and Level 2 institutions. The Agencies should revise these additional, overly broad restrictions on incentive-based compensation to allow businesses to use flexible approaches that fit their respective industry norms.

XII. The Reproposal unnecessarily tasks boards of directors with review of compensation plans and requires excessive recordkeeping.

The Agencies have proposed not only to regulate the specific content of incentive-based compensation plans with a slate of one-size-fits-all rules but also who at a covered institution must be involved in the plan-writing process. As a general matter, we support strong corporate governance rules that respect the bifurcated duties of the board of directors and management, and that promote the long-term interests of the shareholders who own the firm. But the Reproposal would require the board of directors or a committee thereof to expressly approve the terms of every incentive based compensation plan for senior executive officers—a group that is unnecessarily large and diverse under the definitions in the Reproposal—including the amounts, the manner in which compensation vests, payouts, downward adjustments, and clawbacks. This would include subsidiary boards with respect to subsidiary SEO compensation. This task alone will unnecessarily consume an enormous amount of the board's time and resources and divert its attention to other more pressing matters facing the business.[19]

The Reproposal would also force *all* covered institutions to create and maintain records on the structure of every incentive-based compensation plan for a period of at least seven years. First, that requirement seems unnecessarily burdensome given the breadth and diversity of the plans that would be covered. Second, if the Agencies insist on this provision, we would recommend that it be tailored to cover only those employees who are subject to clawback (we infer from the seven-year time periods of the clawback rule and record-keeping rule that the record-keeping is for the purpose of enforcing the clawback rule).

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[19] We note that directors themselves would fall under the Reproposal's definition of Significant Executive Officer. Depending on how a covered firm pays directors and how "incentive-based compensation" is ultimately defined, a covered institution's board could be required to deal with director compensation plans.

In addition, the Reproposal would require the compensation committee to obtain two incentive-compensation reports per year—one from an independent audit and one from management. This requirement is unnecessary; the redundancy will impose costs on the firm without any marginal benefit. The Agencies should pare back this requirement to a single report from management.

Finally, we welcome the Agencies' proposed change from the 2011 proposal, which would have required institutions to provide annual reports to their respective regulator(s) concerning incentive-based compensation plans, to the more sensible approach of providing them upon request to the applicable regulator.

CONCLUSION

Thank you for your consideration of these views, issues and comments. The Chamber has serious concerns regarding the scope and application of the Reproposal. In our view the Reproposal will have significant consequences for the financial services industry because it fails to take into account the diversity of financial firms. It ultimately will harm the ability of non-financial businesses to access the resources needed to grow and operate a businesses. Additionally, we are extremely concerned with the disjointed comment period and failure of Federal Banking Agencies to provide commenters with an economic analysis necessary to review the Reproposal and provide informed commentary.

We stand ready to discuss our concerns with you in greater detail.

Sincerely,

Tom Quaadman