May 25, 2011

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F. Street, NE
Washington, DC 20549-1090

Re: Proposed Rules on Incentive-Based Compensation Arrangements Release No. 34–64140; File No. S7-12-11

Dear Ms. Murphy:

The undersigned organizations and institutions represent hundreds of thousands of businesses, small and large, from all sectors of the economy employing tens of millions of Americans, as well as non-profit public policy groups interested in fostering entrepreneurship and investor return. We welcome this opportunity to comment on the Proposed Rules on Incentive-Based Compensation Arrangements ("proposed rules") proposed by the U.S. Securities and Exchange Commission ("SEC").

Rules concerning incentive compensation should be precisely crafted to accomplish the regulatory goals but still provide covered financial institutions with maximum flexibility to incentivize employees' performance in the long-term interests of such firms' clients and investors. We believe that an overly rigid or uniform approach that ignores the many unique factors impacting individual companies and their industries has the potential to do more harm than good, and indeed may actually introduce risk to the financial system.

Flexibility should be built into these proposed rules to take into account the unique characteristics of each firm's ownership structure and business model, which must account for numerous factors that influence the appropriateness of a firm's compensation program design. As a practical matter, we believe that it is the firms themselves who, together with their investors and clients, are in the best position to assess the reasonable business risks that are associated with a particular incentive compensation arrangement.

Moreover, competition for talent in the financial services sector is fierce and cuts across business models and lines. Broker-dealers and investment advisers compete with each other, and with businesses of all types for talent; boutiques compete with large firms; domestic firms compete with global players, and; financial firms compete with non-financial firms for talent. The reality that human capital is the operating infrastructure of a financial institution must be factored into any analysis of employees' incentive compensation arrangements. The quality of the workforce and ability to attract talent are long-term indicators of the financial institution's ability to be successful and profitable.

Appropriate compensation practices that allow employees to engage in reasonable risk taking and long-term decision making are of great importance. Narrow and rigid compensation policies and practices will drive away talent and erode the foundation and long-term viability of a firm, contributing new and additional unintended risks to the system and harming the competitiveness of the U.S. financial services industry.

Our concerns are centered upon the following issues:

- One-Size-Fits-All Approach
- SEC Economic Analysis
- "Excessive Compensation" and "Inappropriate Risk"
- Calculation of "Total Consolidated Assets"
- "Covered Financial Institution"
- Defining "Incentive-Based Compensation"
- Reporting Requirements
- Timing of Annual Reports

A detailed discussion of our concerns is provided below.

Background

Section 956 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act") requires the SEC, as well as the OCC, Board of Governors of the Federal Reserve System ("Board"), FDIC, OTS, NCUA, and FHFA (together "the Agencies") to jointly prescribe regulations or guidelines with respect to incentive-based compensation practices at covered financial institutions. Specifically, Section 956 requires that the Agencies prohibit incentive-based payment arrangements, or any feature of any such arrangement, at a covered financial institution that the Agencies determine encourages inappropriate risks by a financial institution by providing excessive compensation or that could lead to material financial loss. Under the Act, a covered financial institution also must disclose to its appropriate Federal regulator the structure of its incentive-based compensation arrangements sufficient to determine whether the structure provides "excessive compensation, fees, or benefits" or "could lead to material financial loss" to the institution.

Discussion of Concerns Regarding the Proposed Rules

One-Size-Fits All Approach

This joint agency rulemaking—based on the *Guidance on Sound Incentive Compensation Policies* adopted by the OCC, Board, FDIC, and OTS, which itself is relatively new and its impact on competition largely unknown—attempts to impose a one-size-fits-all approach to financial regulation. Given that various forms of financial market participants each operate in a unique fashion, it is inappropriate to regulate them as if they were all the same. For instance, such basic risk factors as liquidity and diversification are wholly different for managers of mutual funds, private equity funds, hedge funds, investment banks and broker-dealers, yet each of these broad categories of institutions would be subject to the same proposed rules. It is unrealistic to expect one set of rules to be equally applicable to all types of financial institutions that would be swept under these proposed rules. Guidelines could, perhaps, be generally applicable, but the Agencies have proposed rules, which require a more tailored approach that reflects these distinctions.

Because the issues involved are complex, far-reaching, and introduce a number of unknowns into the compensation decision making process, we believe it would be appropriate to convene a series of working groups comprised of investors and institutions representing each of the industries affected by these proposed rules to gain a fuller understanding of the true impact that these rules would have on the ability of covered institutions in each covered industry to raise capital and compete globally. We further recommend that such working groups address each of the issues discussed below.

Informed by the recommendations of these working groups, the SEC should carefully consider revisiting the mandates of Section 956 as guidelines rather than rules. The SEC may very well determine that guidelines are preferable if the working groups recommend significantly different approaches for the different industries involved. It also may need to consider whether a second comment period is necessary to explore any issues raised by the working groups that have not been sufficiently considered during the current comment process.

SEC Economic Analysis

The SEC's economic analysis focuses primarily on the proposed rules' potential costs in terms of administrative burdens on covered financial institutions. The proposed rules' true costs to covered institutions cannot be estimated without due consideration of 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 rules.

Accordingly, the SEC should provide much more robust estimates of the costs and benefits associated with implementation of these rules. Additionally, the SEC should disclose the detailed basis for the estimates provided in its cost-benefit analysis, and, specifically, should explain in detail why conditions assumed to be applicable to banks would be applicable to non-bank broker-dealers and investment advisers, especially given the differences between those entities in terms of risk profiles, operations, regulation, and hiring and retention practices and challenges.

"Excessive Compensation" and "Inappropriate Risk"

"Excessive Compensation"

Competition for Talent. Covered financial institutions face intense competition for talent. Employees can be lured away by direct competitors, global firms, or different industries. Accordingly, a flight of talent from covered financial institutions to other industries or institutions that are not subject to these rules may create a brain drain that can be destructive to the covered institutions. Such an exodus of skill, intelligence, and experience can quickly erode an institution's talent base and impede its ability to compete.

This competitive environment must be factored into any analysis of covered financial institutions' incentive compensation arrangements. A covered financial institution may appropriately put in place incentive compensation arrangements that differ from those of comparable covered financial institutions because it believes that such differing arrangements are necessary to attract and retain the best talent in a competitive environment. Accordingly, we request that the SEC also consider competition for talent as a factor that appropriately affects whether a compensation arrangement is "excessive," particularly in light of the fact that covered institutions must compete with one another as well as with firms that are not "covered financial institutions" subject to these proposed rules.

Comparable Compensation Practices at Comparable Institutions. In determining whether an incentive-based arrangement provides "excessive compensation," the proposed rules provide a number of enumerated factors for the SEC to consider, including "comparable compensation practices at comparable covered financial institutions, based upon such factors as asset size, geographic location, and the complexity of the covered financial institution's operations and assets." The fact that compensation practices fall within the range of compensation practices at comparable institutions strongly suggests that such compensation practices are not excessive. At the same time, compensation practices that differ from those of comparable covered financial institutions should not be presumed to be excessive, because compensation is company specific. In such cases, additional analysis may be required to determine why an institution's compensation practices appear to diverge from those of comparable institutions.

The Financial Condition of the Covered Financial Institution. In determining whether an incentive-based arrangement provides "excessive compensation," the proposed rules provide that "the financial condition of the covered financial institution" is a factor for the SEC to consider. With respect to this factor, we note that high performing employees of high performing institutions would naturally be expected to share in the institutions' success, provided that adequate measures are taken to manage pay riskiness. Additionally, institutions that have experienced financial difficulty may need flexibility to set compensation arrangements that attract and retain personnel who will be key to improving performance, provided that adequate measures are taken to manage pay riskiness.

"Inappropriate Risk"

The prohibition against incentive-based compensation arrangements that encourage "inappropriate risk" provides that an arrangement will not be in compliance unless it: (i) balances risk and financial rewards, for example by using deferral of payments, risk adjustment of awards, reduced sensitivity to short-term performance, or longer performance periods; (ii) is compatible with effective controls and risk management; and (iii) is supported by strong corporate governance, including active and effective oversight by the covered financial institution's board of directors or a committee thereof.

Risk-taking is at the core of the free enterprise system, and is the essential factor distinguishing it from other types of financial systems. We agree that there is a distinction to be made between appropriate and inappropriate risk-taking, but the distinction is a facts and circumstances one that calls for a good degree of experience and judgment as applied to individual cases. Whether appropriate or inappropriate, there is no escaping the reality that risk can result in losses as well as in gains.

While the proposal provides several pages describing each of the above mentioned standards of "inappropriate risk" in greater length, these lengthier descriptions are in some respects circular and provide little practical insight to guide institutions' efforts to achieve compliance with this prohibition. For example, "inappropriate risks" are described as those that "may encourage inappropriate risks that could lead to material financial loss" or "may encourage excessive risk-taking." As is implicit in the rules' use of "inappropriate," not all risks would lead to a violation. All financial institutions take risks, including some that may expose the firm to a material financial loss. Accordingly, it will be crucial for these firms to be able to clearly distinguish between "appropriate" and "inappropriate" risks in order to comply with the proposed rules.

Under the "Compatibility with Effective Controls and Risk Management" heading, it is noted that covered financial institutions must ensure that risk-management personnel "have an appropriate role in the institution's processes for designing incentive-based compensation arrangements, monitoring their use, and assessing whether they achieve balance." We believe that a full understanding of the risks associated with a particular institution's activities requires intimate familiarity with the particular institution, and believe the SEC should allow a reasonable amount of deference to the well-informed judgment of personnel who are familiar with the institution, including what role, if any, would productively be played by risk-management personnel. The determination of the "appropriate" role of risk-management personnel in designing incentive-based compensation arrangements, monitoring their use, and assessing whether they achieve balance, should be left to the institutions' reasonable judgment.

Calculation of Total Consolidated Assets

The proposed rules apply to covered financial institutions that have total consolidated assets of $1 billion or more, with additional requirements for covered financial institutions that have total consolidated assets of $50 billion or more. For broker-dealers registered with the SEC, asset size would be determined by the total consolidated assets reported in the firm's most recent year-end audited Consolidated Statement of Financial Condition filed pursuant to Rule 17a-5 under the Securities Exchange Act of 1934. For investment advisers, asset size would be determined by the adviser's total assets shown on the balance sheet for the adviser's most recent fiscal year end.

Indexing for Inflation. We believe that the $1 billion and $50 billion asset thresholds should be indexed for inflation so that, in the future, only those institutions whose assets, in real terms, are equivalent to $1 billion and $50 billion today will be swept into the coverage of these rules. This would help ensure that the asset thresholds remain constant in real terms in the future and that smaller institutions, which are currently intended to be outside the scope of this rule, are not unintentionally brought within its scope in the future merely because of inflation.

Balance Sheet Assets. We note that there is currently some uncertainty with respect to requirements under US GAAP regarding the circumstances in which the assets of certain funds managed by an investment adviser should be included in the balance sheet of the investment adviser. Third party non-proprietary assets invested in funds managed by the adviser should be excluded from the adviser's total assets, even if those funds are required to be consolidated under GAAP.

Exclude Deferred Compensation and Bonuses Payable. Deferral of some compensation is required for firms above the $50 billion threshold, and is a factor of pay riskiness for covered firms below the $50 billion threshold. Assets set aside as deferred compensation and bonuses payable should be excluded from firms' assets because the inclusion of these assets—which have been earned or accrued by employees but not yet paid—for purposes of calculating the firm's total consolidated assets both overstate the firm's assets and provide a disincentive for firms to voluntarily defer employee compensation.

Covered Financial Institution

Many firms are complex, multi-level organizations comprised of numerous subsidiaries and affiliates, some of which may meet the definition of a covered financial institution while others do not. It is essential that the definition of "covered financial institution" is clear and unambiguous in the final rule. We believe that the covered financial institution should be defined as the entity identified in Section 956(e)-(f), and should not be expanded to include affiliated companies such as subsidiaries and parent companies that do not themselves qualify as covered financial institutions.

We further believe that any covered financial institution (a "parent CFI") should be permitted to comply with these rules on its own behalf and on behalf of any subsidiary that is itself a covered financial institution (a "subsidiary CFI") by adopting procedures and by making reports to the parent CFI's primary regulator that cover both the parent CFI and any subsidiary CFIs. Firms should be permitted the flexibility – but not required – to comply separately. Some firms may decide that it would be more appropriate to treat subsidiary CFIs as separate and distinct covered financial institutions, with separate policies and procedures and separate reporting obligations to a different regulator. Others may prefer to take a more holistic approach with respect to their policies and reports.

Defining Incentive-Based Compensation

The proposed rules define "incentive-based compensation" to mean any variable compensation that serves as an incentive for performance. The notice further indicates that the definition is broad and principles-based in order to address the objectives of Section 956 in a manner that provides for flexibility as forms of compensation evolve.

The notice also indicates that certain types of compensation would not fall within the scope of the definition, including 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, we request that the final rule 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 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 purpose of these rules, would therefore tend to encourage less risky behavior. 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 pay riskiness.

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 would be excluded, because it is the grant-date value that is considered when compensation decisions are made. The final rules 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.

Reporting Requirements

The proposed rules would require that a covered financial institution submit a report annually to its appropriate regulator or supervisor in a format specified by its appropriate Federal regulator. Such report would be required to describe the structure of the covered financial institution's incentive-based compensation arrangements for covered persons. The Agencies note that they have intentionally chosen phrases like "clear narrative description" and "succinct description" to describe the disclosures being sought.

We applaud the SEC's decision to keep its instructions broad and to clarify that reports should be "succinct". In light of the general trend towards increased disclosures rather than improved disclosures, it is appropriate that the proposed rules seek to elicit such information through broad requirements that enable covered financial institutions to tailor their reports to their own situations in a succinct manner.

In addition, we note that the proposed rules apply to incentive compensation arrangements "established or maintained" by the institution. We request that the SEC clarify that the requirements of proposed §248.205 be applied prospectively, and not retroactively to compensation that has been previously awarded but not paid, or to compensation subject to existing employment agreements.

Timing of Annual Reports

With respect to the timing of reports, we are concerned that the requirement that total consolidated assets be determined based on a single date snapshot may inadvertently capture firms that only meet the $1 billion threshold on that particular date. In order to avoid inadvertently covering firms that would ordinarily fall below the $1 billion or $50 billion threshold, financial institutions should be permitted, where appropriate, to elect to measure assets by reference to another date that is more indicative of its true situation, or instead use a median or average of a period of months or consecutive reporting periods (similar to the approach adopted by the OCC, Board, FDIC, OTS and NCUA), provided that the methodology used to select the reference date is applied consistently year-over-year.

Such flexibility regarding the annual filing date may also be important to permit firms to select a reference date that coincides with their annual compensation review. This would minimize uncertainty likely to result from a reference date that differs from the date on which compensation decisions are finalized.

Conclusion

The undersigned organizations and institutions once again would like to thank the SEC for the opportunity to comment on the proposed rules. Without question, financial institutions should avoid excesses that imperil the long-term viability of the firm. However, the SEC's rules and regulations must be crafted to allow financial institutions to design the types of compensation arrangements that will attract and retain talented personnel. Profitable, stable financial institutions will ensure vibrant capital markets which are the engines and providers of long-term job growth. Appropriately crafted rules that recognize the significant differences between market participants can assist in the effective operation of capital markets, while improper rules or enforcement can create underperformance values that will harm economic growth.

Sincerely,

Center on Executive Compensation
The Financial Services Roundtable
Investment Adviser Association
Investment Company Institute
Managed Funds Association
Private Equity Growth Capital Council
The Real Estate Roundtable
United States Chamber of Commerce