June 22, 2016

BY ELECTRONIC MAIL:

Brent J. Fields
Secretary, Securities and Exchange Commission
100 F Street, NE., Washington, DC 20549

RE: Comments on Incentive-based Compensation Arrangements; File Number S7-07-16

Dear Secretary Fields:

The Arlington Young Democrats (AYD) respectfully submit the following comments on the proposed regulations of Executive Incentive-based Compensation Arrangements, jointly proposed by the Department of the Treasury, Federal Reserve System, Federal Deposit Insurance Corporation, Federal Housing Finance Agency, National Credit Union Administration, and the Securities and Exchange Commission.

As the largest Young Professional Chapter of the Virginia Young Democrats, AYD has a diverse membership of students and young professionals committed to making a positive impact in the Arlington community and supporting issues important to young people in Arlington, the Commonwealth of Virginia, and nation-wide. In this capacity, we strongly support the proposed regulations requiring covered financial institutions to appropriately balance risk and reward in its incentive-based compensation scheme.

1. Poorly Designed Incentive-Based Compensation Packages Resulted in Risky Business Practices that Lead to the 2008 Financial Crisis

As the drafters of these regulations appropriately noted, "[t]here is evidence that flawed incentive-based compensation practices in the financial industry were one of many factors contributing to the financial crisis that began in 2007"[1] and continued into 2008. These flawed incentives include factors such as providing bonuses to employees for boosting the immediate profits of the company regardless of the risks assumed by the deal. For example, in the time leading up to the financial crisis many mortgage lenders saw higher personal profits for selling Adjustable Rate Mortgages (ARMs) which would have a ballooned interest rate after several years than for selling a traditional 30 year fixed interest mortgage. As the quality of the underlying loans decreased over time—increasing the overall risk to the market—the lenders were still compensated by the same

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[1]SEC Proposed Rules, S7-07-16, *available at:* https://www.sec.gov/rules/proposed/2016/34-77776.pdf

structure. Essentially, the system incentivized lenders to focus on the number of loans they could make regardless of the suitability of the borrower and the borrower's ability to repay the loan.

With a system designed to compensate lenders based on the quantity of loans they made, rather than the quality, it is unsurprising that the lenders found new ways to provide loans to as many borrowers as possible without taking into consideration the borrowers' ability to repay the loan. Compounding the issue, financial institutions found new ways to expand the pool of borrowers despite the risk to the overall system. Primarily, financial institutions tried to dilute the risk of the subprime mortgages by incorporating them into collateralized debt obligations (CDOs) that were then sold as new "diversified" financial instruments.

In addition to the diluted sense of risk created by the proliferation of CDOs, large financial institutions continued to create new and complicated financial instruments built on the precarious foundation of the mortgage market. These instruments, such as credit default swaps (where the buyer insures against the default of a loan) and synthetic CDOs (a CDO comprised of credit default swaps), enabled many individuals traders to make enormous short term financial gains. However, these same individuals saw little pecuniary loss when the underlying mortgage market collapsed in 2008 and reduced the median net worth of families by nearly 40 percent.[2]

2. The 2008 Financial Crisis Economically Injured Students and Young Professionals Irreparably

With many of our members entering the workforce at the height of the financial crisis and following Great Recession, we saw first hand the consequences of a financial investors making business decisions fueled by extreme personal gain without regard for the day-to-day lives of the people's whose money they were investing. Almost a decade later, financial analyst still see the lasting effects the financial crisis had on Millennials, with the head of UBS investor insights once stating that "Millennials seem to be permanently scarred by the 2008 financial crisis...[t]hey have a Depression-era mind-set largely because they experienced market volatility and job security issues very early in their careers, or watched their parents experience them..."[3]

Beyond the psychological impact the financial crisis had for young professionals starting their careers, there is significant research indicating that recent graduates, high school or college, will see significant and long-lasting economic consequences when graduating in a weak economy.4 Young professionals, all of whom are now considered part of the Millennial generation, are still unemployed and underemployed at rates higher than before the Great Recession. Wages for recent graduates, both high school and college, have remained relatively flat since 2000 despite the massive increased cost to higher education and related student loan debt. Additionally, the quality of the jobs available to young professionals has declined overall as many employers of young professionals do not provide benefits such a pensions. Even with the economic recovery

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[2] Yian Q. Mui, *Americans saw wealth plummet 40 percent from 2007 to 2010, Federal Reserve Says*, THE WASHINGTON POST, Jun. 11, 2012, *available at:* https://www.washingtonpost.com/business/economy/fed-americans-wealth-dropped-40-percent/2012/06/11/gJQAlIsCVV_story.html

[3] Walter Hamilton, *Study: Millennial generation most fiscally cautions since Depression*, LOS ANGELES TIMES, Jan. 28, 2014 *available at:* http://articles.latimes.com/2014/jan/28/business/la-fi-mo-millennial-generation-financially-conservative-depression-20140128 (quoting UBS head of investor insights Emily Pachuta).

from the Great Recession, we are in the eighth year of weak economic growth and a significant portion of the workforce is still struggling to find full employment and decent wages.

3. Proposed Regulations are a Small Step to Safeguard Financial Markets from Bad Actors that Could Cause Another Financial Crisis

Many factors led up to the 2008 Financial Crisis and ensuing Great Recession and no single entity is solely responsible for the market collapse that gravely injured the economic prospects of millions of young professionals. However, it is prudent that we learn from the systemic failures leading up to the crisis to prevent a future economic downturn. One such protection would be to enact the proposed rule governing incentive-based compensation arrangements for executives at covered financial institutions.

Under the proposed rule, the leaders within the financial services industry will have their bonuses tied not just to immediate performance and profits but contingent on the long-term impact of their decisions. The proposed rule remains flexible enough to account for typical market risk while empowering the regulatory bodies to intervene if an executive makes too risky of a decision that negatively impacts the business. Importantly, these rules allow regulatory bodies to determine what an improper risk is, enabling the regulators to nimbly adapt to new financial products and concepts. This small, but important, step toward a stronger regulatory framework surrounding the financial services industry will help re-align the incentives of day to day business decisions with supporting the long-term fiscal health of the business.

For the aforementioned reasons, the Arlington Young Democrats strongly support this proposed rule.

Sincerely,

The Arlington Young Democrats

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