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INCENTIVE-BASED COMPENSATION ARRANGEMENTS: AN EXAMINATION OF THE WELLS FARGO SCANDAL AND THE NEED FOR REFORM IN FINANCIAL INSTITUTIONS

*Ashley Triplett**

I. INTRODUCTION

Since 2011, Wells Fargo employees—without their customers' knowledge or consent—"created millions of unauthorized bank and credit card accounts."[1] The fake accounts generated income for the bank, allowing the employees to boost their sales figures and, thus, earn more money under the bank's compensation structure.[2] The scandal propelled leaders at the Office of the Comptroller of the Currency (OCC) and the Consumer Financial Protection Bureau (CFPB) to investigate the sales practices and incentive-based compensation structures at other large banks to determine whether their practices promote undue risk.[3]

After the 2007 financial crisis, the government looked at incentive-based compensation arrangements as one of the many causes of the crisis.[4] "These arrangements serve several important objectives,

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1. Matt Egan, *5,300 Wells Fargo Employees Fired over 2 Million Phony Accounts*, CNN MONEY (Sept. 9, 2016, 8:08 AM), http://money.cnn.com/2016/09/08/investing/wells-fargo-created-phony-accounts-bank-fees/.

2. *Id.* Wells Fargo has dismissed some 5,300 workers during the past five years for such illegal practices. *Id.* The bank has agreed "to pay a fine of $185 million to various state and federal agencies, including $100 million to the . . . [Consumer Financial Protection Bureau], the largest fine ever collected by that office." Renae Merle, *Wells Fargo Boots 5,300 Employees for Creating Accounts Its Customers Didn't Ask for*, WASH. POST (Sept. 8, 2016), https://www.washingtonpost.com/news/business/wp/2016/09/08/wells-fargo-fined-185-million-for-creating-accounts-its-customers-didnt-ask-for/?tid=a_inl&utm_term=.9a77b2fd783c.

3. Evan Weinberger, *Federal Regulators Open Review of Bank Sales Practices*, LAW360 (Oct. 25, 2016, 4:40 PM), https://www.law360.com/articles/855483/federal-regulators-open-review-of-bank-sales-practices.

4. *See* INST. OF INT'L FIN., COMPENSATION IN FINANCIAL SERVICES: INDUSTRY PROGRESS AND THE AGENDA FOR CHANGE 2 (2009), https://www.iif.com/file/7101/download?token=xsksV4yg ("98% of . . . respondents [to a survey of banking organizations engaged in wholesale banking activities] believe that compensation structures were a factor underlying the crisis.").

including attracting and retaining skilled staff and promoting better performance of the [financial] institution and individual employees."[5] However, "poorly structured incentive-based compensation arrangements can provide executives and employees with incentives to take inappropriate risks that are not consistent with the long-term health of the institution and, in turn, the long-term health of the . . . [United States] economy."[6]

Congress and financial regulators sought to combat the inherent risk in poorly structured compensation programs through legislation and principle-based, regulatory guidance.[7] Under the authority of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank),[8] financial regulators (Agencies)[9] proposed a joint rule in 2011 (2011 Proposed Rule) meant to impose regulations surrounding these arrangements.[10] In 2016, the Agencies revised and re-proposed the rule (2016 Proposed Rule), addressing public comments to the 2011 Proposed Rule and changes in the financial service industry.[11]

In light of the conduct by Wells Fargo, the 2016 Proposed Rule has come under scrutiny as to whether, if finalized, it could actually prevent similar risky, incentive-driven practices in other banks.[12] While the 2016 Proposed Rule is an improvement on the 2011 Proposed Rule and pre-existing agency guidance, the current language of the rule, if finalized, would be ineffective at preventing incidents like the Wells Fargo scandal.[13] The Agencies should take measures to strengthen the 2016 Proposed Rule to better address the inherent risk in incentive-based compensation arrangements.[14]

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5. Incentive-Based Compensation Arrangements, 81 Fed. Reg. 37,670, 37,673 (proposed June 10, 2016) [hereinafter 2016 Proposed Rule].
6. *Id.* at 37,674.
7. *See infra* Part II.
8. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).
9. *See* Incentive-Based Compensation Arrangements, 76 Fed. Reg. 21,170 (proposed Apr. 14, 2011) [hereinafter 2011 Proposed Rule]. The Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Board of Directors of the Federal Deposit Insurance Corporation, the Director of the Office of Thrift Supervision, the National Credit Union Administration Board, the Securities and Exchange Commission, and the Federal Housing Finance Agency all jointly proposed the rule. *Id.*
10. *See id.* at 21,173.
11. *See infra* notes 90–91 and accompanying text.
12. *See* Alistair Gray, *US Democratic Senators Urge Regulators to Strengthen Bank Bonus Reform*, FIN. TIMES (Oct. 27, 2016), https://www.ft.com/content/fb33a347-1578-3442-8ef4-f57b76927a42.
13. *See infra* Part V.
14. *See infra* Section V.A.

Part II of this Comment provides background on the fundamental pieces of banking legislation passed before and in response to the 2007 financial crisis, and it examines current federal agency guidance meant to address incentive-based compensation programs.[15] Part III examines the steps taken by federal agencies—using the guidance in place to combat inherent risk in financial institutions—to address Wells Fargo's unethical sales practices throughout the five-year scandal.[16] Part IV of this Comment details the 2016 Proposed Rule and how it differs from the 2011 version.[17] Finally, Part V questions the ability of current agency guidance, as opposed to final agency rulemaking, to adequately address the inherent risk in incentive-based compensation programs.[18] Further, this Part addresses whether the 2016 Proposed Rule, in its current form, could be effective in its intended goal of disincentivizing risk, and it offers suggestions to strengthen the rule.[19]

II. LEGISLATIVE AND REGULATORY BACKGROUND

Congress has sought to limit risk in the financial industry since the Great Depression.[20] After the 2007 financial crisis, Dodd-Frank specifically addressed incentive-based compensation programs and their inherent risk to the overall United States economy.[21] Acting under the authority of Dodd-Frank, the Agencies issued guidelines and guidance, as opposed to final rules, to monitor the use of such arrangements.[22]

A. *The Glass-Steagall Act of 1933 and Its Repeal*

In response to the stock-market crash in 1929 and a banking panic in late 1932,[23] Congress passed the Banking Act of 1933, commonly known as the Glass-Steagall Act (Glass-Steagall).[24] The main provisions of Glass-Steagall effectively separated commercial and

15. *See infra* Part II.
16. *See infra* Part III.
17. *See infra* Part IV.
18. *See infra* Part V.
19. *See infra* Part V.
20. *See infra* Section II.A.
21. *See infra* Section II.B.
22. *See infra* Section II.C.
23. *See* MICHAEL P. MALLOY, BANKING LAW AND REGULATION § 9.02 (2017), Westlaw BKLAR.
24. Banking Act of 1933, ch. 89, 48 Stat. 162 (codified as amended at 12 U.S.C. § 227 (2012)).

investment banking.[25] The Act imposed limits on permissible banking practices of securities firms,[26] prohibited member banks—any depositary institution of the Federal Reserve System—from affiliating with firms engaged principally in securities activities,[27] and prohibited officer, director, and employee interlocks between member banks and securities firms.[28] The rationale behind Glass-Steagall was that separating commercial and investment banking would lead to a healthier financial system, with less inherent risk.[29] Separation would prevent conflicts of interest, prevent exposure of clients' deposits to the risk of a speculative market, and prevent unhealthy competition among financial institutions.[30]

However, Glass-Steagall did not result in its intended divorce of commercial and investment banking.[31] Section 16 of the Act set out permissible securities activities of national banks, "allow[ing] commercial banks to underwrite certain government securities called 'bank-eligible' securities . . . and . . . permitt[ing] dealings in . . . [United States] government and agency securities."[32] Section 16, thus, created a loophole that banks would exploit in the coming decades.[33] By the 1960s, as inflation began to frustrate banks' ability to turn a profit, banks began to cross regulatory boundaries in order to expand.[34] Instead of being met with opposition, the Comptroller of the Currency encouraged such expansion.[35] Subsequent bank regulation and court rulings[36] followed suit, "interpret[ing] banking

25. *See id.*
26. *See id.* § 21.
27. *See id.* § 20.
28. *See id.* § 32.
29. *See* MALLOY, *supra* note 23, § 9.02.
30. *See* Amirsaleh Azadinamin, Separation of Investment and Commercial Banking 4–6 (2012) (unpublished manuscript), http://docplayer.net/32965938-Separation-of-investment-and-commercial-banking.html.
31. *See* Jerry W. Markham, *The Subprime Crisis—A Test Match for the Bankers: Glass-Steagall vs. Gramm-Leach-Bliley*, 12 U. PA. J. BUS. L. 1081, 1094 (2010).
32. *Id.* at 1097.
33. *See id.* at 1094.
34. *See id.* at 1095.
35. *Id.*
36. *See, e.g.*, Barnett Bank, N.A. v. Nelson, 517 U.S. 25, 37 (1996) (finding that a federal statute pre-empted a Florida state law that prohibited banks from selling most types of insurance); Nationsbank, N.A. v. Variable Annuity Life Ins. Co., 513 U.S. 251, 260 (1995) (holding that banks could serve as agents in the sale of annuities based on the Comptroller's reasonable conclusion that brokerage of annuities was an "incidental power" necessary to carry out the business of banking).

laws in ways that allowed banks to expand into areas that competed with other financial services firms."[37]

By the end of the 1990s, the separation intended by Glass-Steagall was breached, and Congress repealed the statute with the Gramm-Leach-Bliley Act (GLBA)[38] on November 12, 1999.[39] The GLBA repealed Section 20 and Section 32 of Glass-Steagall, allowing commercial banks to create "financial holding companies" and "financial subsidiaries."[40] These entities could provide a number of services, including investment banking, so long as they were "financial in nature."[41] This opened the door for commercial banks to enter other areas of finance.[42]

B. *The Dodd-Frank Act as a Response to the Financial Crisis*

In 2007 and 2008, the United States economy underwent another financial crisis.[43] Lawmakers and scholars link the crisis to risky loans in the housing market, some encouraged by compensation structures at financial institutions.[44] In the years leading up to the burst, banks began to offer a growing amount of subprime loans[45] at

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37. *See* Markham, *supra* note 31, at 1095–96. "The Comptroller adopted regulations in 1997 that permitted national banks to establish 'operating subsidiaries' to engage in activities that a national bank could not engage in directly." *Id.* at 1099; Interpretive Letter #845 from Raymond Natter, Acting Chief Counsel, Comptroller of the Currency, to Karol K. Sparks, Krieg DeVault Alexander & Capehart (Oct. 20, 1998), https://www.occ.gov/static/interpretations-and-precedents/nov98/int845.pdf ("A national bank may establish or acquire an operating subsidiary to conduct . . . activities that are part of *or incidental to* the business of banking . . . .") (emphasis added).
38. Gramm-Leach-Bliley Act, Pub. L. No. 106-102, 113 Stat. 1338 (1999).
39. *See* MALLOY, *supra* note 23, § 9.02.
40. Gramm-Leach-Bliley Act §§ 101, 103, 121.
41. *See id.* § 103.
42. Markham, *supra* note 31, at 1104.
43. *See, e.g.*, Ian D. Ghrist, *How to Sufficiently Consider Efficiency, Competition, and Capital Formation in the Wake of* Business Roundtable, 14 TRANSACTIONS: TENN. J. BUS. L. 221, 222 (2013); *Financial Crisis 2007/2008 Overview*, WSO, https://www.wallstreetoasis.com/financial-crisis-overview (last visited Dec. 30, 2017).
44. *See* Ghrist, *supra* note 43, at 223; *see also* FIN. CRISIS INQUIRY COMM'N, THE FINANCIAL CRISIS INQUIRY REPORT xix (2011), https://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf [hereinafter FCIC REPORT] ("Compensation systems—designed in an environment of cheap money, intense competition, and light regulation—too often rewarded the quick deal, the short-term gain—without proper consideration of long-term consequences.").
45. *See* Ghrist, *supra* note 43, at 224–25 ("Banks traditionally underwrite loans based on the four Cs: (1) credit, (2) capacity, (3) capital, and (4) collateral. A borrower who takes out a subprime loan typically fails to demonstrate adequate strength in one or more of these categories.") (footnote omitted).

artificially low rates.[46] Many of the institutions' compensation practices rewarded executives and employees for increasing the institution's revenue or short-term profit without sufficient recognition of the risks the employees' activities posed to the institution.[47] Mortgage lenders would then sell these loans to investments banks who would bundle them into mortgage backed securities.[48] As the housing market began to drop and the number of foreclosures increased, banks and hedge funds that invested in these mortgages were left with worthless assets.[49] Then, one by one, some of the largest banks began to fail.[50]

In response, Congress passed the Dodd-Frank Act.[51] Dodd-Frank's stated purpose is "[t]o promote the financial stability of the United States by improving accountability and transparency in the financial system, to end 'too big to fail', [sic] to protect the American taxpayer by ending bailouts, [and] *to protect consumers from abusive financial services practices*."[52] Dodd-Frank also aimed to correct the flaws in the previous approach to executive compensation.[53] Those measures included shareholder votes on executive compensation, new listing standards to ensure that compensation committees and their consultants at public companies are independent from management, mandatory disclosure of executive compensation in relation to corporate performance, and recovery of erroneously awarded compensation.[54]

Notably, Section 956 of Dodd-Frank requires regulatory agencies to jointly prescribe regulations or guidelines with respect to incentive-based compensation practices at certain financial institutions.[55] Specifically, this Section requires that the Agencies

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46. *Id.* at 225.
47. *See* FCIC REPORT, *supra* note 44, at 64.
48. Ghrist, *supra* note 43, at 225–26. This process is known as securitization. *Id.* Institutions would "aggregat[e] and pool[] . . . assets with similar characteristics in such a way that investors may purchase interests or securities backed by those assets." *Id.*
49. *See Financial Crisis 2007/2008 Overview*, *supra* note 43.
50. *See id.*
51. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).
52. *Id.* (emphasis added).
53. *See id.* §§ 951–57 (codified as amended in scattered sections of 12 U.S.C. and 15 U.S.C.).
54. *See id.*
55. *See id.* § 956 (codified at 12 U.S.C. § 5641 (2010)). The United States House of Representatives recently passed the "Financial CHOICE Act of 2017," which repeals Section 956 of Dodd-Frank. H.R. 10, 115th Cong. § 857(a)(26) (2017); *H.R. 10: Financial CHOICE Act of 2017*, GOVTRACK, https://www.govtrack.us/congress/bills

prohibit any type of incentive-based compensation arrangement, or any features of such, that the Agencies determine encourage inappropriate risk.[56] Such risk can manifest itself where the compensation arrangement: (1) provides "an executive officer, employee, director, or principal shareholder of the . . . institution with excessive compensation, fees, or benefits; or" (2) potentially leads "to material financial loss to the . . . institution."[57] Further, the covered financial institutions must disclose the structure of its incentive-based compensation arrangement to the appropriate federal regulator.[58] It is under this authority that the Agencies drafted the 2011 and 2016 Proposed Rules to regulate incentive-based compensation arrangements.[59]

C. *Regulation of Incentive-Based Compensation Arrangements*

Empowered by Dodd-Frank, regulators have taken steps since the financial crisis to address flawed incentive-based compensation practices.[60] In 2010, the Federal Banking Agencies adopted the 2010 Federal Banking Agency Guidance (2010 Guidance) that governed incentive-based compensation programs and applied to all banking organizations regardless of size.[61] The 2010 Guidance utilizes a principle-based approach, requiring that: (1) incentive-based compensation arrangements "should provide employees incentives that appropriately balance risk and financial results . . . ; (2) these arrangements should be compatible with effective controls and risk-management; and (3) these arrangements should be supported by strong corporate governance."[62]

The OCC reviews and assesses incentive-based compensation arrangements at individual institutions "as part of its normal supervisory activities."[63] Further, the OCC issued the Guidelines

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/115/hr10 (last visited Dec. 30, 2017). The Senate has not yet considered a repeal of Dodd-Frank, therefore Section 956 is still effective. *See H.R. 10: Financial CHOICE Act of 2017*, *supra*.

56. Dodd-Frank Wall Street Reform and Consumer Protection Act § 956(b) (codified at 12 U.S.C. § 5641(b) (2010)).

57. *Id.* § 956(b)(1)–(2).

58. *Id.* § 956(a)(1).

59. 2011 Proposed Rule, *supra* note 9, at 21,170; 2016 Proposed Rule, *supra* note 5, at 37,670.

60. *See, e.g.*, *supra* note 56 and accompanying text; *infra* notes 61–64 and accompanying text.

61. *See* Guidance on Sound Incentive Compensation Policies, 75 Fed. Reg. 36,395, 36,396 (June 25, 2010).

62. *Id.* at 36,398.

63. 2016 Proposed Rule, *supra* note 5, at 37,676.

Establishing Heightened Standards for Certain Large Insured National Banks, Insured Federal Savings Associations, and Insured Federal Branches (OCC Heightened Standards) that require covered institutions to establish and adhere to written risk governance frameworks to manage and control their risk-taking activities.[64]

However, this agency action came in the form of principle-based guidance as opposed to prescriptive rules.[65] While financial institutions are subject to this guidance, a principles-based approach gives the institutions greater discretion over the management and structure of their incentive-based compensation arrangements.[66] "[W]hen improperly utilized, discretionary decisions can undermine the goal of incentive-based compensation arrangements to . . . balance risk and reward."[67]

III. THE WELLS FARGO SCANDAL

The Wells Fargo scandal highlights the need for further supervision and regulation of financial institutions.[68] The timeline of the scandal and regulatory response demonstrates that the principle-based approach of standing agency guidance is ineffective at curbing the inherent risk in incentive-based compensation arrangements.[69]

A. *OCC Supervision of Wells Fargo's Sales Practices*

The Comptroller of the Currency, Thomas Curry, testified before the Senate Committee on Banking, Housing, and Urban Affairs, in which he outlined the OCC's supervision of Wells Fargo throughout the scandal.[70] In March 2012, the OCC received some complaints from consumers and Wells Fargo employees alleging "improper sales practices" at the bank.[71] Following inquiries into the complaints and a December 2013 *Los Angeles Times* article regarding the bank's

64. OCC Guidelines Establishing Heightened Standards for Certain Large Insured National Banks, Insured Federal Savings Associations, and Insured Federal Branches, 12 C.F.R. pt. 30 app. D (2015).
65. *See supra* notes 61–64 and accompanying text.
66. *See* Julia Black, *The Rise, Fall and Fate of Principles Based Regulation* 8 (London Sch. of Econ. & Political Sci., Working Paper No. 17, 2010), http://eprints.lse.ac.uk/32892/1/WPS2010-17_Black.pdf.
67. 2016 Proposed Rule, *supra* note 5, at 37,712.
68. *See infra* Section III.A.
69. *See infra* Section III.A.
70. *Testimony of Thomas J. Curry Comptroller of the Currency Before the S. Comm. on Banking, Hous., & Urban Affairs*, 114th Cong. 1–9 (2016) [hereinafter *Testimony*].
71. *Id.* at 3.

sales practices,[72] the OCC examiners "initiated a series of meetings" with Wells Fargo management.[73] The "[b]ank stated that it terminated employees as a result" of the complaints, "and that it was investigating such reports and re-evaluating its oversight of sales practices."[74] From 2013 to 2016, the OCC continued to supervise Wells Fargo's sales practices and address weaknesses in the bank's risk management.[75]

In February 2013, the OCC issued a Supervisory Letter to Wells Fargo.[76] The letter required "the [b]ank to develop its operational risk compliance program."[77] Throughout 2013 and early 2014, the OCC sought to address Wells Fargo's sales practices "and monitor the quality of [the bank's] compliance oversight."[78] In March 2015, the OCC "completed a multi-year assessment of . . . [Wells Fargo's] compliance management systems," applying the OCC Heightened Standards.[79] This assessment "identified the need for the [b]ank to improve its risk management and governance related to operational and compliance risk."[80] Throughout 2015, the OCC issued a series of Supervisory Letters and Matters Requiring Attention requiring Wells Fargo to take "significant action" to address oversight failures and re-evaluate its compensation plans "to ensure they did not provide an incentive for inappropriate behavior."[81]

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72. E. Scott Reckard, *Wells Fargo's Pressure-Cooker Sales Culture Comes at a Cost*, L.A. TIMES (Dec. 21, 2013, 12:00 PM), http://www.latimes.com/business/la-fi-wells-fargo-sale-pressure-20131222-story.html.
73. *Testimony*, *supra* note 70, at 4.
74. *Id.*
75. *Id.*
76. *Id.* at 5. "OCC-regulated institutions are subject to . . . ongoing supervision designed to enable examiners to identify problems and obtain corrective action" without formal enforcement action. *Id.* at 3. Examples of written supervisory actions include "Reports of Examination, Supervisory Letters, and Matters Requiring Attention." *Id.*
77. *Id.* at 5.
78. *Id.*
79. *Id.*
80. *Id.* at 6.
81. *See id.* at 6–7. The Matters Requiring Attention required Wells Fargo to address:

> the lack of an appropriate control or oversight structure given corporate emphasis on product sales and cross-selling; the lack of an enterprise-wide sales practices oversight program; the lack of an effective enterprise-wide customer complaint process; the lack of a formalized governance process to oversee sales practices and effectively oversee and test branch sales practices; and the failure of the [b]ank's audit services to identify the above issues or to aggregate sales practice issues into an enterprise view.

Id. at 6–7.

The OCC then issued its annual Report of Examination in July 2015, which noted that Wells Fargo "needed to act more proactively."[82] This report was followed by a Notice of Deficiency on July 28, 2015, which cited the bank's failure to comply with the expectation in the OCC Heightened Standards.[83] The OCC continued to review these matters into 2016, and it concluded in its 2016 Report of Examination that Wells Fargo's "sales practices were unethical; the [b]ank's actions caused harm to consumers; and [b]ank management had not responded promptly to address these issues."[84]

The Comptroller concluded his testimony by stating: "It is clear . . . that the misaligned priorities and unacceptable behavior at Wells Fargo resulted in unsafe and unsound practices that led to widespread consumer harm. *Issues of incentive compensation are relevant to ensuring behavior aligns with acceptable corporate practice*."[85] The Comptroller's testimony suggests that the principles-based regulatory guidance in place after Dodd-Frank, alone, is ineffective at curbing risky, anti-consumer banking practices.[86] A more prescriptive agency rule would be better equipped to address the risk inherent in such compensation practices.[87]

IV. AN ATTEMPT TO CURB INCENTIVE-BASED COMPENSATION ARRANGEMENTS

Section 956 of Dodd-Frank authorizes regulatory agencies to prescribe rules and guidelines to target incentive-based compensation arrangements that the Agencies believe promote undue risk.[88] In April 2011, the Agencies published a joint notice of proposed rulemaking to implement Section 956.[89] In light of developments in incentive-based compensation practices in the financial services industry[90] and comments received on the 2011 Proposed Rule, the

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82. *Id.* at 7.
83. *Id.* at 7–8.
84. *Id.* at 8.
85. *Id.* at 14 (emphasis added).
86. *See supra* note 85 and accompanying text.
87. *See infra* Part V.
88. *See supra* notes 55–56 and accompanying text.
89. 2011 Proposed Rule, *supra* note 9, at 21,170.
90. *See* 2016 Proposed Rule, *supra* note 5, at 37,678.

> In June 2013, the European Union adopted the Capital Requirements Directive ("CRD") IV, which sets out requirements for compensation structures, policies, and practices that apply to all banks and investment firms subject to the CRD. . . . Also in 2013, the . . . [European Banking Authority] finalized the process

agencies revised and re-proposed the Rule in 2016.[91] This section outlines both the 2011 Proposed Rule and the 2016 Proposed Rule and highlights the adjustments and changes made between the two.[92]

A. *The 2011 Proposed Rule*

The 2011 Proposed Rule would have prohibited "incentive-based compensation arrangements . . . that [could] encourage inappropriate risks."[93] The Rule "would have required compensation practices at regulated financial institutions to be consistent with three key principles—that incentive-based compensation arrangements should [(1)] appropriately balance risk and financial rewards, [(2)] be compatible with effective risk management and controls, and [(3)] be supported by strong corporate governance."[94] Financial institutions with $1 billion or more in assets[95] would have been required to have policies and procedures to ensure compliance with the requirements of the Rule and submit annual reports to their federal regulator outlining the structure of their compensation arrangements.[96]

The 2011 Proposed Rule would have imposed two additional requirements for "larger covered financial institutions."[97] First, these institutions would have been required to defer at least fifty percent of the incentive-based compensation for executive officers for a period of at least three years.[98] Second, the Rule would have required the board of directors to identify and approve the incentive-based compensation for those covered persons who had "the ability to expose the institution to possible losses that are substantial in relation to the institution's size, capital, or overall risk tolerance."[99]

The Agencies received over 10,000 comments for the 2011 Proposed Rule, which varied on different methods to strengthen the Rule.[100] Suggestions included extending the deferral period to five

> and criteria for the identification of categories of staff who have a material impact on the institution's risk profile . . . .

Id.

91. *See id.* at 37,673.
92. *See infra* Sections IV.A–B.
93. 2011 Proposed Rule, *supra* note 9, at 21,173.
94. 2016 Proposed Rule, *supra* note 5, at 37,677.
95. 2011 Proposed Rule, *supra* note 9, at 21,174.
96. *See id.* at 21,194.
97. *Id.* at 21,180. A "larger covered financial institution" is generally one "with $50 billion or more in total consolidated assets." *Id.*
98. *Id.*
99. *Id.* at 21,181.
100. 2016 Proposed Rule, *supra* note 5, at 37,677.

years for executive bonuses and increasing the amount of compensation subject to the deferral requirements; defining "excessive compensation"; and "[a]dopting a corporate governance measure tied to stock ownership by board members."[101] Many covered institutions and financial industry associations commented on the Rule.[102] Their comments raised questions concerning the scope of the Rule, opposed the mandatory deferral provision, and requested that "the final rule provide specific standards for determining when compensation is excessive."[103]

B. *The 2016 Proposed Rule*

Like the 2011 Proposed Rule, the 2016 Proposed Rule would prohibit incentive-based compensation arrangements at covered institutions that could encourage inappropriate risks.[104] The 2016 Proposed Rule "provides that compensation, fees, and benefits will be considered excessive when amounts paid are unreasonable or disproportionate to the value of the services performed by a covered person."[105] Further, compensation arrangements "will be considered to encourage inappropriate risks[,] . . . unless the arrangement: [a]ppropriately balances risk and reward; . . . [i]s compatible with effective risk management and controls; and . . . [i]s supported by effective governance."[106] However, unlike the 2011 Proposed Rule, the 2016 Proposed Rule specifies that a compensation arrangement would not "appropriately balance risk and reward unless it: . . . [i]ncludes financial and non-financial measures of performance; . . . [i]s designed to allow non-financial measures of performance to override financial measures of performance, when appropriate; and . . . [i]s subject to adjustment to reflect actual losses, inappropriate risks taken, [or] compliance deficiencies."[107]

101. *Id.*
102. *See id.*
103. *Id.*
104. *Id.* at 37,679.
105. *Id.* This assessment takes into consideration relevant factors including: (1) "[t]he combined value of all compensation, fees, or benefits provided to a covered person;" (2) "[t]he compensation history of the covered person . . . ;" (3) "[t]he financial condition of the covered institution;" (4) "[c]ompensation practices at comparable institutions . . . ;" and (5) "[a]ny connection between the covered person and any fraudulent act or omission, breach of trust or fiduciary duty, or insider abuse with regard to the covered institution." *Id.*
106. *Id.*
107. *Id.* at 37,679–80.

The 2016 Rule also categorizes covered institutions into three levels "based on average total consolidated assets,"[108] imposing stricter requirements for Level 1 and Level 2 covered institutions.[109] Additionally, the Rule includes a definition of "significant risk-taker," which is intended to include individuals who are not "senior executive officers,"[110] but individuals who "are in the position to put a Level 1 or Level 2 covered institution at risk of material financial loss."[111] As Wells Fargo would be considered a Level 1 covered institution,[112] the rest of this section will focus on the requirements for Level 1 institutions only.[113] Specifically, this section will analyze the 2016 Proposed Rule's requirements and prohibitions concerning deferral, forfeiture and downward adjustment, and the clawback of incentive-based compensation.[114]

1. Deferral

As a tool to balance risk and reward, the Rule would require covered institutions to defer the vesting[115] "of a certain portion of all incentive-based compensation awarded."[116] The institution must

108. *Id.* at 37,679 ("Level 1 (greater than or equal to $250 billion); . . . Level 2 (greater than or equal to $50 billion and less than $250 billion); and . . . Level 3 (greater than or equal to $1 billion and less than $50 billion).") (footnotes omitted).

109. *See id.*

110. *Id.* at 37,801–02. "Senior executive officer" can include: "[p]resident, 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." *Id.* at 37,801.

111. *Id.* at 37,692.

112. *See Investment Profile*, WELLS FARGO, https://www.wellsfargo.com/about/investor-relations/investment-profile/ (last visited Dec. 30, 2017). As of June 30, 2017, Wells Fargo has an average of $1.9 trillion in consolidated assets, the third largest in the United States. *Id.*

113. *See infra* Sections IV.B.1–3.

114. *See infra* Sections IV.B.1–3. The 2016 Proposed Rule sets forth additional requirements and prohibitions, including: prohibiting the purchase of hedging instruments to offset any decrease in the value of compensation; prohibiting awarding compensation in excess of 125 percent of the targeted amount of compensation; and setting minimum requirements for risk management framework and governance structures. *See* 2016 Proposed Rule, *supra* note 5, at 37,681, 37,734.

115. 2016 Proposed Rule, *supra* note 5, at 37,717. "*Vesting* of incentive-based compensation means the transfer of ownership of the incentive-based compensation to the covered person to whom the incentive-based compensation was awarded, such that the covered person's right to the incentive-based compensation is no longer contingent on the occurrence of any event." *Id.* at 37,802.

116. *Id.* at 37,717.

"defer at least 60 percent of each senior executive officer's qualifying incentive-based compensation for at least four years, and at least 60 percent of . . . compensation awarded under a long-term incentive plan for at least two years beyond the end of that plan's performance period."[117] The institution must follow the same requirements for significant risk-takers, however, the deferral amount is decreased to at least fifty percent of their compensation.[118]

A covered institution would be permitted to engage in pro rata vesting, allowing the institutions "to make deferred incentive-based compensation eligible for vesting during the deferral period on a schedule that paid out equal amounts on each anniversary of the end of the relevant performance period."[119] Additionally, the Rule generally prohibits "the acceleration of vesting and subsequent payment of incentive-based compensation that is required to be deferred."[120]

2. Forfeiture and Downward Adjustment

Forfeiture and downward adjustment review would require the covered institutions "to consider reducing some or all of a senior executive officer's or significant risk-taker's incentive-based compensation when the covered institution becomes aware of inappropriate risk-taking or other . . . behavior that could lead to material financial loss."[121] This could be accomplished "by reducing the amount of unvested deferred incentive-based compensation (forfeiture), by reducing the amount of . . . compensation not yet awarded for a performance period that has begun (downward adjustment), or . . . a combination of both."[122]

The 2016 Proposed Rule would require the institutions to place "100 percent of . . . deferred and unvested incentive-based compensation" at risk of forfeiture and downward adjustment.[123] The Rule lists events that trigger forfeiture and downward adjustment

117. *Id.* (footnote omitted).

118. *Id.*

119. *Id.* at 37,718 ("For example, if a Level 1 covered institution is required to defer $100,000 of a senior executive officer's incentive-based compensation for four years, the covered institution could choose to make $25,000 available for vesting on each anniversary of the end of the performance period for which the $100,000 was awarded.").

120. *Id.*

121. *Id.* at 37,728.

122. *Id.* The Rule would require the institutions "to formalize the governance and review processes surrounding such decision-making, and to document the decisions made." *Id.*

123. *Id.* at 37,729.

review[124] and allows the institution to determine how much reduction in compensation is warranted, subject to review by the appropriate regulator.[125]

3. Clawback Provisions

The 2016 Proposed Rule would also require "covered institutions to include clawback provisions in [their] incentive-based compensation arrangements,"[126] something the 2011 Proposed Rule did not require.[127] "[A]t a minimum, [the clawback provisions] would allow for the recovery of up to 100 percent of vested incentive-based compensation from a current or former senior executive officer or significant risk-taker for seven years following the date on which such compensation vests."[128]

The Rule identifies three triggers for invoking the clawback provision that "include situations where a senior executive officer or significant risk-taker engaged in: (1) [m]isconduct that resulted in significant financial or reputational harm to the covered institution; (2) fraud; or (3) intentional misrepresentation of information used to determine the senior executive officer's or significant risk-taker's incentive-based compensation."[129] Yet, while the Rule requires a clawback provision and identifies these triggers, the Rule would not require that the "covered institutions exercise the clawback provision."[130]

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124. *See id.* Such events include:

> (1) Poor financial performance attributable to a significant deviation from the risk parameters set forth in the covered institution's policies and procedures; (2) inappropriate risk-taking, regardless of the impact on financial performance; (3) material risk management or control failures; and (4) non-compliance with statutory, regulatory, or supervisory standards that results in: Enforcement or legal action against the covered institution brought by a Federal or state regulator or agency.

Id.

125. *See id.* at 37,730.
126. *Id.* at 37,731. "Clawback" is "a mechanism by which a covered institution can recover vested incentive-based compensation from a covered person." *Id.*
127. *Id.* at 37,732.
128. *Id.* at 37,731.
129. *Id.* at 37,731–32 (footnotes omitted).
130. *Id.* at 37,732.

V. RECOMMENDED CHANGES TO THE 2016 PROPOSED RULE

While an improvement from the 2011 Proposed Rule, the 2016 Proposed Rule, in its current form, would be ineffective. It gives covered institutions too much discretion in determining whether to utilize some of the key provisions of the Rule meant to disincentivize risk.[131] These loopholes would significantly undermine the effectiveness of the rule in practice and would allow covered institutions to pay a majority of compensation despite inappropriate risk-taking.[132] In light of this, the 2016 Proposed Rule should adopt the following suggested changes to adequately address the inherent risks in incentive-based compensation arrangements.[133]

A. *Suggestions to Strengthen the 2016 Proposed Rule*

1. Extend the Deferral Period

If the goal of the deferral period is to disincentivize risk within the institution,[134] the deferral period must be extended. The Rule currently proposes that institutions would defer sixty percent of compensation for a period of four years, and it allows equal pro rata payments over those four years.[135] This would mean that high-ranking senior executives at some of the country's largest financial institutions "could receive 70% of incentive pay within two years and 85% within three years (40% in the initial performance year, and then an additional 15% per year after that)."[136] Further, the length of a typical business cycle is roughly six years.[137] This suggests "that the costs of inappropriate risk-taking" may not be realized before a large

131. *See infra* Section V.A.
132. *See infra* Section V.A.
133. *See infra* Section V.A.
134. *See* 2016 Proposed Rule, *supra* note 5, at 37,717.
135. *Id.* at 37,717–18.
136. Letter from Ams. for Fin. Reform to Robert deV. Frierson, Sec'y, Bd. of Governors of the Fed. Reserve Sys. et al. 3 (July 22, 2016), https://www.sec.gov/comments/s7-07-16/s70716-52.pdf [hereinafter Letter from Ams. for Fin. Reform]. This calculation is obtained by: (1) starting with the forty percent of compensation that is not required to be deferred; (2) splitting the deferred sixty percent into four equal payments of fifteen percent for each year of the four-year period; and (3) adding a fifteen percent payment after the end of each year's compensation period. *See id.*
137. 2016 Proposed Rule, *supra* note 5, at 37,721 n.154 ("From 1945 to 2009, the average length of the business cycle in the . . . [United States] was approximately 5.7 years.").

majority of the compensation has been paid out to the senior executive officer or significant risk-taker.[138]

The OCC began reviewing Wells Fargo's sales practices in 2012 after receiving complaints,[139] and it was not until 2016 that the OCC declared the practices unethical.[140] Within that time frame, the bank, under the current language of the 2016 Proposed Rule, could have paid out over 85% of compensation for senior executives despite the ongoing regulatory supervision and inappropriate risk-taking.[141] This issue is further frustrated by the weak clawback requirement within the 2016 Proposed Rule.[142] Without a mandatory clawback requirement,[143] there is no incentive to avoid inappropriate risk-taking, knowing that a majority of the deferred, vested compensation will be safe from recoupment.

The deferral period must be extended to compensate for these issues. The United Kingdom Prudential Regulation Authority (PRA) has imposed a deferral period of *seven years* for senior executives, with pro rata vesting beginning no sooner than the *third anniversary* of the reward.[144] This is more than double the level of effective deferral that the 2016 Proposed Rule requires for senior executive officers.[145] For the Rule to be effective, the deferral period should be extended to at least six years to coincide with the typical business cycle.[146] This would allow for more opportunities to address inappropriate risk-taking before a vast majority of compensation has been paid.[147]

2. Limit the Discretion Given to Covered Institutions

Under the 2016 Proposed Rule, whether the financial institution chooses to exercise the forfeiture and downward adjustment review and the mandatory clawback provision is left to the discretion of the

138. Letter from Ams. for Fin. Reform, *supra* note 136, at 3.
139. *See Testimony*, *supra* note 70, at 3–4.
140. *See id.* at 8.
141. *See supra* note 136 and accompanying text.
142. *See supra* notes 126–30 and accompanying text.
143. *See* 2016 Proposed Rule, *supra* note 5, at 37,732.
144. *See* PRUDENTIAL REGULATION AUTH., STRENGTHENING THE ALIGNMENT OF RISK AND REWARD: NEW REMUNERATION RULES 6 (2015), http://www.bankofengland.co.uk/pra/Documents/publications/ps/2015/ps1215.pdf.
145. *See id.*; *see also* 2016 Proposed Rule, *supra* note 5, at 37,717 (providing for a deferral period of four years with pro rata vesting beginning on the one-year anniversary for senior executives).
146. *See supra* note 137 and accompanying text.
147. *See supra* note 138 and accompanying text.

institution.[148] The Rule states only that "the forfeiture and downward adjustment review requirements . . . would require a Level 1 . . . covered institution to *consider* reducing some or all of a senior executive officer's or significant risk-taker's incentive-based compensation when the covered institution becomes aware of inappropriate risk-taking."[149] Further, the Rule explicitly states that it would not require the covered institutions to exercise the clawback provision upon one of the three triggers.[150]

Both provisions were included in the 2016 Proposed Rule to disincentivize senior executive officers and significant risk-takers from engaging in risky behavior that could lead to "material financial loss."[151] Yet, without a clear requirement to enforce the provisions, the Agencies cannot ensure that such steps will be taken. Clawback provisions are fairly common in financial institutions, yet recoupment is rare.[152] The 2016 Proposed Rule should be adjusted to require that both the clawback provision and the forfeiture and downward adjustment review be mandatory in order to properly disincentivize risky behavior.

3. Hold Senior Executive Officers Accountable

By making the clawback provision mandatory, the next issue concerns when the provision must be exercised. In its current form, the Rule lists three triggers for exercising the clawback provision: "(1) Misconduct that resulted in significant financial or reputational harm to the covered institution; (2) fraud; or (3) intentional misrepresentation of information used to determine the senior executive officer's or significant risk-taker's incentive-based compensation."[153] The Rule goes on to state that "[i]f a . . . covered institution discovers that a senior executive officer or significant risk-taker was involved in one of the triggering circumstances . . . the institution would potentially be able to recover from that" individual."[154]

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148. *See infra* notes 149–50 and accompanying text.
149. 2016 Proposed Rule, *supra* note 5, at 37,728 (emphasis added).
150. *See id.* at 37,732.
151. *See id.* at 37,678–79.
152. *See* Michael Greene, *Will Wells Fargo Scandal Lead to Changes in Pay Plans?*, BLOOMBERG BNA (Oct. 5, 2016), https://www.bna.com/wells-fargo-scandal-n57982078163/ ("According to ISS Corporate Solutions, 86.4 percent of S&P 500 companies and 70.5 percent of S&P Midcap 400 companies have clawback provisions.").
153. 2016 Proposed Rule, *supra* note 5, at 37,731–32 (footnotes omitted).
154. *Id.* at 37,732.

The wording of the Rule suggests that the clawback triggers apply only to individual employee misconduct.[155] In the case of Wells Fargo, the individual sales employees who created the fake accounts would arguably have triggered the clawback provision by engaging in "[m]isconduct that resulted in significant financial or reputational harm"[156] to the bank. But what about supervisors and senior executives who did not individually create the fake accounts or order these anti-consumer practices? Could they trigger the clawback provision if they did not engage in such conduct, but allowed it to continue?

It is unclear whether the triggers would be interpreted to cover failures in risk management or inadequate supervision. To address this, the Rule should be revised to state that the clawback provision can be triggered when a senior executive official or significant risk-taker *participated in or was responsible for* misconduct that resulted in significant financial or reputational harm.[157] This is the standard currently used by the PRA,[158] and it is better suited to disincentivize risky behavior throughout the supervisory chain than the current Rule.

B. *What Do the Financial Institutions Have to Say?*

In their comments to the 2016 Proposed Rule, many financial institutions and interest groups have opposed the attempt by the Agencies to impose regulations on incentive-based compensation arrangements.[159] Primarily, they are concerned that the restrictions on compensation structures will limit the ability of institutions to

155. *See supra* notes 126–30 and accompanying text.
156. 2016 Proposed Rule, *supra* note 5, at 37,731–32.
157. *Cf. id.* (limiting the clawback provision to senior executive officers and significant risk takers who "engaged in" one of the three triggers).
158. *See* PRUDENTIAL REGULATION AUTH., *supra* note 144, Annex A at 14–15.
159. *See, e.g.*, Letter from Henry D. Eickelberg, Chief Operating Officer, Ctr. on Exec. Comp., to Office of the Comptroller of the Currency et al. (July 22, 2016), https://www.regulations.gov/contentStreamer?documentId=OCC-2011-0001-2412&attachmentNumber=1&contentType=pdf [hereinafter Ctr. on Exec. Comp. Letter]; Letter from Kenneth E. Bentsen, Jr., President & CEO, SIFMA, to Office of the Comptroller of the Currency et al. (July 22, 2016), https://www.regulations.gov/contentStreamer?documentId=OCC-2011-0001-2402&attachmentNumber=1&contentType=pdf [hereinafter SIFMA Letter]; Letter from Edward J. DeMarco, Jr., Gen. Counsel & Dir. of Regulatory Relations, The Risk Mgmt. Ass'n, to Legislative & Regulatory Activities Div. et al. (July 20, 2016), https://www.regulations.gov/contentStreamer?documentId=OCC-2011-0001-2387&attachmentNumber=1&contentType=pdf [hereinafter The Risk Mgmt. Ass'n Letter].

attract talent in the field,[160] and they suggest a principles-based approach to minimize risk over a more prescriptive rule-based approach.[161]

Incentive-based compensation programs are critical tools in the management of financial institutions,[162] and they are often used as tools to attract the most talented individuals in the field.[163] But as financial institutions begin to offer aggressive incentives to compete for the best talent, financial interest can override effective risk management.[164] This very pattern of behavior was predominate in financial institutions in the years leading up to the financial crisis of 2007.[165] To keep the talent in-house, financial institutions "began providing aggressive incentives, often tied to the price of their shares and often with accelerated payouts."[166] As the profitability of the firms grew, the compensation packages increased for senior executives and key employees, and the firms did little to check risky behavior.[167] Where risk is so inherent in the make-up of incentive-based compensation, there needs to be regulation addressing the issue.

Those opposed to the Rule would prefer a principles-based approach, similar to the 2010 Guidance[168] and the 2011 Proposed Rule,[169] as opposed to more prescriptive rules.[170] Such an approach

160. *See, e.g.*, Ctr. on Exec. Comp. Letter, *supra* note 159, at 16; SIFMA Letter, *supra* note 159, at 4; The Risk Mgmt. Ass'n Letter, *supra* note 159, at 30, 45.

161. *See, e.g.*, Ctr. on Exec. Comp. Letter, *supra* note 159, at 4; SIFMA Letter, *supra* note 159, at 2–3; The Risk Mgmt. Ass'n Letter, *supra* note 159, at 5.

162. *See* Jian Cai et al., *Compensation and Risk Incentives in Banking and Finance*, FED. RES. BANK CLEV. (Sept. 24, 2010), https://www.clevelandfed.org/~/media/content/newsroom%20and%20events/publications/economic%20commentary/2010/ec%20201013%20compensation%20and%20risk%20incentives/ec%20201013%20compensation%20and%20risk%20incentives%20in%20banking%20and%20finance%20pdf.pdf. Well-structured incentive-based arrangements align the interest of executives and employees with the interests of the institution's shareholders. *Id.*

163. *See id.*

164. *See* John Thanassoulis, *The Case for Intervening in Bankers' Pay*, 67 J. FIN. 849, 850 (2012) ("[C]ompetition by banks for bankers generates an empirically relevant negative externality that drives up rival banks' default risk.").

165. *See* FCIC REPORT, *supra* note 44, at 62–63. "When . . . investment banks went public . . . the close relationship between bankers' decisions and their compensation broke down. They were now trading with shareholders' money. Talented traders and managers once tethered to their firms were now free agents who could play companies against each other for more money." *Id.* at 62.

166. *Id.* (noting that commercial banks followed suit to remain competitive in the industry).

167. *See id.* at 62–63.

168. *See supra* notes 61–62 and accompanying text.

169. *See supra* Section IV.A.

170. *See supra* note 161 and accompanying text.

would allow for more discretion in making incentive-based compensation decisions.[171] In July 2016, Wells Fargo submitted a comment to the 2016 Proposed Rule advocating this point.[172] In its comment, Wells Fargo stated:

> In line with the 2010 Guidance, we have used a principles-based approach to identify those team members who could have a material impact on the safety and soundness of Wells Fargo and to establish compensation arrangements that manage specific underlying risks and differentiate among diverse risk profiles.
>
> . . . .
>
> We identify material risk takers and balance risk and reward in our incentive compensation arrangements through our Incentive Compensation Risk Management Program . . . . We believe our ICRM Program has allowed us to achieve both our risk management objectives and our other compensation goals.[173]

Yet, as the Wells Fargo incident suggests, a principles-based approach does not always adequately address the inherent risk, nor does it properly disincentivize risk-taking.[174] "[D]iscretionary decisions can undermine the goal of incentive-based compensation arrangements to . . . balance risk and reward" when used improperly or inadequately.[175]

Notably, the 2016 Proposed Rule does not eliminate a principles-based approach altogether.[176] The Rule uses this approach to allow "covered institutions . . . the flexibility to structure incentive-based compensation arrangements that do not constitute excessive compensation."[177] However, the rule attempts to prescribe certain requirements on covered institutions to limit the inherent risk of incentive-based compensation arrangements.[178] While these

171. *See* Black, *supra* note 66, at 9.
172. Hope A. Hardison, Senior EVP, Chief Admin. Officer & Dir. of Human Res., Wells Fargo, to Robert deV. Frierson, Sec'y, Bd. of Governors of the Fed. Reserve Sys. et al. 2–3 (July 22, 2016), https://www.sec.gov/comments/s7-07-16/s70716-48.pdf.
173. *Id.*
174. *See supra* Part III.
175. 2016 Proposed Rule, *supra* note 5, at 37,712.
176. *See id.* at 37,781.
177. *Id.*; *supra* notes 104–07 and accompanying text.
178. *See supra* Section IV.B (describing the deferral requirement, the forfeiture and downward adjustment provision, and the clawback requirement).

requirements may be ineffective in their current form,[179] they are necessary additions to the principles-based aspects of the 2016 Proposed Rule to disincentivize risk-taking at covered institutions.

VI. CONCLUSION

Poorly structured incentive-based compensation arrangements can have substantial effects on the health of the United States economy.[180] Since the passage of Dodd-Frank, federal regulators have taken steps to address the inherent risk in such arrangements.[181] However, the principle-based approach of current agency guidance has given financial institutions too much discretion in structuring their incentive-based compensation arrangements, leading to damaging consequences as demonstrated by the Wells Fargo scandal.[182]

The Agencies' 2016 Proposed Rule seeks to address this issue by implementing more prescriptive rules to regulate incentive-based compensation arrangements.[183] Yet, if the 2016 Proposed Rule were to be promulgated in its current form, it would be ineffective at achieving its intended goal of disincentivizing risk.[184] The rule must be strengthened by extending the deferral period, requiring use of the clawback provision thereby limiting the discretion given to financial institutions, and utilizing new language to hold senior executives accountable for misconduct and harm to the institution.[185]

179. *See supra* Section V.A.
180. *See supra* note 6 and accompanying text.
181. *See supra* Section II.C.
182. *See supra* Part III.
183. *See supra* Section IV.B.
184. *See supra* Section V.A.
185. *See supra* Section V.A.