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United States Senate

WASHINGTON, DC 20510

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OFFICE OF THE SECRETARY

March 31, 2011

Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

RE: RIN 3064 – AD56, "Incentive-based Compensation Arrangements"

Dear Secretary Feldman:

We write today to comment on a rule jointly prescribed by federal regulators to implement Section 956(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (P.L. 111-203), concerning the prohibition of certain compensation arrangements to deter excessive risk-taking at major financial institutions.

On page 49 of the proposed rule, the agencies questioned if the use of personal hedging strategies – such as financial derivatives, insurance contracts, etc. – on incentive-based compensation arrangements for highly-paid executives would make many of the provisions prescribed by the agencies less effective. The agencies invited comments as to whether limits should be placed on these personal hedging strategies.

We strongly believe that hedging strategies used by highly-paid executives on their own incentive-based compensation should be prohibited. Quite simply, the use of hedging takes the "incentive" out of incentive-based compensation, undermining accountability of the executives who engage in these tactics.

There is ample evidence to suggest that this is not only a widespread problem, but also a problem that has serious implications for investors and for the health of the companies that the executives work for.

Carr Bettis, the co-founder of the forensic accounting firm Gradient Analytics and co-author of a recent study on hedging found 2,010 hedging transactions reported in filings by 1,181 executives at 911 firms over a ten-year period from 1996 to 2006.[1] A recent article in Bloomberg Businessweek describes the potential impact these transactions may have on investors:

> "There is no question these transactions should be a red flag for investors," says Carr Bettis. "The evidence is pretty compelling that hedges tend to be used before bad news hits the market." Bettis' research found that in the year after executives and directors had engaged in hedging, their company's stock often dropped markedly. He also found evidence of an increase in financial

[1] http://www.businessweek.com/magazine/content/10_10/b4169044647894.htm

restatements and shareholder lawsuits during the same period. Executives at MCI, Enron, ImClone, Krispy Kreme – companies that suffered some of the great stock melt-downs of the last decade – hedged their shares.[2]

In 2009 alone, 107 instances of executive hedging were reported to the SEC.[3]

Other governmental offices have taken exception with the tactic. Kenneth Feinberg, the U.S. Treasury Special Master for TARP Executive Compensation, who was responsible for overseeing the distribution of compensation to top executives at companies that received federal bailout assistance, banned executives under his jurisdiction from this practice. He said, "We wanted to make sure they couldn't undercut the links we created between compensation and long-term performance."[4]

And many companies, perhaps realizing the hypocrisy in this practice, have banned it themselves. Johnna Torsone, the chief human-resources officer at Pitney Bowes Inc. has said, "We think it is inappropriate for senior employees to, in effect, bet against the company."[5] Procter & Gamble and Kellogg have reportedly banned these tactics.[6] However, many large banks such as JPMorgan Chase, Morgan Stanley and Goldman Sachs ban only their highest-ranking executives.[7]

During debate of the Dodd-Frank Act, we offered Senate Amendment #3818 to prohibit exactly this type of behavior. The amendment would have banned executives and other highly-compensated employees – those making more than $1 million – from engaging in trades that would bet against their own company's stock. While the amendment was not voted on, it was supported by several advocacy groups and prominent figures, including Americans for Financial Reform, the Council of Institutional Investors, and former SEC Chief Accountant Lynn Turner.

We continue to stand by this legislation. Stock hedging significantly undermines the purpose of incentive-based compensation. Executives should benefit when their company does well. If allowed to hedge, it takes their company out of the equation, allowing them to profit regardless, and further encourages excessive risk-taking.

In short, we would strongly urge the agencies to consider including prohibitions preventing highly-paid executives from hedging in any way on incentive-based compensation arrangements. We thank you for the opportunity to comment.

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[2] http://www.businessweek.com/magazine/content/10_10/b4169044647894.htm
[3] http://www.businessweek.com/magazine/content/10_10/b4169044647894.htm
[4] http://www.businessweek.com/magazine/content/10_10/b4169044647894.htm
[5] http://online.wsj.com/article/SB124407837568483691.html
[6] http://www.businessweek.com/magazine/content/10_10/b4169044647894.htm
[7] http://dealbook.nytimes.com/2011/02/05/stock-hedging-lets-bankers-skirt-efforts-to-overhaul-pay/

Sincerely,

Robert Menendez
United States Senator

Jeff Merkley
United States Senator

Frank Lautenberg
United States Senator

CC: Office of the Comptroller of the Currency
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Docket Number OCC-2011-0001

Jennifer J. Johnson
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Board of Governors of the Federal Reserve System
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Docket No. R-1410

Regulation Comments
Chief Counsel's Office
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Washington, DC 20552
Attention: OTS-2011-0037

Mary Rupp
Secretary of the Board
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Elizabeth M. Murphy
Secretary
Securities and Exchange Commission

100 F Street, NE
Washington, DC 20549
File Number: S7-12-11

Alfred M. Pollard
General Counsel
Attention: Comments/RIN 2590-AA42
Federal Housing Finance Agency
Fourth Floor
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