SIFMA
Securities Industry and Financial Markets Association

November 25, 2009

Via Electronic Delivery

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, D.C. 20551

Re: Proposed Guidance on Sound Incentive Compensation Policies (Docket No. OP-1374)

Dear Ms. Johnson:

The Securities Industry and Financial Markets Association ("SIFMA")[1] is submitting this letter in response to the request by the Board of Governors of the Federal Reserve System (the "Board") for comments on the Proposed Guidance On Sound Incentive Compensation Policies (74 FR 55227 (Oct. 27, 2009)) (the "Proposed Guidance"). We appreciate the opportunity to comment on certain of the matters discussed in the Proposed Guidance.

The Proposed Guidance's Three Core Principles

We believe that the Proposed Guidance's use of three core principles (balanced risk-taking incentives; compatibility with effective controls and risk management; and strong corporate governance) provides a thoughtful and effective method for ensuring the consistency of banking organizations' incentive compensation arrangements and policies with the principles of safety and soundness. The Proposed Guidance notes that "incentive compensation arrangements are one way that firms can encourage managers and other employees to take actions that are consistent with the interests of shareholders by appropriately rewarding behavior that increases the organization's revenue, profits, or other measures of performance," and the three core principles provide banking organizations with the necessary flexibility to continue to effectively use incentive compensation arrangements in this manner. We concur with the Proposed Guidance's statement that its use of these principles is consistent with the Principles for Sound Compensation Practices adopted by the Financial Stability Board in April 2009 (the "April Principles") and we believe that its primary focus on maintaining the safety and soundness of banking organizations is wholly appropriate. For reasons discussed in more detail under "Unintended Consequences"

[1] The Securities Industry and Financial Markets Association brings together the shared interests of securities firms, banks and asset managers. SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members' interests locally and globally. It has offices in New York, Washington D.C., and London and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong.

below, we are of the opinion that neither additional principles nor more substantive rules would be effective in promoting this goal.

While SIFMA is in agreement with the core principles, we recommend that the final guidance confirm that firms may, in their discretion, consider risk-taking incentives on a group, rather than individual, basis. While this is certainly what the Proposed Guidance contemplates with respect to a large group of non-executive employees, it is also true that individuals working together on a trading desk may not need to be assessed individually.

Use of Formulaic Limits

We do not believe that formulaic limits are likely to be effective in promoting the safety and soundness of banking organizations. The April Principles emphasized that "[o]ne size does not fit all – financial firms differ in goals, activities and culture, as do jobs within a firm." We do not think that applying formulaic limits or requirements to the determination or payment of incentive compensation is consistent with this view. Furthermore, as discussed in greater detail below, unintended consequences are far more likely to arise from rigid rulemaking than from a flexible, principles-based approach.

Information Collection and Public Disclosure

We believe that the Board's proposed collection of information is likely to be overly burdensome for affected banking organizations. We think that the forty-hour estimate provided in the Proposed Guidance with respect to the time to be spent on information collection is unrealistic and would prove to be a fraction of the time necessary to assemble such information. We strongly urge the Board to carefully consider the amount of material requested and its precise relationship to matters of safety and soundness in order to maintain an appropriate cost-benefit balance.

In recognizing the need for clear disclosure relating to compensation policies, we encourage the Board to consider the extent to which public disclosure of the information that is collected as part of the proposed supervisory process is consistent with principles of safety and soundness. We support disclosure that is geared towards a firm's shareholders in a way that helps them to ensure that incentive compensation arrangements do not encourage employees to take risks beyond the risk tolerance of shareholders. We expect that such disclosure would be most relevant and appropriate in a form similar to the Compensation Discussion and Analysis that the Securities and Exchange Commission ("SEC") requires all U.S. public companies to file annually. We note that the SEC's proposed rules, released in July 2009, would require new disclosure relating to the relationship between compensation policies, risk management practices and/or risk-taking incentives for employees. We do not believe that charts with data relating to specific incentive compensation arrangements for a number of a banking organization's employees would contribute to safety and soundness or provide information material to investors. As an example, disclosure of compensation bands is neither conducive to safety and soundness nor material to investors generally.

Unintended Consequences

We believe that the surest way to mitigate the potential for negative unintended consequences arising from the Proposed Guidance is for the Board to maintain its principles-based approach. We support the Proposed Guidance's emphasis on process, rather than rigid formulaic regulation, as we believe that this approach encourages both management and the Board of Directors of a banking organization to rely on their appropriate judgment as informed by the principles put forward in the Proposed Guidance. This principles- and process-based approach gives a banking organization the flexibility necessary to manage its business while simultaneously giving due regard to the guidance of the Board in respect of protecting its safety and soundness and not incentivizing excessive risk-taking. By contrast, a more formulaic approach to regulating incentive compensation, even if implemented with the intent of promoting safety and soundness, runs the risk of unintentionally driving firms to adopt incentive compensation arrangements that may not prove to be sufficiently effective in terms of disincentivizing excessive risk-taking. Furthermore, mandating a single compensation structure for twenty-eight large, complex banking organizations in a formulaic manner would likely increase, rather than decrease, the potential for systemic risk.

Incentive compensation arrangements are also affected by tax and employment law issues. Mandating specific compensation requirements will likely give rise to conflicts between such requirements and the tax and employment laws that are already in place. These types of conflicts are far more easily avoided with a principles-based approach.

Additional Issues

Reconciling Proposed Guidance with Foreign Regulation

We would like to express a general concern relating to the inconsistent supervisory reform efforts that have recently been advanced in a number of jurisdictions around the world. Many multinational banking organizations stress a policy of a unified global organization, including in the area of compensation structure. If these organizations are to be subject to multiple regulatory or supervisory schemes relating to incentive compensation arrangements, it is crucial that these schemes be as consistent as possible. While a consistent approach to principles-based versus rule-based regulation is desirable, consistency in the jurisdictional scope of each regulatory scheme is similarly important. We note that the Proposed Guidance gives deference to foreign banks' home country supervisors, which seems to us appropriate. We additionally note that U.S. banking organizations are likely to be subject to both the Proposed Guidance and, with respect to each branch or subsidiary operation, the rules of the jurisdiction in which such branch or subsidiary is located (for instance, a U.S. banking organization's U.K. branch will be subject to the remuneration rules promulgated by the U.K. Financial Services Authority). Generally, if a regulated entity is part of a banking group, and its compensation policies, governance and practices satisfy the required standard of the supervisory authority of the parent bank or head office that should be accorded deference by regulatory authorities in host countries. We urge the Board to continue to consult with foreign regulators so that these approaches to incentive compensation regulation are harmonized.

Use of Prescriptive Examples

We would request that the Board clarify in the final version of the Proposed Guidance that its use of examples of certain compensation practices is not intended as prescriptive guidance, but rather that such examples are intended only as an explanatory tool to clarify the intent of the Proposed Guidance's principles. For example, although the Proposed Guidance questions the use of a standard three-year deferral period, we expect that the Board does not mean to imply that a standard deferral period is per se inappropriate, but rather that a banking organization should consider the use of such a practice in light of the overarching goal of appropriately incentivizing its employees.

Use of "Golden Parachutes" and "Golden Handshakes"

As stated above, given the broad and varied scope of activities in which different banking organizations engage, we do not believe that limits or bans on "golden parachute" and "golden handshake" arrangements are an effective means of protecting a banking organization's safety and soundness. While we support the Proposed Guidance's concern that a "golden parachute" arrangement might incentivize an employee to act without regard to risk or risk outcomes, we believe that the potential benefits to a banking organization of such arrangements (e.g., increased retention, improved employee job focus, etc.) do not support a formulaic limitation or outright ban. For example, we note with interest the Board's view that "provisions that require an employee to forfeit deferred incentive compensation payments upon departure from the organization may weaken the effectiveness of the deferral arrangement in achieving balance by removing the employee's financial exposure to the risk outcomes of the employee's activities at the firm." This view, which differs from the views of other regulators who have advocated for the necessity of forfeitures, illustrates that "one size does not fit all." Each institution must determine for itself, based on its own needs, what compensation practices will best promote its safety and soundness. Consequently, we believe that deferred compensation arrangements are best regulated as part of the corporate governance process.

Expertise of Members of the Compensation Committee

We note the proposed guidance for large, complex banking organizations that one or more of the board of directors should have a level of expertise and experience in risk management and compensation practices in the financial services industry that is appropriate for the nature, scope, and complexity of the organization's activities. We urge the Board to recognize that the necessary expertise and experience can be obtained from serving as a member of a compensation committee or a risk committee. Such recognition would accord with the practice of boards that seek members with broad experience and sound judgment to provide leadership in a wide range of circumstances over a substantial period of time and who gain more particularized experience from their service over time. It should also be recognized that compensation and risk management expertise can be obtained from independent compensation consultants, outside counsel and/or risk management specialists and does not necessarily have to reside in individual committee members.

Deadline for Submission of Compliance Plans

We understand that the Board has informally set a deadline of February 1, 2010 for large, complex banking organizations to submit to the Board an initial plan for compliance with the final version of the Proposed Guidance. A later date, perhaps June 1, 2010, would allow organizations more time to thoroughly assess and, to the extent necessary, modify their incentive compensation practices in light of the final version of the Proposed Guidance.

We thank you for the opportunity to submit this comment letter. We would be happy to discuss with you any of the comments described above or any other matters you feel would be helpful in your review of the Proposed Guidance and the comments you receive. Please do not hesitate to contact Liz Varley at 202-962-7329 or via email at evarley@sifma.org if you would like to discuss these matters further.

Sincerely,

Kenneth E. Bentsen, Jr.
Executive Vice President, Public Policy and Advocacy
Securities Industry and Financial Markets Association

cc: Scott Alvarez
William Treacy
Mark Carey