October 26, 2016

The Honorable Janet Yellen
Chair
Board of Governors of the Federal Reserve System
1800 K Street NW
Washington, DC 20006

The Honorable Thomas J. Curry
Comptroller
Office of the Comptroller of the Currency
400 7th Street SW, Suite 3E-218
Washington, DC 20429

The Martin J. Gruenberg
Chair
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

The Honorable Rick Metsger
Chair
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314

The Honorable Melvin Watt
Director
Federal Housing Finance Agency
400 7th Street SW
Washington, DC 20219

The Honorable Mary Jo White
Chair
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549

Dear Chair Yellen, Comptroller Curry, Chair Gruenberg, Chair Metsger, Director Watt, and Chair White:

We write today to urge you to strengthen and finalize the Notice of Proposed Rulemaking issued by your Agencies in May regarding incentive-based compensation arrangements pursuant to Section 956 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank).

The recent revelations concerning widespread fraudulent practices at Wells Fargo have increased our concern about pay practices at major financial institutions. Wells Fargo management created a culture that incentivized and led to widespread fraud and misconduct throughout the organization. Yet, key senior executives at the bank who were both aware of the behavior and were instrumental in designing policies that led to the scandal, such as former Senior Executive Vice President for Community Banking Carrie Tolstedt and former Chairman and CEO John Stumpf, have received hundreds of millions of dollars in bonus compensation, even as over 5,300 low-paid retail banking employees were fired. In fact, Wells Fargo's 2015 proxy statement specifically cites success in cross-selling as a reason for the bonuses paid to Ms. Tolstedt and three other senior executives.[1] Not only is this outrageous, allowing them to keep their bonuses sends a dangerous signal to other executives that you can oversee excessive risk-taking and widespread fraud and still get a multi-million dollar payout. Therefore, we need

[1] Wells Fargo & Company 2015 Proxy Statement, p. 50 (available at: https://www08.wellsfargomedia.com/assets/pdf/about/investor-relations/annual-reports/2015-proxy-statement.pdf).

tough rules that will ensure that executives who engage in this type of misconduct will have their bonuses clawed back so we can deter similar actions in the future.

Recently, the Board of Directors acted, belatedly and in the face of intense negative publicity, to reclaim a small fraction of this compensation. However, it seems clear that without unusual public pressure, high-level Wells Fargo executives would not have been held financially accountable at all and would have received their entire bonuses. In fact, clawback policies are already in place at over 86 percent of S&P 500 companies, yet recouping compensation is extraordinarily rare. Clearly corporate boards are either unwilling or unable to use their authority to enforce clawbacks designed to protect shareholders and other stakeholders from the dangers posed by incentive-based compensation arrangements.

This is just the latest example of the lack of executive accountability for illegal activity at a major bank. Although tens of billions of dollars in penalties have been levied at big banks for mortgage fraud and other illegal activities related to the financial crisis, key executives have rarely been required to pay back bonuses connected to these activities.[2]

Your current work in crafting new executive pay rules implementing Section 956 of Dodd-Frank offers a unique opportunity to address these accountability issues at major banks. As you know, Section 956 requires your agencies to ban incentive pay practices at financial institutions that encourage inappropriate risk-taking. The proposed rule implementing Section 956 requires, among other things, that bonus pay be deferred, adjusted downward if misbehavior occurs, and subject to a contractual claw-back provision that could be exercised for up to seven years after the deferral period is over and all bonus pay has been granted.[3]

We strongly support your general approach of holding bonus pay at risk for a substantial period of time in order to determine if significant misconduct has occurred, and reclaiming incentive pay if executives have behaved inappropriately. In concept, such an approach could create strong financial incentives for top managers to prevent inappropriate risk-taking.

However, we have concerns that a number of specific weaknesses in the proposed rule could render the new rule ineffective in creating accountability for top executives. Specifically, there are three key weaknesses in the proposal that could undermine its effectiveness:

1) **The deferral period for bonuses is too short.** The maximum level of bonus deferral in the proposal, affecting the most senior executives at the largest banks, would require 60 percent of bonus pay to be deferred over four years. Equal pro rata payments could be made over the four year deferral. This implies that even the top executives at the largest banks could receive 70 percent of their bonus pay within two years after the performance year, and all of it within four years. However, it often takes more than four years for the full scope of

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[2] *See* Stacy Cowley, *Wells Fargo to Claw Back $41 Million of Chief's Pay Over Scandal*, N.Y. TIMES, Sept. 27, 2016 (available at: http://www.nytimes.com/2016/09/28/business/dealbook/wells-fargo-john-stumpf-compensation.html); Francine McKenna, *Wells Fargo CEO's $41 million ranks only third among executive-pay clawbacks, forfeitures*, MarketWatch, Sept. 29, 2016 (available at: http://www.marketwatch.com/story/wells-fargo-ceos-41-million-pay-forfeit-is-neither-the-biggest-nor-the-toughest-clawback-2016-09-29).

[3] The Office of the Comptroller of the Currency (OCC) et al., "Incentive-Based Compensation Arrangements," 81 *Federal Register* 37670, June 10, 2016.

wrongdoing to be apparent. Wells Fargo is a case in point; the institution has been opening fraudulent accounts since at least 2011, and likely well before that date. Further, financial crisis penalties were not levied until approximately a decade after the fraudulent activities occurred.

2) **Clawbacks and downward adjustments are optional, and not mandatory.** Under the proposal, downward adjustment of unvested executive bonuses is optional for the company, even if misconduct has clearly occurred. The proposal states only that the company must "consider" downward adjustment in cases of misconduct, not that it should require the return of executive bonuses if misconduct or inappropriate risk-taking has clearly occurred.[4]

   The clawback requirement in the proposal is similarly flawed. The proposal clearly states that "while the proposed rule would require the inclusion of clawback provisions in incentive-based compensation arrangements, the proposed rule would not require that Level 1 or Level 2 covered institutions exercise the clawback provision."[5] A discretionary clawback provision is not likely to have much if any practical deterrent effect against inappropriate risk-taking. The reluctance of companies to exercise clawback, and the legal difficulties in clawing back executive pay once granted, have meant that such optional clawback provisions have rarely been exercised.[6]

3) **The triggers for clawbacks are too limited.** Adding to the weakness of the contractual clawback requirement in this rule, the triggers governing when clawback can be exercised are limited to malfeasance by an individual employee. Specifically, if an individual employee engages in fraud, deliberate misrepresentation, or "misconduct that resulted in significant financial or reputational harm to the institution," the financial institution can seek to clawback their bonus pay. Because the triggers appear to be based entirely on individual employee misconduct, it is unclear whether they would be interpreted by the courts to cover failures in risk management or culpable negligence in employee oversight. As such, we are concerned that if companies do pursue executive clawbacks, which they are under no obligation to do, they would be unable to reach high-level executives and others whose role is managerial. We encourage you to broaden the triggers for the clawbacks.

Combined, these weaknesses could mean that the practical effects of the deferral and clawback provisions in the proposal will be limited. They are unlikely to increase Wall Street executive accountability to the degree necessary to deter the kind of misconduct we have seen at Wells Fargo and in numerous other cases.

To be clear, we agree with Comptroller Curry and "strongly support completing the [section 956 rule] as quickly as practical."[7] However, we also urge you to address the concerns above to

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[4] OCC et al., "Incentive-Based Compensation Arrangements," 81 *Federal Register 37681*, June 10, 2016
[5] *Id.*, at 37732.
[6] Gretchen Morgenson, *Clawbacks? They're Still a Rare Breed*, N.Y. TIMES, Dec. 28, 2013 (available at: http://www.nytimes.com/2013/12/29/business/clawbacks-theyre-still-a-rare-breed.html?_r=2).
[7] Thomas J. Curry, Testimony to the Senate Committee on Banking, Housing, and Urban Affairs, p. 16. *An Examination of Wells Fargo's Unauthorized Accounts and the Regulatory Response*, September 20, 2016 (available at http://www.banking.senate.gov/public/_cache/files/b536fe39-6a01-423c-b2a9-bf47e2617af9/6A84E268645FE4120535CAE43C198DBC.092016-curry-testimony.pdf).

strengthen the proposed rule to ensure that any final rule serves as a tool for ensuring executive accountability and deterring future instances of misconduct.

Sincerely,

Robert Menendez	Tammy Baldwin
Al Franken	Sherrod Brown
Jack Reed	Elizabeth Warren
Jeffrey A. Merkley	Edward J. Markey
Barbara Boxer	Richard J. Durbin
Richard Blumenthal	Sheldon Whitehouse

Ron Wyden

Kirsten Gillibrand

Patrick Leahy

Ron Wyden

Kirsten Gillibrand

Patrick Leahy