

July 22, 2016

Comment on the proposed rule: “Incentive-based Compensation Arrangements”, issued by the U.S. Agencies

Japanese Bankers Association

We, the Japanese Bankers Association (“JBA”), would like to express our gratitude for this opportunity to comment on the proposed rule: *Incentive-based Compensation Arrangements*, issued on May 2, 2016 by six U.S. agencies: Office of the Comptroller of the Currency, Treasury (“OCC”); Board of Governors of the Federal Reserve System (“Board”); Federal Deposit Insurance Corporation (“FDIC”); Federal Housing Finance Agency (“FHFA”); National Credit Union Administration (“NCUA”); and U.S. Securities and Exchange Commission (“SEC”) (collectively, the “Agencies”).

The requirements provided in the proposed rule still seem to have certain unclear aspects related to treatment of foreign banking organizations. Specifically, in applying the proposed rule, some of definitions pertaining to Incentive-based Compensation Arrangements should be further clarified, and the clawback provisions should be applied in a way to avoid extraterritorial application. In particular, the proposed rule could be developed more appropriately by revisiting some of requirements, taking into account their impacts on expatriates of foreign banks.

We respectfully expect that the following comments will contribute to your further discussion.

1. Part236-INCENTIVE-BASED COMPENSATION ARRANGEMENTS (REGULATION JJ)

(1) Review of the definition of compensation, fees, or benefits [§236.2(f)]

The total of annual base salary and incentive-based compensation should include all economic value received by a covered person. Specifically, when calculating the one-third threshold for covered persons of Level 1 and Level 2 covered institutions, rent assistance and various allowances (including fees and benefits) paid to expatriates who are seconded from Japan and do not have necessary housing, etc. to live in the U.S. should also be included in fixed compensation for labor rendered to a covered institution.

(2) Introduction of a threshold amount of incentive-based compensation [§236.2(j)]

A specific threshold amount should be established to limit the scope of a covered person to those who receive more than a certain amount of compensation. Presumably, actual conditions of incentive-based compensation differ significantly between U.S. banks and Japanese banks (particularly, expatriates seconded from Japan). In order to prevent unnecessarily broadening the scope of a covered person, it would be reasonable to set a threshold amount to the extent that it does not undermine the objectives of the proposed rule.

(3) Review of the definition of incentive-based compensation [§236.2(r)]

The amount of compensation paid as a bonus on a semi-annual basis to expatriates seconded from Japan is comprised of a fixed component and a variable component whose amount changes according to the company's performance or the employee's level of contribution to the company. The fixed component should not be included in incentive-based compensation (variable compensation) but instead should be included in annual based salary as fixed compensation.

Furthermore, the definition of incentive-based compensation should be modified to limit to those compensation, fees, or benefits that the employee can receive only if he/she achieves specific goal(s) (e.g. sales, revenue and profits). The Agencies' proposed definition ("any variable compensation, fees, or benefits that serve as an incentive or reward for performance") will result in an unnecessarily broad coverage, which may not be consistent with the objectives of the proposed rule to, among other things, prohibit incentive-based payment arrangements that encourage inappropriate risks and to provide for partial deferral and clawback requirements. The current definition, if not modified, may impose undue restriction on the provision of a bonus which has the nature of salary paid in arrears.

(4) Clarification with respect to determination of the level of U.S. branches of foreign banks [§236.2(v)-(x)]

It should be clarified that a state-licensed uninsured branch of a foreign banking organization is not classified as §236.2(dd)(6) but instead is classified as §236.2(dd)(5), and thus needs to calculate "average total consolidated assets" defined in §236.2(b) based on the amount described in the Reports of Assets and Liabilities of U.S. Branches and Agencies of Foreign Banks-FFIEC 002. We would like to confirm this because there is room for interpretation in determining the level of U.S. branches of foreign banks.

Additionally, the proposed rule refers to the term “common equity tier 1 capital”. Since however U.S. branches of foreign banks do not have a concept that is equivalent to the “capital”, a concept aligned to the actual conditions of U.S. branches should be provided.

(5) Clarification of the definition pertaining to covered person (e.g. the scope of “major business line” in relation to the senior executive officer definition) [236.2(gg)]

The definition of the term “major business line” should be clarified as it is unclear.

While “head of a major business line” is included in the proposed definition of senior executive officer along with CEO, COO, CFO and others, it should be further clarified by explicitly defining the term “major business line”. The scope of “head of a major business line” could result in unnecessarily broad coverage depending on how the term “major” is interpreted.

(6) Review of the determination method pertaining to covered person (senior executive officer) (Establishment of a threshold amount) [§236.2(gg), (hh)]

For covered persons of Level 1 and Level 2 covered institutions, compensation arrangements for expatriates, even senior executive officers, seconded from Japan are unlikely to encourage misconduct or fraud. The reason is that their compensation is based on a medium- to long-term, stable compensation system which assumes lifetime employment and is lower than the compensation level prevailing in the U.S., and tends to change only within a relatively narrow range. Given the existence of such employees, the definition of covered persons should not be uniformly based on a title, instead, a threshold amount (e.g. the amount of variable compensation) should be established to determine a covered person.

Also from the viewpoints of ensuring consistency with compensation rules in Europe, the compensation level subjected to the proposed rule should be clarified, and from the viewpoints of business practice, the scope of covered persons should be determined based on substantive criteria. Furthermore, conditions specific to expatriates seconded from Japan (i.e. medium- to long-term, stable compensation system) should be taken into account.

(7) Review of the determination method pertaining to covered persons (significant risk-taker) (Establishment of a threshold amount) [236.2(hh)]

For covered persons of Level 1 and Level 2 covered institutions, the Agencies proposed to determine a significant risk-taker based on the highest 5% or the highest

2% criteria. However, such criteria do not result in a consistent determination and hence is not considered to be stable and reasonable, because even if a person is engaged in the same position at the same level of compensation before and after the determination, this person may be deemed as a covered person or may not be deemed as such, depending on staff composition. Therefore, significant risk-takers should be determined using a threshold amount.

Also from the viewpoint of ensuring consistency with compensation rules in Europe, the compensation level subjected to the proposed rule should be clarified, and from the viewpoints of business practice; the scope of significant risk-taker should be determined based on substantive criteria. Further, conditions specific to expatriates seconded from Japan (i.e. compensation system with little variability in the compensation level) should be taken into account.

(8) Clawback [§236.7, I.E. Overview of the Proposed Rule]

In the case of expatriates seconded from Japan, events that trigger clawback may occur after they return to Japan or are seconded to another country other than the U.S. However, in such a case, it is extremely difficult to make adjustments for aligning with the applicable laws of Japan (e.g. the Labour Standards Act in Japan) and employment practices of Japan, etc. and it is assumed that a part or all of compensation already paid may not be recovered. Given this, the Agencies are respectfully requested to establish a regulatory framework that will not give rise to extraterritorial application (for example, only Malus (cancellation of a part or all of unpaid deferred compensation) should be applied after an expatriate returns from overseas or retires). This is because expatriates of foreign banks will be subject to laws and employment practices of their respective home countries after they return to their home countries.

(9) Establishment of a compensation committee [§236.10(a)]

As a decision-making body for incentive-based compensation differs across jurisdictions and banks, it is not reasonable to uniformly require the establishment of a compensation committee. Moreover, requiring banks to establish a compensation committee in form is not considered to be meaningful (in particular, as is a common practice in Japan, in cases where the compensation system does not allow flexible arrangements for increasing or decreasing). Actual situations specific to each jurisdiction and bank and a variety of decision-making methods should be taken into account. If a financial institution has a different salary system between the home country and the U.S., the proposed rule should only require the establishment of a compensation committee that oversees salary and compensation paid under the U.S.

salary system.

2. Others

(1) Clarification of the scope of covered persons

Please confirm that a person who belongs to a U.S. operating entity but works outside the U.S. (e.g. Canada) is not deemed as a covered person.

(2) Clarification of the definition of subsidiary and applicability [I.E. Overview of the Proposed Rule, Applicability]

Please clarify the definition of subsidiary and a level applied to subsidiaries as they are unclear.