December 17, 2015

The Honorable Thomas J. Curry
Comptroller of the Currency
Office of the Comptroller of the Currency ("OCC")
400 7th Street, S.W.
Washington, DC 20219

The Honorable Janet L. Yellen
Chair
Board of Governors of the Federal Reserve System ("Federal Reserve")
20th Street and Constitution Avenue, NW
Washington, DC 20551

The Honorable Martin Gruenberg
Chairman
Federal Deposit Insurance Corporation ("FDIC")
550 17th Street, NW
Washington, DC 20429

The Honorable Mary Jo White
Securities and Exchange Commission ("SEC")
100 F Street, NE
Washington, DC 20549

Re: Re-proposal of Rules on Incentive-Based Compensation Arrangements

Under Section 956 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), the OCC, the Federal Reserve, the FDIC, the National Credit Union Administration, the SEC, and the Federal Housing Finance Agency (collectively, the "Agencies") are responsible for jointly promulgating regulations or guidelines regarding incentive-based compensation arrangements at covered financial institutions. Proposed regulations were initially published in 2011. *See* 76 Fed. Reg. 21,170 (2011). Recent press reports and public statements suggest that in the near future, the Agencies intend to revise and re-propose the regulations for additional notice and comment.[1] Revision and re-proposal are appropriate. The initial

[1] *See, e.g.*, Evan Weinberger, *SEC Could Bring Dodd-Frank Bonus Proposal in December*, Law360 (Nov. 20, 2015), *available at* http://www.law360.com/employment/articles/729797?nl_pk=d008fa17-f584-4426-

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proposal raised a number of concerns, as reflected in previous comments[2] by the Securities Industry and Financial Markets Association ("SIFMA")[3] and others.

Section 956 directs the Agencies to establish disclosure obligations for covered financial institutions regarding their incentive-based compensation arrangements, 12 U.S.C. § 5641(a), and to "prohibit" any "payment arrangement" that "encourages inappropriate risks" by providing "excessive compensation" or because it "could lead to material financial loss" to the institution, § 5641(b). The statute requires that these regulations be "comparable to," and take into consideration, the standards under 12 U.S.C. § 1831p-1 regarding compensation at institutions insured by the Federal Deposit Insurance Act (FDIA). *See* § 5641(c).

The rules that the Agencies adopt under this provision will have a significant impact on financial institutions' compensation practices, which are critical to recruiting and retaining top talent and to overseeing personnel in the performance of their duties. Accordingly, it will be important that in preparing the revisions to the proposed rules, the Agencies adhere to the requirements of Section 956, to other applicable statutory requirements, and to general principles of administrative law. SIFMA submits this letter to address certain overarching principles that we respectfully submit should guide the Agencies' development of the revised proposal.

Statutory Considerations To Guide The Revised Rules

As the Agencies revise the regulations regarding incentive-based compensation arrangements, it is important, *first*, that the rules' potential costs be fairly evaluated, as the Agencies appear to have recognized in the initial proposal. The Paperwork

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2 *See* Letter from SIFMA (May 31, 2011), *available at http://www.sifma.org/issues/item.aspx?id=25742*

3 SIFMA is the voice of the U.S. securities industry, representing the broker-dealers, banks and asset managers whose 889,000 employees provide access to the capital markets, raising over $2.4 trillion for businesses and municipalities in the U.S., serving clients with over $16 trillion in assets and managing more than $62 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit *http://www.sifma.org*.

Reduction Act requires an assessment of the burden of the rules' disclosure obligations. *See* 44 U.S.C. § 3506(c). Moreover, some agencies have special cost-benefit obligations imposed on their rulemakings by statute. The SEC, for example, acknowledged its responsibility to perform an economic analysis when the compensation rules were initially proposed. *See* 76 Fed. Reg. at 21,196. This is consistent with the SEC's *Current Guidance on Economic Analysis in SEC Rulemakings* (Mar. 16, 2012), which explains that "[t]he Commission has long recognized that a rule's potential benefits and costs should be considered in making a reasoned determination that adopting the rule is in the public interest." Because of Dodd-Frank's requirement that the rulemaking be joint, rulemaking requirements that must be satisfied by one agency will, as a practical matter, need to be satisfied by the rulemaking as a whole.

Apart from special obligations to consider benefits and costs that may be imposed by statute, there is a general obligation—as the Supreme Court recently explained in *Michigan v. EPA*, 135 S. Ct. 2699 (2015)—to evaluate the rules' economic impacts, including whether the rules "ensure cost-effectiveness." *Id.* at 2711. Thus, for example, while the Dodd-Frank Act directs the prohibition of incentive-based compensation arrangements that "encourage[ ] inappropriate risks," § 5641(b), "[o]ne would not say that it is even rational, never mind 'appropriate,' to impose billions of dollars in economic costs in return for a few dollars in" risk-avoidance benefits, *Michigan*, 135 S. Ct. at 2707. The Court explained in *Michigan* that administrative agencies have long considered costs in determining whether and how to regulate, on the "understanding that reasonable regulation ordinarily requires paying attention to the advantages *and* the disadvantages of agency decisions." *Id.*

The re-proposal should heed the Supreme Court's instruction that assessing costs requires "more than the expense of complying with regulations; any disadvantage could be termed a cost." *Id.* For instance, it is necessary to consider 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 regulation. The Agencies should also make compliance with the re-proposal simpler and less burdensome by, among other things, clarifying the regulator to which members of a controlled group should report, and avoiding the use of multiple definitions of the same term (such as "executive officer" and "material risk-taker") for the same purpose. *See* SIFMA Letter at 2–6.

Second, as the Agencies proceed with revisions to the incentive-based compensation rules, it is important that the rules not be unduly vague on key points. After the initial rules were proposed, SIFMA and other commenters objected that some

of the proposal's most important definitions were almost circular or provided little practical guidance to firms. *See, e.g.*, SIFMA Letter at 2–8. As the Supreme Court has cautioned, however, government agencies must provide "fair warning of the conduct [a regulation] prohibits or requires," *Christopher v. SmithKline Beecham Corp.*, 132 S. Ct. 2156, 2167 (2012) (quotation marks omitted). The Court has expressed reluctance to allow agencies to "promulgate vague and open-ended regulations that they can later interpret as they see fit, thereby frustrating the notice and predictability purposes of rulemaking." *Id.* at 2168 (quotation marks omitted). This would prevent the Agencies from giving the rules fuller, more definitive meaning later through administrative "guidance." Multiple justices have even called for the Court to end its practice of deferring to an agency's interpretation of its own regulations. *See, e.g.*, *Perez v. Mortgage Bankers Ass'n*, 135 S. Ct. 1199 (2015) (opinions of JJ. Alito, Scalia, and Thomas).

Indeed, because Section 956 requires the Agencies to act "jointly," particular difficulties would be presented if vaguely worded requirements were set forth in the rules themselves, with the expectation that individual agencies would flesh out the rules' actual meaning and requirements at a later date. Such an approach would appear inconsistent with Congress's requirement that the Agencies' action be joint. And it would remove the clarity that is necessary for the rules to be applied consistently by multiple agencies and across multiple regulated parties.

For these and other reasons, it is important for the re-proposal to deploy meaningful and useful terminology in setting forth firms' obligations. During the initial rulemaking, SIFMA and other commenters observed that the final rule should be clearer about the following questions, among others: Which employees will qualify as an "executive officer" or a "material risk-taker"? How will the rules apply to firms that are part of a larger controlled group containing more than one entity that is a "covered financial institution"? Which types of incentive-based compensation, if any, will be required to be deferred for some period of years? What specific occurrences, if any, will trigger forfeiture of deferred incentive-based compensation? SIFMA respectfully requests that these topics, among others, be addressed more clearly in the re-proposed rules.

Third, the re-proposal must, of course, adhere to the statutory factors set forth in Section 956. Apart from its disclosure requirement, the statute authorizes the Agencies only to "prohibit" payment "arrangement[s]" that "encourage[ ] inappropriate risks" by providing compensation that is "excessive" or could lead to "material financial loss." These governing standards set meaningful limits on the Agencies' discretion, and do not confer general authority to re-design compensation arrangements

based on perceived best practices, emerging international norms, or beliefs about the ideal alignment among compensation, shareholders' interest, and public policy goals. For example, the original proposal would have required individuals' deferred compensation to be "monitored in light of risks taken and outcomes," 76 Fed. Reg. at 21,182, and to be "adjusted for *actual losses or other measures or aspects of performance* that are realized or become better known during the deferral period," *id.* at 21,183 (emphasis added). In addition to being vague—a problem discussed above—this language appears to require a retrospective assessment of performance that goes beyond the Agencies' authority to prohibit identified "arrangements" that the Agencies "determine" "encourage[ ] inappropriate risks." Similarly, when defining the persons that will be subject to any proposed compensation requirements, it is important to carefully differentiate the narrow class of senior executives and employees who genuinely could expose the institution to "material financial loss." Other employees whose roles do not risk material financial loss cannot be covered by the rules, even if they are highly compensated or hold key positions in the company. SIFMA respectfully suggests that the Agencies should re-examine the requirements in the initial proposal in light of Section 956's limited mandate.

The re-proposal should also be guided by Section 956's provision that the regulations must be "comparable" to the standards established under section 1831p-1. On the whole, the existing standards under section 1831p-1 are significantly less detailed and prescriptive than the initial proposed rule under Section 956. Commenters have noted that multiple features of the original Section 956 proposal were not comparable to the section 1831p-1 regulations, including the mandatory requirement that a portion of incentive-based compensation be deferred for a period of three years. The proposed rules described this requirement as "consistent with international standards," 76 Fed. Reg. at 21,180, but notably, did not say that the requirement is comparable to any requirement under the FDIA regulations. And in fact, the FDIC does not impose a similar mandate on all insured depository institutions under section 1831p-1. Similarly, federal banking agencies do not mandate that executives' deferred compensation at insured depository institutions be in a set percentage of debt, rather than equity, as some regulators have intimated may be required under the Section 956 re-proposal.[4] And there is no comparable regulation under section 1831p-1 to the original proposal's suggested limitations on "personal hedging strategies," 76 Fed. Reg. at 31,183, which should not be regulated under Section 956 for the additional

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[4] *See* Remarks by William C. Dudley, President and CEO of Fed. Reserve Bank of N.Y., at Workshop on Reforming Culture and Behavior of the Fin. Servs. Industry, New York City (Oct. 20, 2014), *available at* https://www.newyorkfed.org/newsevents/speeches/2014/dud141020a.html.

reasons that "personal" hedging strategies are not "payment arrangements," 12 U.S.C. § 5641(b), and they are specifically covered by a separate provision (Section 955) of the Dodd-Frank Act. *See* SIFMA Letter at 12.

In issuing the original proposal in 2011, the Agencies observed that, unlike Section 956, the standards under section 1831p-1 do not expressly address compensation arrangements that "encourage[ ] inappropriate risks" that "could lead to material financial loss." Accordingly, the Agencies suggested, the portion of their Section 956 regulations aimed at those types of arrangements did not need to be "comparable" to the standards promulgated under section 1831p-1. 76 Fed. Reg. at 21,178. That is mistaken. The statute is plain that the *entirety* of the rules under Section 956 are to be based on consideration of, and comparable to, the FDIA standards in section 1831p-1.

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The incentive-based compensation rules required by Section 956 of the Dodd-Frank Act could have a significant impact on practices in the financial services industry. SIFMA respectfully requests that the Agencies consider the principles set forth above as this important rulemaking proceeds. We look forward to providing our comprehensive comments and suggestions when a re-proposal is issued. Please do not hesitate to contact Peter Matheson at 202-962-7324 if you would like to discuss these matters further.

Kenneth E. Bentsen, Jr.
President & CEO

Cc:
The Honorable Melvin L. Watt, Director
Federal Housing Finance Agency

The Honorable Debbie Matz, Chairman
National Credit Union Administration