



3-1-2017

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Recommended Citation

Justin H. Mims, *The Wells Fargo Scandal and Efforts to Reform Incentive-Based Compensation in Financial Institutions*, 21 N.C. BANKING INST. 429 (2017).

Available at: <http://scholarship.law.unc.edu/ncki/vol21/iss1/21>

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The Wells Fargo Scandal and Efforts to Reform Incentive-Based Compensation in Financial Institutions

I. INTRODUCTION

Without proper safeguards, incentive-based compensation arrangements in financial institutions may encourage excessive risk-taking by employees, leading to serious financial loss for financial institutions.¹ The incentive to take excessive risk was a contributing factor to the financial crisis that began in 2007, with some saying that employee incentives were “most at fault in contributing to the financial crisis.”² For example, in incentive-based compensation arrangements, a high-risk loan has the potential to generate more revenue for the financial institution, and consequently more compensation for the employee who approved the loan, than a low-risk loan due to higher interest generated by high-risk loans.³ These compensation arrangements were based on short-term revenue, and thereby incentivized employees to expose the financial institution to more risk.⁴ The financial institution would often not realize this risk until the loan was consummated and the employee had received compensation.⁵ To combat this risk, financial institutions, with oversight from federal regulators, have implemented compensation policies that tie pay to performance, with risk evaluated at different points in time.⁶

1. Guidance on Sound Incentive Compensation Policies, 75 Fed. Reg. 36395, 36396 (June 25, 2010).

2. David F. Larker, et al., *Follow the Money: Compensation, Risk, and the Financial Crisis*, STAN. CLOSER LOOK SERIES (Sept. 8, 2014), <https://www.gsb.stanford.edu/sites/gsb/files/publication-pdf/cgri-closer-look-43-risk-compensation-financial-crisis.pdf>. See also Guidance on Sound Incentive Compensation, 75 Fed. Reg. at 36396; BD. OF GOVERNORS OF THE FED. RESERVE SYS., INCENTIVE COMPENSATION PRACTICES: A REPORT ON THE HORIZONTAL REVIEW OF PRACTICES AT LARGE BANKING ORGANIZATIONS (2011) [hereinafter HORIZONTAL REVIEW], <https://www.federalreserve.gov/publications/other-reports/files/incentive-compensation-practices-report-201110.pdf>.

3. HORIZONTAL REVIEW, *supra* note 2, at 5.

4. HORIZONTAL REVIEW, *supra* note 2, at 5.

5. See HORIZONTAL REVIEW, *supra* note 2, at 5 (“Some of these risks may be realized in the short term, while other may become apparent only over the long term.”).

6. E.g., HORIZONTAL REVIEW, *supra* note 2, at 5. See also *Financial Services Firms*

In 2009, federal agencies and financial institutions began to develop policies and procedures to mitigate the incentive for excessive risks arising from incentive-based compensation policies.⁷ The process began when certain financial regulators—Office of the Comptroller of the Currency (“OCC”), Board of Governors of the Federal Reserve System (“FRB”), Federal Deposit Insurance Corporation (“FDIC”), and Office of Thrift Supervision (“OTS”)—issued final guidance (“Interagency Guidance”) on incentive-based compensation arrangements, and financial institutions responded by implementing risk conscious provisions into their incentive-based compensation policies.⁸ Meanwhile, the Federal Reserve initiated a horizontal review (“Horizontal Review”) of incentive-compensation arrangements to ensure that the compensation arrangements in financial institutions were consistent with safe and sound banking policies outlined in the Interagency Guidance.⁹ Congress specifically addressed incentive-based compensation in Section 956 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act” or “Dodd-Frank”)¹⁰ which requires six federal agencies—FRB; OCC; FDIC; the National Credit Union Administration Board (“NCUA”); the Securities and Exchange Commission (“SEC”); and the Federal Housing Finance Agency (“FHFA”) (collectively the “Federal Regulators”)¹¹—to prescribe rules or issue guidelines that prohibit certain compensation arrangements and require disclosure of compensation arrangements in certain financial institutions.¹² Pursuant to Section 956, Federal Regulators initially proposed a rule in 2011 (“2011 Proposed Rule”) to

Increase Focus on Building Sound Risk Culture to Prevent Inappropriate Risk Taking, MERCER (July 18, 2016), <http://www.mercer.us/newsroom/financial-services-firms-increase-focus-on-building-sound-risk-culture-to-prevent-inappropriate-risk-taking.html> (noting that over 90% of financial firms have some type of policy which allows compensation to be adjusted or forfeited).

7. HORIZONTAL REVIEW, *supra* note 2, at 1.

8. Guidance on Sound Incentive Compensation Policies, 75 Fed. Reg. 36395, 36396 (June 25, 2010); HORIZONTAL REVIEW, *supra* note 2, at 1.

9. HORIZONTAL REVIEW, *supra* note 2, at 1–2.

10. Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”) § 956, 12 U.S.C. § 5641 (2015).

11. Dodd-Frank § 956, 12 U.S.C. § 5641(e)(1) (“The term ‘appropriate Federal regulator’ means (1) the FRB, (2) the OCC, (3) the FDIC, (4) the OTS, (5) the NCUA, (6) the SEC, and (7) the FHFA (Only six of these institutions remain after OTS authority was transferred to the FDIC, OCC, and FRB pursuant to 12 U.S.C. § 5412).

12. Dodd-Frank § 956(a)(1), 12 U.S.C. § 5641(a)(1).

prohibit certain incentive-based compensation arrangements.¹³ The 2011 Proposed Rule was not finalized, and on June 10, 2016, over five years after the enactment of Dodd-Frank, Federal Regulators re-proposed uniform rules (the “2016 Proposed Rule” or the “Proposed Rule”) for incentive-based compensation arrangements in financial institutions.¹⁴

Despite regulatory efforts and policy changes by financial institutions, the incentive for excessive and inappropriate risks continues to be a problem in financial institutions.¹⁵ When regulators proposed uniform rules on compensation policies, financial institutions fought back against additional regulation, arguing that current policies promote a proper balance between risk and reward.¹⁶ In the wake of the Wells Fargo scandal in the fall of 2016, however, politicians have pressured regulators to reign in excessive compensation and impose tougher regulations.¹⁷ With increased political pressure, regulators are less likely to accept arguments against compensation rules for financial institutions.¹⁸ Moreover, with the recent election of President Donald J. Trump, who has stated that he plans to roll back Dodd-Frank and the accompanying regulations, the fate of the Proposed Rule remains uncertain.¹⁹ Regardless of whether the Proposed Rule is adopted, in

13. Proposed Rule on Incentive-based Compensation Arrangements, 76 Fed. Reg. 21170, 21170 (proposed Apr. 14, 2011) (to be codified at 12 C.F.R. § 42 (OCC); 12 C.F.R. § 236 (FRB); 12 C.F.R. § 563h (OTS); 12 C.F.R. § 372 (FDIC); 12 C.F.R. §§ 741, 751 (NCUA); 12 C.F.R. § 1232 (FHFA); & 17 C.F.R. § 248 (SEC)).

14. Proposed Rule on Incentive-Based Compensation Arrangements, 81 Fed. Reg. 37670, 37670 (proposed June 10, 2016) (to be codified at 12 C.F.R. § 42 (OCC); 12 C.F.R. § 236 (FRB); 12 C.F.R. § 372 (FDIC); 12 C.F.R. §§ 741, 751 (NCUA); 12 C.F.R. § 1232 (FHFA); & 17 C.F.R. §§ 240, 275, 303 (SEC)).

15. See, e.g., Letter from Sen. Menendez, et al. to Janet Yellen, Chair, Bd. of Governors of the Fed. Reserve Sys., et al. (Oct. 26, 2016) [hereinafter Menendez Letter], <https://www.menendez.senate.gov/imo/media/doc/Incentive-Based-Pay-Letter-Wells-Fargo-Sec-956-2016-10-26.pdf> (asking Federal Regulators to strengthen and finalize proposed rules on incentive-based compensation arrangements and noting that the improper sales practices at Wells Fargo provide an example of continued problems in incentive-based compensation).

16. Jesse Hamilton, *Wells Fargo Scandal Hurts Wall Street's Fight Against Pay Rules*, 107 Banking Rep. (BNA) No. 10, at 353, 364–65 (Sept. 19, 2016).

17. Menendez Letter, *supra* note 15.

18. Hamilton, *Wells Fargo Scandal Hurts Wall Street's Fight Against Pay Rules*, *supra* note 16.

19. See Zeke Faux & Jenny Surane, *Wall Street Hope Revived as Trump Signs Plan to Roll Back Rules*, 108 Banking Rep. (BNA) No. 6, at 201 (Feb. 6, 2017) (noting that the new administration will attempt to roll back many rules implemented as part of Dodd-Frank).

continuing to address excessive risks created by incentive-based compensation Federal Regulators must work with financial institutions to determine whether policies encourage excessive risks.²⁰ In addition, financial institutions are advised to adjust their compensation policies to appropriately reduce risk.²¹

This Note proceeds in four parts. Part II summarizes the regulatory measures and policy changes related to incentive-based compensation since the financial crisis.²² Part III explains the Wells Fargo scandal as it relates to incentive-based compensation.²³ Part IV describes unintended consequences of over-regulation of compensation.²⁴ Part V concludes by explaining the possibility of future regulation of incentive-based compensation.²⁵

II. REGULATORY MEASURES AND POLICY CHANGES IN INCENTIVE-BASED COMPENSATION SINCE THE FINANCIAL CRISIS

In response to the financial crisis and pressure from regulators, financial institutions have developed policies to decrease the incentive for employees to expose the financial institution to excessive risk.²⁶ Federal Regulators have reviewed compensation policies of financial institutions and now require financial institutions to incorporate risk analysis when developing compensation policies.²⁷ As of July 18, 2016, over 90% of banks had a policy of deferring compensation and monitoring employee performance over an extended period of time.²⁸

20. See Jeff Bater, *OCC Flags Sales Practices at Banks in Semiannual Risk Report*, 108 Banking Rep. (BNA) No. 2, at 65 (Jan. 9, 2017) (noting that the OCC has flagged governance of sales practices as a key risk facing the financial industry).

21. See Larker et al., *supra* note 2 (explaining that “one approach to reducing risk in the bank industry is for regulators to monitor the riskiness of bank assets and restrict the amount of leverage” and “another approach is for boards to restructure compensation contracts to reduce incentive to take risk in the first place”).

22. See *infra* Part II.

23. See *infra* Part III.

24. See *infra* Part IV.

25. See *infra* Part V.

26. See HORIZONTAL REVIEW, *supra* note 2, at 13 (explaining risk adjustments of compensation and performance measures implemented after the financial crisis).

27. See Guidance on Sound Incentive Compensation Policies, 75 Fed. Reg. 36395, 36399 (June 25, 2010) (“[F]acts and circumstances will determine which employees have the ability to expose the organization to material amounts of risk.”).

28. MERCER, *supra* note 6.

These compensation arrangements vary based on the size, complexity, risk profile, and business strategy of each financial institution.²⁹

When a financial institution implements a new compensation policy, it must employ a complex balancing scheme to (1) “attract and reward talented employees”; (2) “promote appropriate behavior”; and (3) “[incentivize] highly productive work.”³⁰ In addition, many financial institutions include a risk management component when “selecting performance measures, goal setting, and performance evaluation, which is a significant development for aligning performance with sound risk-taking.”³¹ The overarching goal of a financial institution’s compensation policy should be to maximize shareholder return while promoting a proper balance between risk-taking and risk management.³² When issuing guidance or proposing rules on compensation policies in financial institutions, Federal Regulators should consider a highly individualized approach that incorporates this complex balancing process.³³ Since 2010, financial institutions have worked with Federal Regulators to develop more risk-conscious incentive-based compensation policies using a principles and risk-based approach based on the specific characteristics of the financial institution.³⁴

Financial institutions and regulators are under pressure to reform compensation policies and reduce the incentive to take excessive risk.³⁵ Due to the nature of the financial industry, however, it is

29. Guidance on Sound Incentive Compensation Policies, 75 Fed. Reg. at 36406 n.6; Comment Letter from McGuireWoods, LLP, to Robert deV. Frierson, Sec’y, Bd. of Governors of Fed. Reserve Sys., et. al. (July 22, 2016) [hereinafter McGuireWoods Comment on Proposed Rule], <https://www.sec.gov/comments/s7-07-16/s70716-56.pdf>.

30. Comment Letter from American Bankers Ass’s. et al., to Robert deV. Frierson, Sec’y, Bd. of Governors of Fed. Reserve Sys., et al. (July 22, 2016) [hereinafter ABA Comment on Proposed Rule], <https://www.sec.gov/comments/s7-07-16/s70716-30.pdf>.

31. MERCER, *supra* note 6.

32. ABA Comment on Proposed Rule, *supra* note 30, at 2.

33. ABA Comment on Proposed Rule, *supra* note 30, at 2.

34. Guidance on Sound Incentive Compensation Policies, 75 Fed. Reg. 36395, at 36396–97; Comment Letter from Hope A. Hardison, Senior Exec. Vice President, Wells Fargo & Co., to Robert deV. Frierson, Sec’y, Bd. of Governors of Fed. Reserve Sys. (July 22, 2016) [hereinafter Wells Fargo Comment on Proposed Rule], <https://www.sec.gov/comments/s7-07-16/s70716-48.pdf>.

35. Joe Mont, *Wells Fargo Scandal Prompts Senators to Focus on Clawbacks*, KPMG, COMPLIANCE WK. (Oct. 27, 2016), <https://www.complianceweek.com/blogs/the-filing-cabinet/wells-fargo-scandal-prompts-senators-to-focus-on-clawbacks-kpmg#.WBfXfHeZPBI>.

impossible to completely eliminate risk.³⁶ Therefore, financial institutions must decide what level of risk is appropriate and develop compensation policies that encourage employees to pursue objectives in a manner consistent with the chosen level of risk.³⁷ Meanwhile, Federal Regulators are tasked with preventing banks from engaging in activities which encourage excessive risk.³⁸

A. *Regulatory Efforts to Reduce the Risk of Incentive-based Compensation*

In the wake of the financial crisis, four federal agencies—the FRB, OCC, FDIC, and OTS³⁹—issued Interagency Guidance which requires financial institutions to develop compensation policies consistent with safe and sound banking practices.⁴⁰ The Interagency Guidance requires financial institutions with incentive-based compensation arrangements to ensure that compensation arrangements provide employees with benefits “that appropriately balance risk and reward,” are “compatible with effective controls and risk management,” and are supported by sound governance, “including active and effective oversight by the organization’s board of directors.”⁴¹ Specifically, financial institutions must address the risk-taking behavior of individual employees and groups of employees whose actions, when taken together, could affect the risk profile of the institution.⁴²

In addition to issuing Interagency Guidance, in late 2009 Federal Regulators initiated a Horizontal Review of incentive-based compensation practices at twenty-five large, complex financial institutions.⁴³ The purpose of the Horizontal Review was: (1) to

36. Larker et al., *supra* note 2, at 1.

37. Larker et al., *supra* note 2, at 1.

38. Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”) § 956, 12 U.S.C. § 5641(b) (2015).

39. The OTS ceased to exist on October 19, 2011. *See* Dodd-Frank § 312, 12 U.S.C. § 5412 (transferring powers and duties of OTS to FRB, FDIC, and OCC).

40. Guidance on Sound Incentive Compensation Policies, 75 Fed. Reg. 36395, 36396 (June 25, 2010).

41. *Id.*

42. *Id.* at 36413.

43. The financial institutions in the Horizontal Review were “Ally Financial Inc.; American Express Company; Bank of America Corporation; The Bank of New York Mellon Corporation; Capital One Financial Corporation; Citigroup Inc.; Discover Financial

examine the range of compensation practices across firms and (2) “guide each financial institution in implementing the Interagency Guidance.”⁴⁴ The Horizontal Review found that every financial institution included in the review had implemented policies to balance risk and financial results.⁴⁵ Although compensation practices improved, the FRB report on the Horizontal Review noted that all of the firms could do more to address the issue.⁴⁶ After completing the Horizontal Review, regulators continued to address problems in incentive-based compensation policies through the normal examination process.⁴⁷

The Dodd-Frank Act specifically addresses the excessive amount of risk associated with incentive-based compensation arrangements.⁴⁸ Section 956 of Dodd-Frank requires six Federal Regulators to jointly regulate incentive-based compensation arrangements in covered financial institutions.⁴⁹ Under Section 956, a covered financial institution includes: a bank; bank holding company; broker-dealer; credit union; investment advisor; Federal National Mortgage Association; the Federal Home Loan Mortgage Corporation; and any other financial institution that Federal Regulators determine should be treated as a covered financial institution (collectively “Covered Institutions”).⁵⁰ Section 956 provides an exception, however, for financial institutions with assets of less than \$1 billion, which will not be subject to any rules proposed pursuant to Section 956.⁵¹ In contrast, a Covered Institution with assets of \$1 billion or greater must disclose the structure of all incentive-based compensation arrangements

Services; The Goldman Sachs Group, Inc.; JPMorgan Chase & Co.; Morgan Stanley; Northern Trust Corporation; The PNC Financial Services Group, Inc.; State Street Corporation; SunTrust Banks, Inc.; U.S. Bancorp; and Wells Fargo & Company; and the U.S. operations of Barclays plc, BNP Paribas, Credit Suisse Group AG, Deutsche Bank AG, HSBC Holdings plc, Royal Bank of Canada, The Royal Bank of Scotland Group plc, Societe Generale, and UBS AG.” HORIZONTAL REVIEW, *supra* note 2, at 1n.1.

44. HORIZONTAL REVIEW, *supra* note 2, at 1.

45. These policies include deferring compensation and evaluating performance over a longer period. For more information see *infra* Part II.B.

46. HORIZONTAL REVIEW, *supra* note 2, at 1.

47. HORIZONTAL REVIEW, *supra* note 2, at 1.

48. Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”) § 956, 12 U.S.C. § 5641 (2015).

49. Dodd-Frank § 956(e)(1), 12 U.S.C. § 5641(a)(1).

50. Dodd-Frank § 956(e)(2)(A)–(G), 12 U.S.C. § 5641(e)(2)(A)–(G).

51. Dodd-Frank § 956(f), 12 U.S.C. § 5641(f).

to its appropriate Federal Regulator.⁵² Upon disclosure, the Federal Regulator must determine whether the compensation structure provides excessive compensation or could lead to material financial loss.⁵³ In addition, Federal Regulators must prohibit incentive-based compensation that encourages inappropriate risk by providing excessive compensation or compensation arrangements that could lead to material financial loss.⁵⁴ Under Section 956, Federal Regulators have the option of either issuing guidance or proposing regulations on incentive-based compensation arrangements.⁵⁵

In 2011, Federal Regulators issued a proposed rule on incentive-based compensation policies in Covered Institutions.⁵⁶ The 2011 Proposed Rule would have required executives at larger Covered Institutions—those with at least \$50 billion in assets—to defer at least 50% of compensation for three years.⁵⁷ The 2011 Proposed Rule would also have required the board of directors or a board committee of a larger Covered Institution to approve all compensation arrangements for certain covered employees who had “the ability to expose the entity to possible losses that are substantial in relation to the entity’s size, capital or overall risk tolerance.”⁵⁸ Finally, the 2011 Proposed Rule would have required all Covered Institutions to provide an annual report to the appropriate Federal Regulator to determine compliance with the regulations.⁵⁹

The 2011 Proposed Rule was never finalized, but Federal Regulators re-proposed rules pursuant to Section 956 on June 10, 2016.⁶⁰ The Proposed Rule regulates incentive-based compensation⁶¹

52. Dodd-Frank § 956(a), 12 U.S.C. § 5641(a), (f).

53. Dodd-Frank § 956(a)(1)(A)–(B), 12 U.S.C. § 5641(a)(1)(A)–(B) (2015).

54. Dodd-Frank § 956(b)(1)–(2), 12 U.S.C. § 5641(b)(1)–(2).

55. Dodd-Frank § 956(a)(1), 12 U.S.C. § 5641(a)(1); Proposed Rule on Incentive-Based Compensation Arrangements, 81 Fed. Reg. 37670, 37670 (proposed June 10, 2016) (to be codified at 12 C.F.R. § 42 (OCC); 12 C.F.R. § 236 (FRB); 12 C.F.R. § 372 (FDIC); 12 C.F.R. §§ 741, 751 (NCUA); 12 C.F.R. § 1232 (FHFA); & 17 C.F.R. §§ 240, 275, 303 (SEC)).

56. Proposed Rule on Incentive-based Compensation Arrangements, 76 Fed. Reg. 21170, 21170 (proposed Apr. 14, 2011) (to be codified at 12 C.F.R. § 42 (OCC); 12 C.F.R. § 236 (FRB); 12 C.F.R. § 563h (OTS); 12 C.F.R. § 372 (FDIC); 12 C.F.R. §§ 741, 751 (NCUA); 12 C.F.R. § 1232 (FHFA); & 17 C.F.R. §§ 248 (SEC)).

57. *Id.* at 21216.

58. *Id.* at 21218.

59. *Id.* at 21215.

60. Proposed Rule on Incentive-Based Compensation Arrangements, 81 Fed. Reg. at

using three tiers of regulation based on total consolidated assets.⁶² Like the 2011 Proposed Rule, the basic disclosure requirements and prescriptions apply to all Covered Institutions.⁶³ The Proposed Rule also imposes uniform rules for determining covered employees, senior executive officers (“SEOs”), and significant risk takers (“SRTs”) of each Covered Institution.⁶⁴ In addition to disclosure requirements, Level 2 Covered Institutions—those with between \$50 and \$250 billion in assets—must restrict the timing and amount of incentive-based compensation for covered employees determined to be SEOs and SRTs.⁶⁵ Further restrictions apply to SEOs and SRTs at Level 1 Covered Institutions—those with \$250 billion or more in assets.⁶⁶

The restrictions on timing and amount of compensation apply to covered employees at Level 1 and Level 2 Covered Institutions who qualify as an SEO or SRT.⁶⁷ An SEO is defined as an employee who, regardless of title, salary, or compensation, performs the functions of a senior officer or head of a major business line or control function of a Covered Institution.⁶⁸ A more complex test is used to determine the SRTs of a Covered Institution.⁶⁹ The SRT definition depends on whether the employee meets the relative compensation test or the

37670.

61. *Id.* at 37832 (“Incentive-based compensation means any variable compensation, fees, or benefits that serve as an incentive or reward for performance.”).

62. *Id.* at 37833.

63. *Id.* at 37834; Proposed Rule on Incentive-based Compensation Arrangements, 76 Fed. Reg. at 21215.

64. Proposed Rule on Incentive-Based Compensation Arrangements, 81 Fed. Reg. at 37833.

65. *Id.* at 37835 (stating that applicable Level 1 incentive-based compensation must be deferred for four years, whereas applicable Level 2 compensation need only be deferred for three years) (requiring 50% of qualifying incentive-based compensation to be deferred for Level 1 significant risk-takers and Level 2 senior executives) (stating that 40% of qualifying incentive-based compensation be deferred for Level 2 significant risk-takers).

66. *Id.*

67. *Id.* at 37833.

68. *Id.* at 37833 (“Senior Executive Officer means any covered employee who holds the title or, without regard to title, salary, or compensation, performs the function of one or more of the following positions at a covered institution for any period of time in the relevant performance period: president, chief executive officer, executive chairman, chief operating officer, chief financial officer, chief investment officer, chief legal officer, chief lending officer, chief risk officer, chief compliance officer, chief audit executive, chief credit officer, chief accounting officer, or head of a major business line or control function.”).

69. *Id.*

exposure test.⁷⁰ Notwithstanding the employee's actual authority or risk exposure, a covered employee will be deemed an SRT if the employee: (1) receives compensation of which at least one-third is incentive-based compensation; and, (2) either (i) receives the highest 5% of compensation compared to all other covered persons at a Level 1 institution—or 2% at a Level 2 institution; or (ii) may commit or expose at least 0.5% or more of the common equity tier 1 capital.⁷¹ If an employee is deemed to be an SEO or SRT, the Covered Institution must defer a portion of his or her incentive-based compensation and subject the incentive-based compensation to downward adjustment, forfeiture, and clawback provisions, which are explained in more detail below.⁷²

B. Mandatory Deferrals, Downward Adjustments, and Clawbacks

Most compensation policies that balance risk and financial results include a combination of risk adjustment of awards and deferral of payments.⁷³ For instance, a portion of incentive-based compensation may be deferred for a specified period of time, and the compensation will be subject to downward adjustment and clawback provisions during the deferral period.⁷⁴ A financial institution can use these provisions to adjust or recoup an employee's compensation if the employee exposes the institution to excessive risk or material financial loss.⁷⁵ Specifically, downward adjustment provisions allow an employer to decrease compensation that has not yet been paid to an employee.⁷⁶

70. *Id.*

71. *Id.* at 37833–34, 37692 n. 83 (“In the proposed rule, the Agencies have tailored the measure of capital to the type of covered institution. For most covered institutions, the exposure test will be based on common equity tier 1 capital.”); Capital Adequacy of FDIC-Supervised Institutions, 12 C.F.R. § 324.22(b) (2016) (defining common equity tier as the sum of the following: common stock, subject to certain limitations; retained earnings; accumulated other comprehensive income (AOCI); and any common equity tier 1 minority interest subject to limitation under § 324.21(c); minus regulatory adjustments and deductions in 12 C.F.R. § 324.22).

72. *See infra* Section II.B.

73. HORIZONTAL REVIEW, *supra* note 2, at 2.

74. HORIZONTAL REVIEW, *supra* note 2, at 15–17.

75. *See, e.g.*, Proposed Rule on Incentive-Based Compensation Arrangements, 81 Fed. Reg. 37670, 37836–37 (proposed June 10, 2016) (to be codified at 12 C.F.R. § 42 (OCC); 12 C.F.R. § 236 (FRB); 12 C.F.R. § 372 (FDIC); 12 C.F.R. §§ 741, 751 (NCUA); 12 C.F.R. § 1232 (FHFA); & 17 C.F.R. §§ 240, 275, 303 (SEC)).

76. Proposed Rule on Incentive-Based Compensation Arrangements, 81 Fed. Reg. at 37832.

Alternatively, clawback provisions allow an employer to recoup compensation that has already been paid and is fully vested to the employee.⁷⁷

While clawback and downward adjustment provisions are common, Covered Institutions vary in the specific actions that trigger enforcement of the provisions.⁷⁸ One common weakness in downward adjustment and clawback provisions is that the activity that triggers enforcement is not broad enough to cover the many potential situations that can arise.⁷⁹ For example, a provision that provides for recoupment of compensation upon a showing of fraud may not be triggered when an employee exposes a financial institution to excessive risk in violation of the financial institution's risk management policy.⁸⁰ Another common issue involves the disparity in the level of discretion financial institutions exercise when enforcing the provisions.⁸¹ In some cases, the effectiveness of the provision depends on how eager the board is to recoup the compensation, especially in the case of clawback provisions, where the compensation has already vested.⁸² For this reason, downward adjustments are used frequently, while clawbacks of compensation are relatively rare.⁸³ According to a recent survey of financial institutions, over a two-year period approximately 50% of financial institutions adjusted deferred compensation pursuant to a downward adjustment provision.⁸⁴ During that same period, only about 10% of financial institutions enforced clawback provisions.⁸⁵

Several successful actions to recoup compensation from employees highlight the potential effectiveness of clawback and

77. *Id.*

78. Michael Greene, *Will Wells Fargo Scandal Lead to Changes in Corporate Pay Plans?*, 107 *Banking Rep.* (BNA) No. 13, 469, 475–76 (Oct. 5, 2016).

79. *Id.*

80. *See id.*

81. Caleb Melby & Yalman Onaran, *Clawing Back Bankers' Pay at Wells Fargo is Harder Than It Looks*, 107 *Banking Rep.* (BNA) No. 11, 393, 405–06 (Sept. 21, 2016) (noting that 76% of the largest banks have clawback policies but the policies are rarely enforced); Greene, *supra* note 78, at 475 (noting that about half of compensation policies are subject to compensation committee discretion).

82. Melby & Onaran, *supra* note 81, at 405; Greene, *supra* note 78, at 475.

83. Melby & Onaran, *supra* note 81, at 405.

84. Melby & Onaran, *supra* note 81, at 405; MERCER, *supra* note 6.

85. Melby & Onaran, *supra* note 81, at 405.

downward adjustment provisions.⁸⁶ In one of the most successful enforcement actions, the SEC recouped over \$600 million from the CEO of UnitedHealth Group.⁸⁷ Similarly, JPMorgan sought recoupment from four traders who lost \$6.2 billion in the London Whale scandal.⁸⁸ Three of the four traders voluntarily forfeited their compensation, and JPMorgan ultimately settled with the fourth employee to recoup a total of \$100 million in compensation from the group.⁸⁹ More recently, when Wells Fargo was accused of opening over two million fake customer accounts, the CEO and manager of community banking voluntarily forfeited a total of \$60 million in unvested compensation.⁹⁰ However, reputational harm rarely leads to recoupment of vested compensation, and therefore Wells Fargo is unlikely to recoup additional funds.⁹¹

Downward adjustment and clawback provisions generally include enforcement triggers such as financial restatements, fraud, or misconduct.⁹² While previous financial statutes focused recoupment provisions primarily on material financial restatements, Section 956 of Dodd-Frank imposes no such limitation.⁹³ Under Section 956,

86. Greene, *supra* note 78, at 475.

87. The former CEO of United Health Group forfeited nearly \$620 million in order to settle civil and federal government claims related to stock option backdating. The complaints came after dozens of companies issued stock options and fraudulently claimed the options were granted on earlier dates when stock was trading at a lower price. For more information, see Vanessa Fuhrmans & James Bandler, *Ex-CEO Agrees to Give Back \$620 Million*, WALL ST. J. (Dec. 7, 2007), <http://www.wsj.com/articles/SB119697535545316199>.

88. The London Whale, Bruno Iksil, was a trader in the London Chief Investment Office (CIO) of JP Morgan. The CIO was responsible for trading the difference between deposits and commercial loans, which was about \$350 billion. This money was primarily invested in derivatives to hedge risk from other items on the balance sheet. Iksil became known by the nickname, London Whale, due to the very large position he took in the CDS markets. In 2012, a massive bet on a complex set of synthetic credit derivatives resulted in a loss of \$6.2 billion. JP Morgan recovered the maximum amount allowed under its employment contracts through a combination of reducing outstanding awards and obtaining repayment of awards previously paid. For more information, see S. PERM. SUBCOMM. ON INVESTIGATIONS, *JPMORGAN CHASE WHALE TRADES: A CASE HISTORY OF DERIVATIVES RISKS AND ABUSES* (2013), <http://www.hsgac.senate.gov/download/report-jpmorgan-chase-whale-trades-a-case-history-of-derivatives-risks-and-abuses-march-15-2013>.

89. Melby & Onaran, *supra* note 81, at 405.

90. Greene, *supra* note 78, at 475.

91. See Greene, *supra* note 78, at 475 (noting that Wells Fargo's clawback provision was triggered by financial restatement, which did not occur in connection with the fraudulent accounts).

92. Greene, *supra* note 78, at 475.

93. Compare Sarbanes-Oxley Act of 2002 § 304, 15 U.S.C. § 7243 (2015), with Dodd-

enforcements to recoup compensation could result from an employee doing the following: exposing the financial institution to inappropriate risks; drawing an enforcement action; or exceeding the institution's risk limits and causing a loss.⁹⁴ In contrast to specific enforcement triggers, financial institutions may choose to develop deferred compensation provisions with a wide range of enforcement triggers in order to give the board of directors broad authority and discretion to enforce the provision.⁹⁵

Under current Interagency Guidance, financial institutions determine their own deferred compensation and clawback policies with oversight and guidance from financial regulators.⁹⁶ Each financial institution is responsible for ensuring that its incentive-based compensation arrangements are consistent with the safety and soundness policy of the institution.⁹⁷ In addition, financial institutions are permitted, and in some cases required, "to incorporate . . . new or emerging methods that are likely to improve the organization's long-term financial well-being."⁹⁸ However, a compensation policy that is effective in one financial institution may not necessarily be effective in another institution.⁹⁹ In order to continue innovation in compensation policies, Federal Regulators should continue to monitor and advise boards of Covered Institutions as the boards establish compensation policies based on the particular needs of the institution and considering whether compensation is excessive or could lead to material financial loss.¹⁰⁰ Moreover, if uniform rules on incentive-based compensation

Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") § 956, 12 U.S.C. § 5641 (2015).

94. Proposed Rule on Incentive-Based Compensation Arrangements, 81 Fed. Reg. 37670, 37835–36 (proposed June 10, 2016) (to be codified at 12 C.F.R. § 42 (OCC); 12 C.F.R. § 236 (FRB); 12 C.F.R. § 372 (FDIC); 12 C.F.R. §§ 741, 751 (NCUA); 12 C.F.R. § 1232 (FHFA); & 17 C.F.R. §§ 240, 275, 303 (SEC)).

95. Greene, *supra* note 78, at 475–76.

96. HORIZONTAL REVIEW, *supra* note 2, at 10.

97. Guidance on Sound Incentive Compensation Policies, 75 Fed. Reg. 36395, 36397 (June 25, 2010).

98. *Id.* at 36400.

99. *Id.*

100. This position is consistent with the policy under current Interagency Guidance, and the policy could be continued under revised guidance. HORIZONTAL REVIEW, *supra* note 2, at 23; Letter from Edward J. DeMarco, Jr., Gen. Counsel and Dir. Regulatory Relations, Risk Management Ass'n, to Robert deV. Frierson, Sec'y, Bd. of Governors of Fed. Reserve Sys., 10 (July 20, 2016) [hereinafter RMA Comment on Proposed Rule], <https://>

policies are adopted, the board of directors of financial institutions are likely to use regulatory provisions as a substitute for independent discretion.¹⁰¹

Under the Proposed Rule, Federal Regulators would require Covered Institutions with \$50 billion or more in assets to defer at least 40% of incentive-based compensation of CEOs and SRTs for a minimum of four years.¹⁰² The deferred portion of incentive-based compensation would be subject to forfeiture, downward adjustment, and clawback.¹⁰³ Deferred compensation could be forfeited or adjusted downward for behavior such as: (i) “poor financial performance”; (ii) “inappropriate risk taking”; (iii) “material risk management or control failures”; or (iv) “non-compliance with statutory, regulatory, or supervisory standards.”¹⁰⁴ Similarly, vested compensation would be subject to clawback as a result of the following: (i) “misconduct that resulted in significant financial or reputational harm to the Covered Institution”; (ii) fraud; or (iii) “intentional misrepresentation of information used to determine . . . incentive-based compensation.”¹⁰⁵ The severity of the employee’s actions and level of culpability usually determine the amount of compensation the Covered Institution will recoup.¹⁰⁶

C. *Categorization of Financial Institutions for Purposes of Regulation*

When developing compensation policies, Federal Regulators and financial institutions must consider the nexus between the actual risk presented by incentive-based compensation and the level of

www.regulations.gov/contentStreamer?documentId=OCC-2011-00012387&attachmentNumber=1&disposition=attachment&contentType=pdf.

101. RMA Comment on Proposed Rule, *supra* note 100, at 9–10 (noting that the proposed rule “apparent[ly] shift[s] oversight from the board of directors of the institution to the regulatory agencies”).

102. Proposed Rule on Incentive-Based Compensation Arrangements, 81 Fed. Reg. 37670, 37835–36. (proposed June 10, 2016) (to be codified at 12 C.F.R. § 42 (OCC); 12 C.F.R. § 236 (FRB); 12 C.F.R. § 372 (FDIC); 12 C.F.R. §§ 741, 751 (NCUA); 12 C.F.R. § 1232 (FHFA); & 17 C.F.R. §§ 240, 275, & 303 (SEC)).

103. *Id.*

104. *Id.* at 37836.

105. *Id.* at 37837.

106. *Id.* at 37836.

regulation.¹⁰⁷ For example, the asset size of a financial institution is one indicator of the level of risk, but asset size may not directly correlate with incentive for excessive risk-taking.¹⁰⁸ In addition, certain types of activities may expose the institution to more risks than others.¹⁰⁹ When regulators attempt to decrease risk by regulating the compensation arrangements of financial institutions and employees, the policies should be tied to the actual risk exposure of each institution based on the activities in which the institution is engaged.¹¹⁰

Despite Federal Regulators' recognition that asset size is only one of many factors to be considered when determining the proper incentive-based compensation arrangements,¹¹¹ in the Proposed Rule, regulators relied almost entirely on asset size as an indicator of risk-taking activity.¹¹² Typically, Federal Regulators categorize financial institutions using asset size, because larger financial institutions "implicate[] the greatest risk[] for the broader economy and financial system."¹¹³ While size is an important indicator of an institution's risk, asset size alone may not be an accurate indicator of the risk an institution imposes on the financial system.¹¹⁴ In some instances, "large and diversified institutions pose less risk than those that are smaller but highly concentrated."¹¹⁵ Moreover, the failure of a large number of

107. See McGuireWoods Comment on Proposed Rule, *supra* note 29, at 52 (concluding that the lack of a nexus between risk-taking activity and the restrictions imposed the proposed rule will have an anti-competitive effect).

108. Proposed Rule on Incentive-Based Compensation Arrangements, 81 Fed. Reg. 37670, 37688 (proposed June 10, 2016) (to be codified at 12 C.F.R. § 42 (OCC); 12 C.F.R. § 236 (FRB); 12 C.F.R. § 372 (FDIC); 12 C.F.R. §§ 741, 751 (NCUA); 12 C.F.R. § 1232 (FHFA); & 17 C.F.R. §§ 240, 275, & 303 (SEC)).

109. See *id.* ("Because of the scalability of the Federal Home Loan Bank business model, it is possible for a Federal Home Loan Bank to pass back and forth over the asset-size threshold without any meaningful change in risk profile.")

110. See generally Guidance on Sound Incentive Compensation Policies, 75 Fed. Reg. 36395, 36400 (June 25, 2010) (requiring financial institutions to "take account of the full range of risks that the employees' activities may pose for the organization").

111. Proposed Rule on Incentive-Based Compensation Arrangements, 81 Fed. Reg. at 37708 (stating that the agencies are not attempting to apply a "one-size-fits-all" approach to designing compensation policies and that the structure of incentive-based compensation arrangement should comply with requirements in a manner consistent with the size, complexity, risk tolerance, and business model of the individual covered institutions).

112. See *id.* at 37837 (applying the most stringent requirements to Level 1 and Level 2 financial institutions based solely on asset size).

113. *Id.* at 37688.

114. Guidance on Sound Incentive Compensation Policies, 75 Fed. Reg. at 36399.

115. McGuireWoods Comment on Proposed Rule, *supra* note 29, at 3.

small banks can create as much systemic risk as the failure of a large bank.¹¹⁶ For example, the savings and loan crisis was caused by hundreds of thrifts failing due to rising interest rates, unstable funding, and high-risk mortgage lending.¹¹⁷ The failure of so many small financial institutions ultimately resulted in the failure of the Federal Savings & Loan Insurance Corporation.¹¹⁸

The problem of using asset size as a proxy for risk to the financial system is particularly important when subsidiaries are regulated based on the asset size of the parent company.¹¹⁹ For example, smaller lines of business within a larger Covered Institution will be subject to regulations that are not comparable to those imposed on similar-sized competitors.¹²⁰ This problem is particularly important in bank holding companies and financial holding companies that are Covered Institutions under the Proposed Rule, because these companies are more likely to participate in a broad range of financial activities.¹²¹ If the Proposed Rule is finalized, subsidiaries of these Covered Institutions will be forced to compete with smaller stand-alone financial institutions when recruiting and retaining employees.¹²² In order to compete, the subsidiary may have to increase compensation for covered employees or spin off certain subsidiaries.¹²³ For this reason, the risk exposure and level of regulation of a subsidiary should be determined

116. Frances Coppola, *Big Banks Versus Small Banks: Size Doesn't Matter*, FORBES (Dec. 10, 2013), <http://www.forbes.com/sites/francescoppola/2013/12/10/big-banks-versus-small-banks-size-doesnt-matter/#386e7d4b1d86>.

117. *Id.*

118. *Id.*

119. See Proposed Rule on Incentive-Based Compensation Arrangements, 81 Fed. Reg. 37670, 37780 (proposed June 10, 2016) (to be codified at 12 C.F.R. § 42 (OCC); 12 C.F.R. § 236 (FRB); 12 C.F.R. § 372 (FDIC); 12 C.F.R. §§ 741, 751 (NCUA); 12 C.F.R. § 1232 (FHFA); & 17 C.F.R. §§ 240, 275, & 303 (SEC)) (“[The Proposed Rule] might affect the ability of these subsidiaries to compete for managerial talent with stand-alone companies of the same size as the subsidiary. If that were the case, the subsidiaries of larger parent institutions may have to provide additional pay to individuals to compensate for the relatively stricter compensation requirements and prohibitions.”).

120. See Wells Fargo Comment on Proposed Rule, *supra* note 34, at 4.

121. For example, a large covered institution could spin off a division into a separate financial institution which may not be subject to any compensation rules. See Proposed Rule on Incentive-Based Compensation Arrangements, 81 Fed. Reg. at 37780.

122. Proposed Rule on Incentive-Based Compensation Arrangements, 81 Fed. Reg. at 37815; Jesse Hamilton, *Pay Rule May Give BlackRock a Recruiting Boost Over JPMorgan*, 106 Banking Rep. (BNA) No. 21, at 759–60 (May 23, 2016).

123. Proposed Rule on Incentive-Based Compensation Arrangements, 81 Fed. Reg. at 37815.

without regard to the parent company.¹²⁴

A final rule on incentive-based compensation should, at a minimum, provide regulators discretion to regulate a Covered Institution based on the actual level of the risk inherent to the institution.¹²⁵ In order to determine the appropriate standard for each Covered Institution, Federal Regulators could consider the activities, complexity of operations, risk profile, and compensation practices.¹²⁶ As a compromise, the final rule could provide general requirements based upon asset size, but provide for relaxed or heightened requirements based on the risk to the financial system of a particular Covered Institution or its subsidiary.¹²⁷ Under the latter approach, regulators would be afforded a uniform approach to regulating compensation while retaining the flexibility to regulate financial institutions with similar size, complexity, and overall risk profile in the same manner.¹²⁸

D. Compensation Policies Should Be Tailored to Specific Risk Profiles of Employees and Departments

Incentive-based compensation accounts for approximately 50% of the compensation paid to employees on Wall Street.¹²⁹ In addition,

124. See Proposed Rule on Incentive-Based Compensation Arrangements, 76 Fed. Reg. 21170, 21202–17 (proposed Apr. 14, 2011) (to be codified at 12 C.F.R. § 42 (OCC); 12 C.F.R. § 236 (FRB); 12 C.F.R. § 563h (OTS); 12 C.F.R. § 372 (FDIC); 12 C.F.R. §§ 741, 751 (NCUA); 12 C.F.R. § 1232 (FHFA); & 17 C.F.R. §§ 248 (SEC)) (applying the restrictions to individual institutions without additional restrictions on subsidiaries based on the parent company's assets).

125. For example, the Proposed Rule provides a reservation of authority for Level 3 institutions, which permits regulators to require a Level 3 institution to comply with some or all of the requirements of Level 1 or Level 2 institutions when the Level 3 institution has between \$10 billion and \$50 billion in assets. The reverse would allow a Level 1 or Level 2 Covered Institution to comply with the regulation of as if it were a Level 3 Covered Institution. See Proposed Rule on Incentive-Based Compensation Arrangements, 81 Fed. Reg. 37670, 37715 (proposed June 10, 2016) (to be codified at 12 C.F.R. § 42 (OCC); 12 C.F.R. § 236 (FRB); 12 C.F.R. § 372 (FDIC); 12 C.F.R. §§ 741, 751 (NCUA); 12 C.F.R. § 1232 (FHFA); & 17 C.F.R. §§ 240, 275, & 303 (SEC)).

126. *Id.*

127. See *id.* (allowing regulators discretion to regulate Level 3 Covered Institutions in the same manner as Level 1 or Level 2 Covered Institutions).

128. *Id.*

129. Donna Borak, Andrew Ackerman & Christina Rexrode, *New Rules Curbing Wall Street Pay Proposed*, WALL ST. J. (Apr. 22, 2016), <http://www.wsj.com/articles/new-rules-curbing-wall-street-pay-announced-1461247600>.

the top 5% of employees at the country's top six banks would include a total of 52,000 employees.¹³⁰ Any compensation rule implemented by Federal Regulators will affect the pay structures of a large portion of those employees.¹³¹ Many of these employees, however, may not expose the financial institutions to excessive risk of material loss.¹³² In order to avoid overregulation, Covered Institutions and Federal Regulators should focus on the particular risk exposure of certain employees and groups of employees.¹³³ For example, certain employees may expose the Covered Institution to excessive risk by the nature of their salary or degree of control over the institution.¹³⁴ Similarly, a group of employees with relatively little control over the Covered Institution may expose the institution to excessive risk based on the aggregate risk exposure of the group.¹³⁵

The approach under the Interagency Guidance is for financial institutions to consider the full range of inherent risk arising from an employee's activities and whether those risks are material to either the organization, or a business line or operating unit of the organization.¹³⁶ If the employee exposes the organization to material risk, then the employee will be considered a covered employee or material risk taker ("MRT") and subject to limits or restrictions on incentive-based

130. *Id.*

131. See Proposed Rule on Incentive-Based Compensation Arrangements, 81 Fed. Reg. at 37815 (applying the SEO definition to any employee in a control function and applying the SRT definition would include anyone with one-third incentive-based compensation who is either in top 5% of highest paid employees or could potentially expose 0.5% of the institution's assets).

132. See *id.* at 37695 (stating that the purpose of the exposure text is to determine whether the employee exposes the institution to market risk or credit risk); see also McGuireWoods Comment on Proposed Rule, *supra* note 29 (stating that financial advisors do not expose the institution to credit risk or market risk).

133. Current Interagency Guidance allows financial institutions to determine covered employees based on the ability to expose the institution to material amounts of risk. Guidance on Sound Incentive Compensation Policies, 75 Fed. Reg. 36395, 36399 (June 25, 2010).

134. See Proposed Rule on Incentive-Based Compensation Arrangements, 81 Fed. Reg. 37670, 37808 (proposed June 10, 2016) (to be codified at 12 C.F.R. § 42 (OCC); 12 C.F.R. § 236 (FRB); 12 C.F.R. § 372 (FDIC); 12 C.F.R. §§ 741, 751 (NCUA); 12 C.F.R. § 1232 (FHFA); & 17 C.F.R. §§ 240, 275, & 303 (SEC)) (applying the exposure test and relative compensation test to determine significant risk takers).

135. See Guidance on Sound Incentive Compensation Policies, 75 Fed. Reg. at 36399 (requiring financial institutions to examine risk exposure of employees and groups of employees who together can expose the institution to material risk of loss).

136. *Id.*

compensation.¹³⁷ This framework deems an employee an MRT based upon the risk directly related to his or her employment, and seeks to appropriately determine which employees could take the type of inappropriate risks that could lead to material financial loss.¹³⁸

The alternative approach in the Proposed Rule imposes a more uniform test to determine the significant risk takers (“SRTs”) of a Covered Institution.¹³⁹ The SRT determination rests on the relative compensation test and exposure test to discern whether the risk exposure of an employee is excessive.¹⁴⁰ The SRT test covers the most highly compensated employees of the Covered Institution and those who have the ability to expose 0.5% of the capital of a Covered Institution.¹⁴¹ The more rigid SRT approach may cover more employees than the MRT approach and subject certain individuals to compensation restrictions who do not necessarily expose the financial institution to excessive risks.¹⁴²

The exposure test, in particular, could cover a broad range of employees, because it does not require that the employee actually expose the Covered Institution to any commitment of capital.¹⁴³ For example, the Proposed Rule assumes a loan officer exceeds the threshold for the SRT test if the employee does not have an annual limit of loan authority.¹⁴⁴ Accordingly, a loan officer with authority to approve \$1,000 loans to each customer would be considered an SRT if

137. *Id.* at 36407.

138. *Id.*; Letter from BB&T Corp. et al., to Robert deV. Frierson, Sec’y, Bd. of Governors of the Fed. Reserve Sys., et al., 9–10. (July 22, 2016) [hereinafter Regional Banks Comment on Proposed Rule], https://www.federalreserve.gov/SECRS/2016/August/20160826/R-1536/R-1536_072816_130383_335536110847_1.pdf.

139. Proposed Rule on Incentive-Based Compensation Arrangements, 81 Fed. Reg. at 37808.

140. The relative compensation test depends upon whether the covered employee is among the highest 5% of covered employees at a level 1 covered institution or among the highest 2% of compensation at a level 2 Covered Institution. The exposure test depends on whether the employee can expose at least 0.5% of tier 1 capital. *See id.* at 37833.

141. *Id.*

142. *See id.* at 37693–96 (“[E]xposure test relates to a covered person’s authority to commit or expose significant amounts of an institution’s capital, regardless of whether or not such exposures or commitments are realized.”).

143. *Id.*

144. *See id.* at 37696 (“If a covered person had no specific maximum amount of lending for the year, but instead his or her lending was subject to approval on a rolling basis, then the covered person would be assumed to have an authorized annual lending amount in excess of the 0.5% threshold.”).

the financial institution does not place annual limit on the number of loans she could make.¹⁴⁵ Although some banks may not limit the amount of loans that a loan officer may make, each loan is heavily scrutinized prior to its approval, thus limiting the particular loan officer's ability to expose the bank to risk through ill-advised loans.¹⁴⁶ In either case, the loan officer would be subject to compensation restrictions, regardless of whether she actually exercised her lending authority, and even if every transaction she participated in was subject to further approval.¹⁴⁷ In order to remove this unintended application, the SRT test should measure the risk exposure of the employee through actual commitments of capital.¹⁴⁸

In addition, certain financial advisors would be considered SRTs, but not all financial advisors are capable of causing the strategic, market, and liquidity risk that the rule is intended to eliminate.¹⁴⁹ For example, a financial advisor who invests capital for unrelated third parties could be categorized as an SRT.¹⁵⁰ Moreover, many financial advisors subject to incentive-based compensation restrictions are employed inside large banks.¹⁵¹ The financial advisors employed by banks could face more stringent compensation restrictions than a financial advisor who does similar work for an independent firm.¹⁵² Even though financial advisors who primarily handle client money in a large bank pose a similar risk to the financial system as a financial advisor in a stand-alone institution, the financial advisor within a large bank will face more strict compensation restrictions.¹⁵³

Overall, industry professionals have indicated that the framework in the Proposed Rule does not reflect how Covered Institutions calculate employee responsibilities and authority in

145. *Id.*

146. McGuireWoods Comment on Proposed Rule, *supra* note 29, at 23.

147. Proposed Rule on Incentive-Based Compensation Arrangements, 81 Fed. Reg. at 37696.

148. McGuireWoods Comment on Proposed Rule, *supra* note 29, at 22.

149. McGuireWoods Comment on Proposed Rule, *supra* note 29, at 20.

150. McGuireWoods Comment on Proposed Rule, *supra* note 29, at 20.

151. Hamilton, *Pay Rule May Give BlackRock a Recruiting Boost Over JPMorgan*, *supra* note 122.

152. Hamilton, *Pay Rule May Give BlackRock a Recruiting Boost Over JPMorgan*, *supra* note 122.

153. Hamilton, *Pay Rule May Give BlackRock a Recruiting Boost Over JPMorgan*, *supra* note 122.

practice.¹⁵⁴ For example, an employee in a sales capacity may receive a high level of compensation relative to other employees, but the employee's sales may be subject to strict review and the employee may have little authority to make final commitments on behalf of the institution.¹⁵⁵ Moreover, authorized limits for commitments may be expressed in terms other than as a percentage of capital and may not be easily translated into terms based on capital.¹⁵⁶ For these reasons, many industry professionals suggested excluding employees with compensation below a certain threshold from the SRT and SEO tests.¹⁵⁷ A compromise of using the MRT approach and giving compensation levels more weight in the determination would provide a more reasonable method for deciding which employees might expose the Covered Institution to excessive risk of material loss.¹⁵⁸

III. INCENTIVE-BASED COMPENSATION CONTINUES TO BE A PROBLEM IN FINANCIAL INSTITUTIONS

In the fall of 2016, Wells Fargo came under fire for its compensation policies when the bank settled with regulators over the creation of fraudulent accounts.¹⁵⁹ The Los Angeles Times initially broke the story that over two million fake accounts were created by front-line employees who were under pressure to meet unrealistic sales

154. ABA Comment on Proposed Rule, *supra* note 30, at 5 (“[E]ach covered institution has its own risk governance model, policies and procedures, the allocation of authority for business decisions is divided in ways that are unique to the institution.”) (citing Guidance on Sound Incentive Compensation Policies, 75 Fed. Reg. 36395 (June 25, 2010)).

155. ABA Comment on Proposed Rule, *supra* note 30, at 3.

156. ABA Comment on Proposed Rule, *supra* note 30, at 5 (“For most bank personnel, risk limits are not set in reference to ability to commit a specific amount of the firm’s capital. In fact, for most risk takers in banks, it is not possible to convert their authorities into a capital-based measure, at least not without making assumptions that are likely to prove unrealistic or inaccurate, leading to results in conflict with the Agencies’ intent.”)

157. See McGuireWoods Comment on Proposed Rule, *supra* note 29, at 9 (suggesting a \$200,000 threshold for covered employees and \$1 million threshold for SRTs); see also Regional Banks Comment on Proposed Rule, *supra* note 137, at 9 (suggesting an exclusion for employees whose incentive-based compensation does not exceed \$50,000).

158. See McGuireWoods Comment on Proposed Rule, *supra* note 29, at 16 (noting that the SRT and SRT approach can be implemented into the current MRT framework).

159. See e.g., Jeff Bater, *Wells Fargo to Pay \$185 Million for Unauthorized Bank Accounts*, 107 Banking Rep. No. 9, at 305 (Sept. 12, 2016) (“Wells Fargo will pay \$185 million in penalties and \$5 million in remediation over allegations its employees secretly opened unauthorized accounts to hit sales targets . . .”).

goals.¹⁶⁰ Much of the responsibility for the scandal fell on John Stumpf, the CEO of Wells Fargo, and Carrie Tolstedt, the executive in charge of the community banking unit.¹⁶¹ Both have resigned and forfeited unvested bonuses totaling \$60 million.¹⁶² Although the total cost to the institution is difficult to calculate, the bank faces total fines of \$185 million from the OCC, CFPB, and State of California.¹⁶³ The Wells Fargo scandal has raised alarms that banks may not have effective policies to monitor and mitigate excessively risky behavior by their employees.¹⁶⁴ Moreover, the scandal occurred while Federal Regulators were in the process of finalizing rules on incentive-based compensation under Section 956 of Dodd-Frank.¹⁶⁵ The Proposed Rule, however, may not have prevented the scandal even if it were finalized in advance of the scandal, causing some to suggest the rules should be more stringent than originally proposed.¹⁶⁶

Wells Fargo was fined substantially for the fraudulent practices

160. James Rufus Koren, *Wells Fargo to Pay \$185 Million Settlement for 'Outrageous' Sales Culture*, L.A. TIMES (Sept. 8, 2016), <http://www.latimes.com/business/la-fi-wells-fargo-settlement-20160907-snap-story.html>; E. Scott. Reckard, *Wells Fargo's Pressure-cooker Sales Culture Comes at a Cost*, L.A. TIMES (Dec. 21, 2013), <http://www.latimes.com/business/la-fi-wells-fargo-sale-pressure-20131222-story.html>.

161. Jenny Surane & Elizabeth Dexheimer, *Stumpf Pay Surrender Buys Time but Lawmakers Say It's Not Enough*, 107 Banking Rep. (BNA) No. 12, at 435–36 (Sept. 28, 2016).

162. *Id.* (noting that Stumpf forfeited approximately \$41 million and Tolstedt forfeited approximately \$19 million).

163. In the Matter of Wells Fargo Bank, N.A., CFPB No. 2016-CFPB-0015 (Sept. 4, 2016); In the Matter of Wells Fargo Bank, N.A., OCC No. 2016-079 (Sept. 6, 2016); State of California v. Wells Fargo & Co., No. BC580778 (Cal. Super. Ct. Sept. 1, 2016) (consent order); see also Greene, *supra* note 78, at 475; Surane and Dexheimer, *supra* note 160.

164. See Jeff Bater, *Wells Fargo Scandal Prompts Regulator to Take Closer Look at Peers' Practices*, 107 Banking Rep. (BNA) No. 11, at 397 (Sept. 26, 2016) (reporting that the OCC has begun an investigation into bank sales practices in response to the Wells Fargo scandal).

165. See, e.g., Menendez Letter, *supra* note 15 (asking Federal Regulators to strengthen and finalize proposed rules under Section 956 of Dodd-Frank).

166. It is unlikely the front-line employees engaged in the sales practices would have been covered by the proposed rule. SEOs and SRTs are generally employees who (a) are in charge of a line of business; (b) have the authority to expose large amounts of capital; or (c) receive the highest compensation relative to others in the same division. See Proposed Rule on Incentive-Based Compensation Arrangements, 81 Fed. Reg. 37670, 37833–34 (proposed June 10, 2016) (to be codified at 12 C.F.R. § 42 (OCC); 12 C.F.R. § 236 (FRB); 12 C.F.R. § 372 (FDIC); 12 C.F.R. §§ 741, 751 (NCUA); 12 C.F.R. § 1232 (FHFA); & 17 C.F.R. §§ 240, 275, & 303 (SEC)). Moreover, the CEO and Director of Community Banking, who likely would have been covered by the Proposed Rule, voluntarily forfeited approximately \$60 million in the wake of the scandal. Surane & Dexheimer, *supra* note 160, at 435.

of its employees, and the bank continues to face additional costs and threats of litigation.¹⁶⁷ In addition to fines levied by the OCC, CFPB, and State of California, several states and municipalities have suspended business with Wells Fargo.¹⁶⁸ For example, California, the bank's home state, along with Illinois, Ohio, and Massachusetts have suspended state bond deals with Wells Fargo because of the scandal.¹⁶⁹ Similarly, the cities of San Francisco, Chicago, and Seattle have suspended business deals with the bank.¹⁷⁰ The bank also faces potential investigations from the Department of Justice and SEC, as well as lawsuits from former customers, employees, and shareholders.¹⁷¹ After the scandal was reported, a complaint was filed for securities law violations, and shareholders initiated a lawsuit related to the 9% drop in the stock price.¹⁷² Although the total extent of the loss to Wells Fargo is yet to be determined, the bank certainly faces a negative public perception after the scandal.¹⁷³

The Wells Fargo scandal has led financial regulators and financial institutions to evaluate incentive-based compensation

167. Kartikay Mehrotra, Laura J. Keller & Romy Varghese, *Wells Fargo Wants Quiet End to Scandal, Risking More Noise*, 107 Banking Rep. (BNA) No. 22, at 813 (Dec. 12, 2016) (noting that in addition to fines, the bank faces investigation from federal agencies, another federal department, state attorneys general, prosecutors' offices and congressional committees).

168. E.g., Romy Varghese, *Massachusetts Becomes Latest State to Penalize Wells Fargo*, 107 Banking Rep. (BNA) No. 15, at 545 (Oct. 24, 2016).

169. *Id.*

170. Romy Varghese, *Wells Fargo Faces Heat From Home State Officials After CEO Exit*, 107 Banking Rep. (BNA) No. 15, at 544 (Oct. 24, 2016).

171. Pamela Maclean & Laura J. Keller, *Wells Fargo Bogus-Account Scandal Said to Draw DOJ Investigation*, 107 Banking Rep. (BNA) No. 10, at 359 (Sept. 19, 2016) (DOJ Investigation); Kartikay Mehrotra, *Wells Fargo Sued by Shareholders Over Cross-Selling Scandal*, 107 Banking Rep. (BNA) No. 12, at 452 (Oct. 3, 2016) (Shareholder Suit); Rob Tricchinelli, *Senators Ask for SEC Probe of Wells Fargo*, 107 Banking Rep. (BNA) No. 13, at 479 (Oct. 10, 2016) (SEC Investigation); Kartikay Mehrotra, *Wells Fargo Ex-Managers' Suit Puts Scandal Blame Higher Up Chain*, 107 Banking Rep. (BNA) No. 22, at 834 (Dec. 12, 2016) (Former Employee Lawsuit); Chris Bruce, *Wells Fargo Faces \$5 Million Lawsuit on Unauthorized Accounts*, 107 Banking Rep. (BNA) No. 11 (Sept. 26, 2016) (Customer Lawsuit).

172. Mehrotra, *Wells Fargo Sued by Shareholders Over Cross-Selling Scandal*, *supra* note 171.

173. Lucinda Shen, *Wells Fargo Scandal Could End Up Costing Bank \$8 Billion*, FORTUNE (Oct. 25, 2016), <http://fortune.com/2016/10/24/wells-fargos-scandal-could-end-up-costing-bank-8-billion/> (reporting that the scandal affected just 3% of Wells Fargo customers and so far, has had little effect on revenue, but public opinion has fallen dramatically, with 14% of customers deciding to bank elsewhere).

policies.¹⁷⁴ For example, the OCC is evaluating compensation arrangements in certain financial institutions.¹⁷⁵ The OCC sent a letter to financial institutions under its regulatory authority requesting information about the institutions' compensation policies.¹⁷⁶ The OCC is also working with other regulators to ensure no other financial institutions have sales practices that encourage employees to open accounts without customer authorization.¹⁷⁷ In addition, Wells Fargo has eliminated product sales goals for its retail banking team and eliminated bonuses for mortgage brokers in response to the scandal.¹⁷⁸ In a Bloomberg Television interview, Paul Miller, an analyst at FBR Capital Markets, said that Wells Fargo's rivals also needed to be sensitive to risk exposure of employees, because he is "very concerned that regulators will really dig, [and come] after these banks aggressively."¹⁷⁹ At least one large financial institution, JPMorgan Chase, has proactively conducted a review of its compensation policies since the news broke regarding Wells Fargo.¹⁸⁰ JPMorgan addressed minor issues in its incentive-based compensation policy, but did not find any systemic risks.¹⁸¹

Lawmakers on Capitol Hill have also expressed concerns about the Wells Fargo scandal.¹⁸² Both sides of the political spectrum have weighed in on the scandal, with Republicans questioning the effectiveness of the CFPB and Democrats calling for tougher regulations.¹⁸³ The Senate Banking Committee conducted an

174. E.g., Hugh Son & Jordyn Holman, *JPMorgan Conducts 'Deep Dive' Review After Wells Fargo Lapse*, 107 Banking Rep. (BNA) No. 14, at 511 (Oct. 17, 2016); Jesse Hamilton, *Wall Street Banks to Face On-Site Reviews of Sales Practices*, 107 Banking Rep. (BNA) No. 16, at 575 (Oct. 31, 2016).

175. Emily Glazer & Christina Rexrode, *Big U.S. Retail Bank Operations Under Scrutiny After Wells Scandal*, WALL ST. J. (Oct. 25, 2016), <http://www.wsj.com/articles/big-u-s-retail-bank-operations-under-scrutiny-follow-wells-scandal-1477400747>; Hamilton, *Wall Street Banks to Face On-Site Reviews of Sales Practices*, *supra* note 174.

176. Glazer & Rexrode, *supra* note 175.

177. Hamilton, *Wall Street Banks to Face On-Site Reviews of Sales Practices*, *supra* note 174, at 575.

178. Son & Holman, *supra* note 174; Laura J. Keller, *Wells Fargo to Stop Paying Brokers Bonuses for Selling Loans*, 107 Banking Rep. (BNA) No. 23, at 862 (Dec. 19, 2016).

179. Son & Holman, *supra* note 174.

180. Son & Holman, *supra* note 174.

181. Son & Holman, *supra* note 174.

182. Menendez Letter, *supra* note 15.

183. Yuka Hayashi, *Political Fight Over CFPB Heats Up After Wells Fargo Scandal*,

investigation into the scandal, and the House Financial Services Committee is also investigating the matter.¹⁸⁴ Senate Democrats have even questioned KPMG, the one-time independent auditor of Wells Fargo, about its failure to catch the abuse of the system.¹⁸⁵ Others have noted that the OCC and CFPB discovered the practices at Wells Fargo as early as 2012.¹⁸⁶ Neither the OCC nor the CFPB, however, brought formal action against Wells Fargo when the sales practices first came to light.¹⁸⁷

As a result of the Wells Fargo scandal, regulators will likely become more involved in compensation arrangements in financial institutions.¹⁸⁸ If regulators do not enforce existing rules, however, additional regulations are unlikely to improve compensation policies.¹⁸⁹ Even with regulatory oversight, Wells Fargo was able to continue the scheme for several years and was not formally punished when the fraudulent practices were initially reported.¹⁹⁰ Comptroller Curry stated that the 2016 Proposed Rule would have prevented the sales practices at Wells Fargo.¹⁹¹ However, the OCC discovered the improper sales practices at Wells Fargo as early as 2012 and failed to effectively address the matter.¹⁹² Although lawmakers are pressuring regulators to toughen rules on incentive-based compensation, regulators could have initiated enforcement action under current rules and guidance.¹⁹³ Perhaps Congress should allow Federal Regulators to focus on effectively enforcing and monitoring financial institutions under the

WALL ST. J. (Sept. 22, 2016), <http://www.wsj.com/articles/political-fight-over-cfpb-heats-up-after-wells-fargo-scandal-1474582741>.

184. Surane & Dexheimer, *supra* note 160.

185. Mont, *supra* note 35.

186. Akshat Tewary, *OCC Deserves More Scrutiny in Wake of Wells Fargo Fraud*, AM. BANKER (Oct. 13, 2016), <https://www.americanbanker.com/opinion/occ-deserves-more-scrutiny-in-wake-of-wells-fraud>.

187. *Id.*

188. See Hamilton, *Wells Fargo Scandal Hurts Wall Street's Fight Against Pay Rules*, *supra* note 16.

189. Hamilton, *Wells Fargo Scandal Hurts Wall Street's Fight Against Pay Rules*, *supra* note 16.

190. Hayashi, *supra* note 183.

191. *Hearing Related to Unsafe and Unsound Sales Practices at Wells Fargo Before the S. Comm. on Banking, Hous., and Urban Affairs*, 112th Cong. (2016) [hereinafter *Senate Hearing*] (testimony of Thomas J. Curry, Comptroller of the Currency).

192. Tewary, *supra* note 186.

193. Tewary, *supra* note 186.

current rules rather than pressuring regulators to adopt new regulations.¹⁹⁴

Had the Proposed Rule been in effect before Wells Fargo's scandalous conduct, it is difficult to determine whether or not Wells Fargo would have altered its practices, thus avoiding its troubles.¹⁹⁵ While the CEO and Director of Community Banking would have been subject to the downward adjustment and clawback provisions of the Proposed Rule, the 5,300 employees at Wells Fargo who were fired leading up to the scandal likely would not have been subject to the more stringent pay restrictions of the Proposed Rule.¹⁹⁶ Moreover, even without a regulation requiring recoupment of compensation, the CEO and Director of Community Banking, who both resigned in the wake of the scandal, forfeited a substantial amount of income.¹⁹⁷ In total, the CEO and Director of Community Banking forfeited \$60 million in unvested compensation.¹⁹⁸ Furthermore, Wells Fargo has eliminated the aggressive sales practices from its retail banking division and shifted more pay towards salary and less toward incentive-based compensation.¹⁹⁹

In order to address other risks and prevent future scandals, Federal Regulators must ensure financial institutions are complying with current regulations and guidance.²⁰⁰ Federal Regulators should

194. See Tewary, *supra* note 186 (“No federal regulator ever stepped up to the plate to initiate a punitive investigation against [WellsFargo].”).

195. See Tewary, *supra* note 186 (“Section 956 was crafted to protect banks from excessive risk-taking by bonus-seeking managers and traders. It will do little to protect customers from dishonest retail banking practices like those perpetrated at Wells Fargo, especially where those practices do not rise to the level of threatening the overall fiscal health of the offending bank.”).

196. SEOs and SRTs are generally employees who (a) are in charge of a line of business; (b) have the authority to expose large amounts of capital; or (c) receive the highest compensation relative to others in the same division. See Proposed Rule on Incentive-Based Compensation Arrangements, 81 Fed. Reg. 37670, 37833–34 (proposed June 10, 2016) (to be codified at 12 C.F.R. § 42 (OCC); 12 C.F.R. § 236 (FRB); 12 C.F.R. § 372 (FDIC); 12 C.F.R. §§ 741, 751 (NCUA); 12 C.F.R. § 1232 (FHFA); & 17 C.F.R. §§ 240, 275, & 303 (SEC)).

197. Greene, *supra* note 78, at 475; Surane & Dexheimer, *supra* note 161, at 435.

198. Surane & Dexheimer, *supra* note 160, at 435.

199. The most stringent requirements only apply to SEO and SRT, which are generally employees who: are in charge of a line of business; who have the authority to expose large amounts of capital; or who receive the highest compensation relative to others in their division. See Proposed Rule on Incentive-Based Compensation Arrangements, 81 Fed. Reg. at 37835–38.

200. See James R. Koren, *Federal Regulator Launches Broad Review of Banks' Sales*

continue to monitor compensation arrangements to minimize excessive risk in financial institutions.²⁰¹ Likewise, financial institutions should continue to monitor their compensation policies and ensure compliance with safe and sound banking practices as outlined in the Interagency Guidance.²⁰² Regardless of whether the Proposed Rule could have prevented the scandal, Federal Regulators are under increasing pressure to implement tougher rules.²⁰³ Due to political pressure, regulators are likely to monitor sales practices more closely in financial institutions going forward, even if the Proposed Rule does not go into effect.²⁰⁴

IV. UNINTENDED CONSEQUENCES OF OVER-REGULATING INCENTIVE-BASED COMPENSATION

Financial institutions and their employees are sensitive to increased regulation of incentive-based compensation arrangements.²⁰⁵ When Federal Regulators initially proposed rules pursuant to Section 956 of Dodd-Frank, industry professionals and advocacy groups submitted over 10,000 comments.²⁰⁶ Many of the comments discuss the unintended consequences of the Proposed Rule, which could negatively affect the financial industry.²⁰⁷ The unintended consequences of

Practices, L.A. TIMES (Oct. 25, 2016), <http://www.latimes.com/business/la-fi-bank-sales-review-20161025-snap-story.html> (noting that the OCC is currently requesting information from financial institutions and coordinating with other bank regulators to review compensation policies); Tewary, *supra* note 184 (opining that regulators should have acted sooner to prevent the stop the unlawful sales practices at Wells Fargo).

201. See Son & Holman, *supra* note 174 (noting that other banks should examine their compensation policies because regulators will monitor banks more closely after the Wells Fargo scandal).

202. HORIZONTAL REVIEW, *supra* note 2, at 15.

203. Menendez Letter, *supra* note 15.

204. See Menendez Letter, *supra* note 15 (requesting regulators to include more stringent requirements in the proposed rule); see also Jeff Bater, *OCC Flags Sales Practices at Banks in Semiannual Risk Report*, 108 Banking Rep. (BNA) No. 2, at 65 (Jan 9, 2017) (noting that the OCC continues to review sales practices in other large and midsize banks and has added governance of sales practice as a key risk that can negatively affect public trust in the financial industry).

205. See generally Proposed Rule on Incentive-Based Compensation Arrangements, 81 Fed. Reg. 37670, 37677 (proposed June 10, 2016) (to be codified at 12 C.F.R. § 42 (OCC); 12 C.F.R. § 236 (FRB); 12 C.F.R. § 372 (FDIC); 12 C.F.R. §§ 741, 751 (NCUA); 12 C.F.R. § 1232 (FHFA); & 17 C.F.R. §§ 240, 275, & 303 (SEC)) (noting that Federal Regulators received over 10,000 comments when rules were initially proposed under Section 956).

206. *Id.*

207. E.g., McGuireWoods Comment on Proposed Rule, *supra* note 29; Wells Fargo Comment on Proposed Rule, *supra* note 34; Regional Banks Comment on Proposed Rule,

potential rules must be fully reviewed when regulators are considering the appropriate level of regulation for incentive-based compensation arrangements.²⁰⁸ First, overregulation of compensation can lead to increased or unfair competition for employees between a Covered Institution and its less regulated competitors.²⁰⁹ Second, rigid compensation policies could reduce the incentive for Covered Institutions to develop new and innovative compensation policies.²¹⁰ Finally, if regulation adversely affects incentive-based compensation, employees may devalue incentive-based compensation and demand more compensation be paid in the form of fixed compensation.²¹¹

A. *Covered Employees May Leave Financial Institutions for Less Regulated Entities*

One of the most serious unintended results of overregulation of compensation is that the regulation will negatively affect a Covered Institution's ability to recruit and retain talented employees.²¹² For instance, competition for talent between large Covered Institutions and less-regulated, smaller Covered Institutions may result in more talented employees choosing the less-regulated institutions.²¹³ Moreover, when

supra note 138.

208. See HORIZONTAL REVIEW, *supra* note 2, at 10 (“The interagency guidance helps to avoid the potential hazards or unintended consequences that would be associated with rigid, one-size-fits-all supervisory limits or formulas.”); see also McGuireWoods Comment on Proposed Rule, *supra* note 29 (“[T]he prescriptive nature of the Proposed Rules fossilizes current compensation practices and prevents innovation that appropriately balances risks and rewards and allows financial institutions to adjust their compensation practices.”).

209. Hamilton, *Pay Rule May Give BlackRock a Recruiting Boost Over JPMorgan*, *supra* note 122.

210. See generally McGuireWoods Comment on Proposed Rule, *supra* note 29 (“[T]he prescriptive nature of the Proposed Rules fossilizes current compensation practices and prevents innovation that appropriately balances risks and rewards and allows financial institutions to adjust their compensation practices.”).

211. See Hamilton, *Pay Rule May Give BlackRock a Recruiting Boost Over JPMorgan*, *supra* note 122 (noting that companies affected the proposed rule may have to pay more to stay competitive or to make up for stricter requirements).

212. Hamilton, *Pay Rule May Give BlackRock a Recruiting Boost Over JPMorgan*, *supra* note 122; Regional Banks Comment on Proposed Rule, *supra* note 138.

213. Proposed Rule on Incentive-Based Compensation Arrangements, 81 Fed. Reg. 37670, 37780 (proposed June 10, 2016) (to be codified at 12 C.F.R. § 42 (OCC); 12 C.F.R. § 236 (FRB); 12 C.F.R. § 372 (FDIC); 12 C.F.R. §§ 741, 751 (NCUA); 12 C.F.R. § 1232 (FHFA); 17 C.F.R. §§ 240, 275, 303 (SEC)); Hamilton, *Pay Rule May Give BlackRock a Recruiting Boost Over JPMorgan*, *supra* note 122.

Covered Institutions compete for talent with other industries that are not subject to financial regulation, employees may choose to leave the financial industry altogether.²¹⁴ Overall, this level of competition for talent requires innovative compensation policies that allow Covered Institutions to compensate employees based on the needs of the particular institution.²¹⁵

When Covered Institutions compete for relatively similar talent regardless of asset size, regulations that increase restrictions based on asset size place larger Covered Institutions at a competitive disadvantage.²¹⁶ Specifically, if an employee has a choice of either working at a large Covered Institution with income subject to compensation restrictions or a smaller Covered Institution with little or no restriction, then the employee is likely to choose the smaller Covered Institution.²¹⁷ In addition, as subsidiaries are treated the same as their top-tier parent company, subsidiaries are further disadvantaged in the competition for talent against stand-alone institutions.²¹⁸ In order to overcome this competition, large Covered Institutions may decide to overpay in order to attract and retain the same talent.²¹⁹ Paying employees higher salaries could increase the Covered Institution's risk profile and prevent the institution from reacting to economic downturns.²²⁰

The most successful financial advisors would be most affected by the proposed rule, and therefore most likely leave a covered institution for an unregulated competitor.²²¹ Financial advisors with

214. Regional Banks Comment on Proposed Rule, *supra* note 138, at 11.

215. Regional Banks Comment on Proposed Rule, *supra* note 138, at 11.

216. Proposed Rule on Incentive-Based Compensation Arrangements, 81 Fed. Reg. at 37780; McGuireWoods Comment on Proposed Rule, *supra* note 29, at 3.

217. McGuireWoods Comment on Proposed Rule, *supra* note 29, at 21.

218. Proposed Rule on Incentive-Based Compensation Arrangements, 81 Fed. Reg. 37670, 37780 (proposed June 10, 2016) (to be codified at 12 C.F.R. § 42 (OCC); 12 C.F.R. § 236 (FRB); 12 C.F.R. § 372 (FDIC); 12 C.F.R. §§ 741, 751 (NCUA); 12 C.F.R. § 1232 (FHFA); & 17 C.F.R. §§ 240, 275, & 303 (SEC)).

219. *Id.* at 37778; Hamilton, *Pay Rule May Give BlackRock a Recruiting Boost Over JPMorgan*, *supra* note 122.

220. McGuireWoods Comment on Proposed Rule, *supra* note 29, at 10.

221. McGuireWoods Comment on Proposed Rule, *supra* note 29, at 20; *see also* Hamilton, *Pay Rule May Give BlackRock a Recruiting Boost Over JPMorgan*, *supra* note 122 ("Of the 669 registered investment advisers subject to the rule, the SEC estimated only 18 would face the toughest level of regulation. Many of those are inside banks, and even the world's largest money manager, BlackRock, doesn't have enough proprietary assets to

income sufficient to meet the compensation requirements of the Proposed Rule are also most likely to have the financial mobility to move to another financial institution.²²² These financial advisors would likely find the mandatory deferral provisions unacceptable, and therefore leave larger, more diversified Covered Institutions for employment in smaller institutions that are not subject to the regulation.²²³ Removing successful financial advisors from Covered Institutions would eliminate a diversified revenue stream, which may be unrelated to excessive risk-taking.²²⁴ This problem directly results from regulating subsidiaries at the level of the top-tier parent company.²²⁵ Financial advisors employed by large banks would be subject to the most stringent requirements, but even the largest stand-alone financial management firms do not have sufficient assets to fall into the top tier of regulation.²²⁶

This problem also presents issues with competition for talent between smaller regional Covered Institutions and larger Covered Institutions.²²⁷ In a regional bank with fewer high-earning employees in a specific division, employees in that division may be deemed SRTs based on the relative compensation test.²²⁸ For example, a covered employee in a small capital markets division at a regional bank could be designated an SRT based on relative compensation, but the same

put it in the top tier.”).

222. McGuireWoods Comment on Proposed Rule, *supra* note 29, at 20.

223. McGuireWoods Comment on Proposed Rule, *supra* note 29, at 20.

224. McGuireWoods Comment on Proposed Rule, *supra* note 29, at 20. See Hamilton, *Pay Rule May Give BlackRock a Recruiting Boost Over JPMorgan*, *supra* note 122 (“Asset managers have become especially valuable for banks in recent years, bolstering profit margins with their steady fee-based income as firms face pressures on lending and trading revenue.”).

225. “The proposed rule would subject covered institution subsidiaries of a depository institution holding company that is a Level 1 or Level 2 covered institution to the same requirements as the depository institution holding company. . . . The main disadvantage of such approach is that it may impose requirements and prohibitions on individuals employed in smaller subsidiaries that are less likely to be in a position to expose the institution to significant risks.” Proposed Rule on Incentive-Based Compensation Arrangements, 81 Fed. Reg. 37670, 37780 (proposed June 10, 2016) (to be codified at 12 C.F.R. § 42 (OCC); 12 C.F.R. § 236 (FRB); 12 C.F.R. § 372 (FDIC); 12 C.F.R. §§ 741, 751 (NCUA); 12 C.F.R. § 1232 (FHFA); & 17 C.F.R. §§ 240, 275, & 303 (SEC)).

226. See Hamilton, *Pay Rule May Give BlackRock a Recruiting Boost Over JPMorgan*, *supra* note 121 (noting that even the largest independent money manager does not have sufficient assets to fall under the top tier of regulation).

227. Regional Banks Comment on Proposed Rule, *supra* note 138, at 2.

228. Regional Banks Comment on Proposed Rule, *supra* note 138, at 10.

employee may not be an SRT at a large national bank with a larger number of high-earning employees.²²⁹ Moreover, since the SRT determination is based on the level of income relative to the Covered Institution's other employees, an employee could fall in and out of the SRT definition from year to year.²³⁰ This volatility may be enough to drive talent to other institutions.²³¹

Employees in non-risk taking support functions could also be subject to restrictions of the Proposed Rule by virtue of their employment at a Covered Institution.²³² Covered Institutions employ many employees in fields not specifically related to the financial industry, particularly those who specialize in technology, human resources, law, and compliance.²³³ These employees are the most likely to find other industries attractive.²³⁴ One way the Covered Institution can attract these employees into the financial industry is by providing incentive-based compensation arrangements.²³⁵ An incentive-based compensation arrangement not only provides the employee with an incentive to work in the financial industry, but also allows the Covered Institution to adjust the compensation in periods of economic downturn.²³⁶ In sum, the incentive-based compensation structure benefits both the institution and the individual employee.²³⁷ In some cases, these employees are actually engaged in activities that reduce the risk of loss to the Covered Institution.²³⁸ Including these employees in the SEO and SRT definitions does little to reduce risks from incentive compensation and makes it more difficult for the financial institution to attract and retain high-quality employees with sought-after expertise.²³⁹ In addition, the potential volatility in pay from year to year could actually subject financial institutions to additional risks associated with difficulty in attracting and retaining high-quality talent in non-risk

229. Regional Banks Comment on Proposed Rule, *supra* note 138, at 10.

230. Regional Banks Comment on Proposed Rule, *supra* note 138, at 11.

231. Regional Banks Comment on Proposed Rule, *supra* note 138, at 11.

232. Regional Banks Comment on Proposed Rule, *supra* note 138, at 11.

233. Regional Banks Comment on Proposed Rule, *supra* note 138, at 11.

234. Regional Banks Comment on Proposed Rule, *supra* note 138, at 11.

235. McGuireWoods Comment on Proposed Rule, *supra* note 29, at 2.

236. McGuireWoods Comment on Proposed Rule, *supra* note 29, at 11.

237. *See generally* McGuireWoods Comment on Proposed Rule, *supra* note 27, at 2.

238. Regional Banks Comment on Proposed Rule, *supra* note 138, at 10.

239. Regional Banks Comment on Proposed Rule, *supra* note 138, at 10.

taking roles.²⁴⁰

B. Uniform Rules May Discourage Innovative Compensation Policies

With a new rule proposed on incentive-based compensation, most Covered Institutions will wait for the final rule before making any major change to their pay programs.²⁴¹ If the Proposed Rule is finalized, Covered Institutions could incorrectly conclude that the standards set by the Federal Regulators are sufficient to fit their risk profiles.²⁴² Therefore, the Proposed Rule could discourage or inhibit institutions from developing new and innovative compensation arrangements.²⁴³ In some cases, complex, uniform rules make it more difficult for the board of directors to oversee a company, while making it easier to simply game the system.²⁴⁴ In order to avoid the aforementioned issues, the board of directors of a Covered Institution must continue to develop appropriate and innovative compensation practices.²⁴⁵

A financial institution should have the ability, with oversight from Federal Regulators, to determine whether its employees are exposing the financial institution to material risk of loss.²⁴⁶ As previously noted, financial institutions need the ability to develop compensation strategies that fit within their size, complexity, business strategy, and risk profiles.²⁴⁷ The board of directors of financial institutions must more closely monitor compensation policies to ensure that the policies do not encourage employees to take excessive risks.²⁴⁸

240. Regional Banks Comment on Proposed Rule, *supra* note 138, at 10.

241. Greene, *supra* note 78.

242. RMA Comment on Proposed Rule, *supra* note 100, at 9–10 (noting that the proposed rule “apparent[ly] shift[s] oversight from the board of directors to the regulators agencies”).

243. McGuireWoods Comment on Proposed Rule, *supra* note 29, at 32.

244. Greene, *supra* note 78.

245. See Regional Banks Comment on Proposed Rule, *supra* note 138, at 13 (“[I]nstitutions should be responsible for designating their employees as SRTs in accordance with principles and rules articulated by the agencies.”).

246. Regional Banks Comment on Proposed Rule, *supra* note 138, at 13.

247. Guidance on Sound Incentive Compensation Policies, 75 Fed. Reg. 36395, 36406 (June 25, 2010).

248. Greene, *supra* note 78.

Flexibility in compensation rules encourages the board of directors to innovate and develop new ways to reduce the risk in incentive-based compensation.²⁴⁹ In order to promote further innovation, Federal Regulators could encourage more board oversight rather than implementing uniform rules,²⁵⁰ and Federal Regulators could supplement board discretion by implementing recordkeeping and documentation of compensation enforcement actions.²⁵¹

C. *Strict Rules on Compensation Could Result in Increased Compensation*

Uniform rules on compensation can increase the exact problems the rules are meant to prohibit.²⁵² Analysis of past legislation and regulation of compensation suggests that additional rules are “generally either ineffective or counterproductive.”²⁵³ For example, IRS rules limiting the deductibility in non-incentive pay actually led to increases in pay through additional stock options and other incentive compensation plans.²⁵⁴ Similarly, SEC rules requiring disclosure of pay and benchmarking used to determine pay actually provided firms a justification for higher pay based on pay of similar firms.²⁵⁵ When regulating incentive-based compensation, increased regulation could

249. ABA Comment on Proposed Rule, *supra* note 30, at 2.

250. Greene, *supra* note 78.

251. For example, the disclosure and recordkeeping requirements in the 2016 Proposed Rule require financial institutions to make additional information available to Federal Regulators. See Proposed Rule on Incentive-Based Compensation Arrangements, 81 Fed. Reg. 37670, 37803 (proposed June 10, 2016) (to be codified at 12 C.F.R. § 42 (OCC); 12 C.F.R. § 236 (FRB); 12 C.F.R. § 372 (FDIC); 12 C.F.R. §§ 741, 751 (NCUA); 12 C.F.R. § 1232 (FHFA); & 17 C.F.R. §§ 240, 275, & 303 (SEC)).

252. *Hearing on Compensation Structure and Systemic Risk Before the H. Comm. on Fin. Serv., Hous.*, Cong. 111th Cong. (2009) (testimony of J.W. Verret, Assistant Professor Geo. Mason U. Sch. of Law) <http://archives.financialservices.house.gov/media/file/hearings/111/verret.pdf>.

253. Michael W. Faulkender & Jun Yang, *Is Disclosure an Effective Cleansing Mechanism? The Dynamics of Compensation Peer Benchmarking*, HARV. L. REV. FORUM (Dec. 12, 2012), <https://corpgov.law.harvard.edu/2012/12/12/the-dynamics-of-compensation-peer-benchmarking/>.

254. See Joy Sabino Mullane, *Incidence and Accidents: Regulation of Executive Compensation Through the Tax Code*, 13 LEWIS & CLARK L. REV. 485, 521–23 (2009) (noting that the initial result was for executives to receive an increase in base compensation).

255. Faulkender & Yang, *supra* note 253.

result in devaluation of incentive-based pay, and therefore, employees may demand more pay be attributed to salary rather than based on performance.²⁵⁶

Prior federal efforts to reduce executive compensation have actually resulted in increased compensation for executives.²⁵⁷ Federal income tax legislation in 1992 limited the deduction for compensation to top executives at \$1 million.²⁵⁸ The limit on deductions only applied to pay that was not tied to performance.²⁵⁹ While the intention was to limit executive pay compared to that of the average worker, the result was to shift more of executive compensation to performance-based pay.²⁶⁰ In response to the rule, firms set base pay at \$1 million and increased compensation through performance-based policies.²⁶¹ Similarly, the SEC attempted to reign in executive compensation by requiring firms to disclose the amount of executive compensation, including the method used to determine compensation, such as comparison among peer firms.²⁶² When more information about executive pay was made public, executives could justify higher compensation based on the pay of similarly situated executives in peer companies.²⁶³ Moreover, a firm could adjust its peer group so its CEO was in the median of CEOs for the peer group.²⁶⁴ In both cases, following the additional restrictions on certain aspects of compensation, the result was an increase in overall compensation for executives.²⁶⁵

In the present case, the Proposed Rule could result in an increase in overall compensation, because employees will devalue

256. Proposed Rule on Incentive-Based Compensation Arrangements, 81 Fed. Reg. at 37790 (“[T]he relatively long clawback horizon may generate uncertainty regarding incentive-based compensation of [SEOs] and [SRTs]. . . . As a response to the potentially increased uncertainty, senior executive officers and significant risk-takers may demand higher levels of overall compensation, or substitution of incentive-based compensation with other forms of compensation such as salary.”).

257. Faulkender & Yang, *supra* note 253.

258. I.R.C. § 162(m) (2015).

259. I.R.C. § 162(m)(4)(A)–(B).

260. Mullane, *supra* note 254, at 523–24.

261. Mullane, *supra* note 254, at 523–24.

262. For background and discussion of the SEC disclosure requirements see Kathryn J. Kennedy, *Excessive Executive Compensation: Prior Federal Attempts to Curb Perceived Abuses*, 10 HOUS. BUS. & TAX L.J. 196, 236 (2009).

263. Faulkender & Yang, *supra* note 253.

264. Faulkender & Yang, *supra* note 253.

265. Faulkender & Yang, *supra* note 253; Mullane, *supra* note 254.

incentive-based compensation and therefore, demand more fixed compensation.²⁶⁶ If incentive-based compensation is deferred for long periods of time, employees may find fixed compensation more desirable.²⁶⁷ When incentive-based compensation is deferred, an employee may place a lower value on the compensation for several reasons including: a discount for a delay in payment; risk of loss due to termination of employment; risk of loss due to failure to attain performance goals; discounted value for stock market risk if compensation is equity-based; and a discount for risk of clawbacks.²⁶⁸ Each of these factors creates a significant gap in the value of deferred compensation and the value of the compensation when the employee earns the incentive-based compensation.²⁶⁹ Specifically, the aggregate discount under the Proposed Rule can be as high as 35% based on all discount factors.²⁷⁰ Furthermore, if employers are withholding the employees' compensation and using it for the company's benefit, the employee will likely want to be compensated for the lost value.²⁷¹ Financial institutions could respond to this negative perception of deferred compensation by shifting a larger portion of income to salary and force regulators to fend off efforts to avoid the rule.²⁷² This discounted value for deferred compensation could also lead financial institutions to shift more compensation to salary.²⁷³ If compensation rules are ultimately adopted, employees with the option to leave the financial institution must decide whether it is worth it to continue working at a highly regulated financial institution.²⁷⁴

266. See Joseph E. Bachelder III, *What is the Real Value of an Incentive Compensation Award When It Is Made?; Executive Compensation*, N.Y. L. J. (online) (Sept. 22, 2016) (explaining the effects deferred compensation have on the present value of overall compensation).

267. Hamilton, *Pay Rule May Give BlackRock a Recruiting Boost Over JPMorgan*, *supra* note 122, at 760.

268. Bachelder, *supra* note 266.

269. Bachelder, *supra* note 266.

270. For a chart with the discount percentage applied to each factor *see* Bachelder, *supra* note 266.

271. Bachelder III, *supra* note 266.

272. Hamilton, *Pay Rule May Give BlackRock a Recruiting Boost Over JPMorgan*, *supra* note 122.

273. Hamilton, *Pay Rule May Give BlackRock a Recruiting Boost Over JPMorgan*, *supra* note 122.

274. Hamilton, *Pay Rule May Give BlackRock a Recruiting Boost Over JPMorgan*, *supra* note 122.

The results from prior attempts to limit executive compensation suggest that strict rules on compensation do not always lead to the intended results.²⁷⁵ If the Proposed Rule follows the trend of past limits on compensation, the rule could lead to an increase in overall pay, or at least a shift towards fixed compensation.²⁷⁶ Federal Regulators may actually reach their goal of limited incentive-based compensation under the current rules.²⁷⁷ For example, if the trend towards restricting incentive-based compensation through risk adjustments of awards and monitoring performance at additional points in time, the overall goal of the Proposed Rule can be obtained.²⁷⁸ Regulators can continue to pressure Covered Institutions to reform compensation policies, and policies will likely become more restrictive over time.²⁷⁹ If the same or similar outcome is achieved under the current rules, perhaps additional regulation is unnecessary.²⁸⁰

V. CONCLUSION

Despite efforts to improve compensation policies and reduce the incentive for excessive risk, incentive-based compensation continues to

275. *Hearing on Compensation Structure and Systemic Risk Before the H. Comm. on Fin. Serv., Hous., Cong. 111th Cong.* (2009) (testimony of J.W. Verret, Assistant Professor Geo. Mason U. Sch. of Law) <http://archives.financialservices.house.gov/media/file/hearings/111/verret.pdf>.

276. Proposed Rule on Incentive-Based Compensation Arrangements, 81 Fed. Reg. 37670, 37785 (proposed June 10, 2016) (to be codified at 12 C.F.R. § 42 (OCC); 12 C.F.R. § 236 (FRB); 12 C.F.R. § 372 (FDIC); 12 C.F.R. §§ 741, 751 (NCUA); 12 C.F.R. § 1232 (FHFA); & 17 C.F.R. §§ 240, 275, & 303 (SEC)) (“As a response to the potentially increased uncertainty, senior executive officers and significant risk-takers may demand higher levels of overall compensation, or substitution of incentive-based compensation with other forms of compensation such as salary.”).

277. See Emily Glazer & Christina Rexrode, *Big U.S. Retail Bank Operations Under Scrutiny After Wells Scandal*, WALL ST. J. (Oct. 25, 2016), <http://www.wsj.com/articles/big-u-s-retail-bank-operations-under-scrutiny-follow-wells-scandal-1477400747> (noting that the OCC is evaluating the practices at large and midsize banks in the aftermath of the Wells Fargo scandal for improper sales practices).

278. See MERCER, *supra* note 6 (stating that as a result of regulatory pressure around 90% of financial institution have some type of policy which requires that all or a portion of deferred or unvested awards can be adjusted or completely eliminated).

279. See Hamilton, *Wall Street Banks to Face On-Site Reviews of Sales Practices*, *supra* note 174 (reporting that Federal Regulators are reviewing sales practices of financial institutions under current rules and guidelines).

280. See ABA Comment on Proposed Rule, *supra* note 30, at 9 (“[E]xcessive and redundant deferral periods . . . are unnecessary to achieve the proposed rule’s objective.”).

present significant issues for financial institutions.²⁸¹ Due to the continuing problems of incentive-based compensation policies in financial institutions, as is illustrated by the recent Wells Fargo fiasco, regulators are likely to become more involved in compensation policies of financial institutions.²⁸² The level of involvement Federal Regulators choose to undertake remains uncertain.²⁸³ Regardless of the ultimate policy chosen by regulators, some degree of discretion will be given to financial institutions and regulators will focus more on detecting unsafe or unsound compensation policies.²⁸⁴

With the election of President Trump, the outcome of the Proposed Rule is even more uncertain.²⁸⁵ In addition, Michael Piwowar, a current commissioner of the SEC who is likely to take over as acting chairman, is not interested in passing a rule to restrict incentive pay.²⁸⁶ Of the six agencies that must adopt rules under Section 956, Piwowar was the only official to vote against the 2016 Proposed Rule.²⁸⁷ Furthermore, the new administration has pledged to work with Congress to dismantle parts of Dodd-Frank, which could remove the obligation of Federal Regulators to issue new rules on incentive-based compensation.²⁸⁸ Under the current law, however, Federal Regulators have an obligation to adopt some version of the Proposed Rule.²⁸⁹ Since the rule must be jointly proposed, however, the

281. Surane & Dexheimer, *supra* note 161.

282. See Menendez Letter, *supra* note 15; Proposed Rule on Incentive-Based Compensation Arrangements, 81 Fed. Reg. 37670, 37677 (proposed June 10, 2016) (to be codified at 12 C.F.R. § 42 (OCC); 12 C.F.R. § 236 (FRB); 12 C.F.R. § 372 (FDIC); 12 C.F.R. §§ 741, 751 (NCUA); 12 C.F.R. § 1232 (FHFA); & 17 C.F.R. §§ 240, 275, & 303 (SEC)).

283. See Menendez Letter, *supra* note 15.

284. Koren, *Federal Regulator Launches Broad Review of Banks' Sales Practices*, *supra* note 200.

285. See Zeke Faux & Jenny Surane, *Wall Street Hope Revived as Trump Signs Plan to Roll Back Rules*, 108 Banking Rep. (BNA) No. 6, at 201 (Feb. 6, 2017) (noting that the new administration will attempt to roll back many rules implemented as part of Dodd-Frank).

286. Ben Bain & Jesse Hamilton, *Wall St. Gets Reprieve as SEC Official Says Bonus Rule 'Dead'*, 108 Banking Rep. (BNA) No. 3, at 99 (Jan 16, 2017). Trump has also pledged to do a "big number on Dodd-Frank," calling the law a "disaster." Ben Bain & Jesse Hamilton, *Trump Pledges 'Big Number' on Dodd-Frank in Anti-Rule Push*, 106 Banking Rep. (BNA) No. 6, at 202 (Feb. 6, 2017).

287. Bain & Hamilton, *Wall St. Gets Reprieve as SEC Official Says Bonus Rule 'Dead'*, *supra* note 286.

288. Bain & Hamilton, *Trump Pledges 'Big Number' on Dodd-Frank in Anti-Rule Push*, *supra* note 286.

289. Bain & Hamilton, *Wall St. Gets Reprieve as SEC Official Says Bonus Rule 'Dead'*,

new leader of the SEC and potential new Director of the CFPB,²⁹⁰ are likely to push for a much weaker version than the 2016 Proposed Rule.²⁹¹

While the fate of the Proposed Rule is uncertain, Federal Regulators should continue to work with financial institutions to develop innovative compensation arrangements that appropriately manage risk and avoid unintended consequences.²⁹² Federal Regulators have presented many sound policies for reducing the risk that incentive-based compensation arrangements pose to the financial system.²⁹³ In drafting new compensation rules Federal Regulators should consider the improvements financial institutions have made to incentive-based compensation arrangements.²⁹⁴ Regulators should also provide flexibility to ensure that each financial institution has the ability to implement an individualized incentive-based compensation plan that will simultaneously reduce risk and foster growth.²⁹⁵

Any new rule on incentive-based compensation should focus on reducing the incentive for excessive risks and avoid the unintended consequences of overregulation.²⁹⁶ Federal Regulators should adopt an approach that correlates with the degree of risk the institution poses to the financial system.²⁹⁷ Regulators should prevent unfair competition among institutions with similar risk profiles by evaluating the actual

supra note 286.

290. See Jeff Bater, *Trump Win Turns CFPB Critic Into Contender for Agency Top Spot*, 108 Banking Rep. (BNA) No. 3, at 103 (Jan. 16, 2017) (noting that the former home builder, intramural trampoline team, the “Flying Metadors,” member, and most conservative member of the House of Representatives is a likely contender to lead the CFPB, who would act like a “tooth fairy” for Wall Street to make all their wildest dreams come true).

291. Bain & Hamilton, *Wall St. Gets Reprieve as SEC Official Says Bonus Rule ‘Dead’*, *supra* note 286.

292. *Hearing on Compensation Structure and Systemic Risk Before the H. Comm. on Fin. Serv., Hous., Cong. 111th Cong.* (2009) (testimony of J.W. Verret, Assistant Professor Geo. Mason U. Sch. of Law) <http://archives.financialservices.house.gov/media/file/hearings/111/verret.pdf>.

293. Proposed Rule on Incentive-Based Compensation Arrangements, 81 Fed. Reg. at 37677 (noting that the agencies saw improvements but proceeding to apply uniform standards for compensation policies).

294. *E.g.*, MERCER, *supra* note 6; Wells Fargo Comment on Proposed Rule, *supra* note 34, at 2.

295. Guidance on Sound Incentive Compensation Policies, 75 Fed. Reg. 36395 (June 25, 2010).

296. McGuireWoods Comment on Proposed Rule, *supra* note 29.

297. Regional Banks Comment on Proposed Rule, *supra* note 138, at 5.

risk the financial institution poses to the financial system rather than relying on asset size as a proxy for the amount of risk.²⁹⁸ Furthermore, the Federal Regulators must ensure that talented employees in positions that pose little risk of material loss to financial institutions are not driven from the financial industry into other industries with less-regulated compensation arrangements.²⁹⁹ If a uniform rule is ultimately adopted, the rule should provide regulators with an appropriate degree of discretion in order to avoid the unintended consequences that are inherent in uniform compensation rules.

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²⁹⁸ Regional Banks Comment on Proposed Rule, *supra* note 138, at 8.

²⁹⁹ Regional Banks Comment on Proposed Rule, *supra* note 138, at 13.

* I am particularly grateful to Professor Lissa Broome, Rhonda Bethea, Fitz Powers, and Max Isaacson for their thoughtful comments and guidance during the editing process. I would also like to thank my family and friends for their encouragement and constant support throughout my law school career.