



AMERICAN BENEFITS  
COUNCIL

November 5, 2010

U.S. Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549

*Submitted electronically via SEC.gov*

**RE: Dodd-Frank Act Title IX – Executive Compensation §§ 953 and 954**

Dear Chairman Shapiro:

I am writing on behalf of the American Benefits Council (the "Council") to provide comments on the implementation of certain provisions relating to executive compensation in Title IX of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). More specifically, this letter focuses on §§ 953 (Executive Compensation Disclosures) and 954 (Recovery of Erroneously Awarded Compensation) of the Dodd-Frank Act.

The Council is a public policy organization principally representing Fortune 500 companies and other organizations that assist employers of all sizes in providing benefits to employees. Collectively, the Council's members either sponsor directly or provide services to retirement and health plans that cover more than 100 million Americans.

Our comments focus on §§ 953 and 954 of the Dodd-Frank Act. We believe that thoughtful SEC guidance will be critical in order to implement the legislative mandate of these provisions in a manner that is feasible and cost-effective for public companies while providing investors with useful and reliable information.

Please contact us if you or your staff has any questions about these comments or would like to discuss them with us.

## § 953(B) – DISCLOSURE OF PAY RATIO

**Generally:** Read literally, the new pay ratio disclosure provision in § 953(b) of the Dodd-Frank Act could impose requirements that may be extremely difficult for most public companies to satisfy. The Council encourages the SEC to promulgate rules that allow issuers to provide investors with useful information that complies with the legislative mandate of these requirements through feasible and cost-effective processes. To the extent the SEC believes it does not have the authority under the statutory language to provide rules meeting these standards, we recommend that the SEC propose any needed technical corrections.

**Concern #1:** *Addressing "All Employees"* – §953(b)(1)(A) refers to "all employees of the issuer" for purposes of determining the median of annual total compensation, thereby creating significant questions as to whether and to what extent issuers are required to factor compensation paid to the following classes of employees into their calculations:

- a) Non-U.S.-based employees;
- b) part-time and seasonal employees;
- c) employees employed for less than the full year of the calculation;  
and
- d) employees of subsidiaries and affiliates of the issuer.

### **Recommendation #1:**

The Council recommends that the SEC issue rules under which the phrase "all employees" is interpreted as meaning all full-time U.S. employees of the issuer. In addition, the SEC should establish safe harbor methodologies that authorize issuers to determine median annual total compensation on the basis of a nondiscriminatory sampling of the issuer's employees, provided that the sampling is reasonably representative of the employer's workforce. For instance, the sampling could be authorized for a sample size that –

- (i) is certified by an independent expert to be reasonably representative of the issuer's total employees; or
- (ii) exceeds a minimum number or a minimum percentage of the issuer's total employees.

If part-time and seasonal employees, and employees employed for less than the full year of the calculation, must be taken into account, the SEC should also permit full-time equivalency adjustments to annualize the pay for such employees.

**Concern #2: *Calculating "Total Compensation"*** – §953(b)(2) requires that "total compensation" be "determined in accordance with the rules in §229.402(c)(2)(x) of title 17, Code of Regulations," the rules for reporting named executive officer compensation in the Summary Compensation Table in the proxy (for simplicity here, "Item 402"). It would be extremely difficult and cost-prohibitive for issuers to make a calculation for all employees that is as comprehensive as the calculation that is applicable to named executive officers. Such a requirement would mean that issuers would have to calculate total Summary Compensation Table compensation for all employees, including with respect to non-cash compensation (e.g., defined benefit pension accruals, defined contribution plan contributions, equity grants, and fringe benefits) under the complicated Item 402 rules. Moreover, §953(b)(2) requires that the applicable Item 402 rules be those "as in effect on the day before enactment of this Act." On its face, this appears to require use of the Item 402 rules in effect on July 21, 2010, notwithstanding future changes in the SEC's rules used to calculate the compensation of named executive officers.

**Recommendation #2:**

We believe that the statutory purpose of the Dodd-Frank Act can be reasonably attained if the SEC's rules establish a safe harbor that allows issuers to calculate their pay ratio on the basis of–

- a. The CEO's total compensation that is taken into account under the Item 402 rules, and
- b. The annual cash compensation (e.g., wages, salary, bonus) and equity awards for all other employees, with all relevant calculations made in accordance with the Item 402 rules.

For purposes of determining the compensation of employees other than the CEO, the SEC should also permit issuers to take into account select elements of other types of compensation (such as pension accruals); provided the inclusion occurs on a uniform basis and is fully disclosed to shareholders.

This methodology should be feasible for issuers and should reasonably implement the Dodd-Frank Act by setting forth a methodology consistent with that required under §953(b)(2).

**Concern #3: *Calculating "Median" Compensation*** – §953(b)(1)(A) requires issuers to compute the "median" of the annual total compensation of all employees of the issuer. To calculate the median amount, an issuer must compute each employee's compensation, rank each employee from top to bottom, and then determine the exact mid-point.

**Recommendation #3:**

We recommend that the SEC issue rules permitting issuers to calculate "average" compensation (instead of median compensation) based on the more readily-available compensation measures suggested above. Such an approach would be a more practical alternative to calculating median compensation while still adhering to the spirit of § 953(b).

**Concern #4: *Limiting The Frequency Of The Calculation*** – §953(b)(1) requires disclosure of the required pay ratio "in any filing of the issuer described in §229.10(a) of title 17, Code of Regulations." However, it is not specified in the statute the extent to which an issuer would be required to make updated calculations with respect to each such filing.

**Recommendation #4:**

In order to relieve issuers from potentially having to make multiple pay ratio calculations throughout a year, the SEC's rules should establish a safe harbor period of at least a year during which an issuer may rely on its pay ratio calculation that is made as of some recent date.

- a. For example, a calculation as of the issuer's fiscal year-end may establish the pay ratio that the issuer discloses for a future annual period such as the 12-month period that begins on the first day of the fourth month after the issuer's fiscal year end.
- b. Issuers should be given the flexibility to select an annual calculation date other than fiscal year end for purposes of determining the pay ratio calculation for the safe harbor period, provided that date is used consistently for future periods. For instance, an issuer whose fiscal year does not end on December 31<sup>st</sup> may find it significantly more efficient to determine median compensation on a calendar year basis (because most issuers need to assemble tax information covering that period).
- c. Note: Such an approach would be consistent with the Treasury Department's regulations in Treas. Reg. §1.409A-1(i) that address the process for identifying "specified employees" for purposes of the 6-month delay rule.

**Concern #5: *Delaying The Effective Date Of The Requirement*** – §953(b)(1) directs the SEC to amend the Item 402 rules to implement the pay ratio requirements, but does not provide any deadline or effective date for the requirements

**Recommendation #5:**

The effective date for the new requirements should be at least one year after the issuance of final rules.

**§ 953(A) – DISCLOSURE OF PAY VERSUS PERFORMANCE**

**Concern #1: *Need For Guidance*** – New §14(i) of the Exchange Act, as added by §953(a) of the Dodd-Frank Act, directs the SEC to issue rules requiring issuers to provide information in the annual proxy disclosures showing the relationship between executive compensation actually paid to executives and the financial performance of the issuer, taking into account changes in the value of the issuer's shares and dividends and any distributions. The required disclosure may be in either graphic or narrative form.

**Recommendation #1:**

The SEC should issue rules under new §14(i) providing the following information on the required disclosures:

- a. Whether issuers are required to provide the information in a uniform manner (as prescribed by the SEC), or whether they will have flexibility in satisfying these requirements (based on principles in SEC guidance) in the manner they choose?
- b. Which executives' compensation is covered by the requirement? (E.g., top-5 named executive officers; all executive officers?)
- c. What compensation must be disclosed? (E.g., total compensation disclosed in the Summary Compensation Table under Item 402?)
- d. What period is covered? (E.g., multiple year period like the 5-year Performance Graph table?)

**§ 954 – RECOVERY OF ERRONEOUSLY-AWARDED COMPENSATION**

**Concern #1: *de minimis Rule; Board Discretion*** – New §10D(b)(2) of the Exchange Act, as added by §954 of the Dodd-Frank Act, provides that rules of the Commission will require that an issuer develop and implement a policy ("Recovery Policy") under which the "issuer will recover" excess payouts relating to an accounting restatement.

**Recommendation #1:**

The SEC should establish both a *de minimis* rule (e.g., \$10,000 based on Rule 16b-3 standards), and a standard under which an issuer is not required to seek recovery when its board or compensation committee reasonably expects the cost of collection to exceed the amount recovered.

Note that a cost-benefit exception is especially important with respect to recoveries from former employees, because an issuer may not have resort to their current or future compensation, and consequently may well be forced to litigate for any recovery. In addition, the SEC should explicitly clarify that the board or compensation committee has the discretion to determine how to recoup excess payments under the Recovery Policy.

**Concern #2: *Grandfathering For Past Awards*** – New §10D(b)(2) directs that an issuer's Recovery Policy apply to incentive compensation that is received "during the 3-year period preceding the date on which the issuer is required to prepare an accounting restatement." The SEC's rules should recognize that issuers cannot necessarily subject past incentive compensation awards (whether paid in cash, stock options, or otherwise) to the Recovery Policy on a retroactive basis.

**Recommendation #2:**

The SEC should establish a grandfathering rule under which incentive compensation awards are exempt from the Recovery Policy required in §954 of the Dodd-Frank Act if the awards occur before the effective date of the SEC's final rules under §954. Otherwise, issuers will face a true Catch-22 of having to unilaterally implement a Recovery Policy for past awards but being barred from doing so under basic contract law principles. Moreover, the SEC should provide issuers with at least one year after the issuance of final rules to develop and implement a Recovery Policy and make any necessary plan amendments.

*Note:* A grandfathering rule that is tied to the July 21, 2010 enactment date of the Dodd-Frank Act would not address the concern raised here because issuers have been making incentive compensation awards subsequent to enactment of the Dodd-Frank Act without including a recovery provision, on the premise that §954 does not become effective until the SEC issues its rules under that section.

**Concern #3: *Clarifying The "Erroneous Data" Condition*** – New §10D(b)(2) directs that an issuer's Recovery Policy apply to incentive compensation that would not have been paid but for "erroneous data" that is subject to a required accounting restatement. The Recovery Policy should not apply to incentive compensation that is not based on any financial performance measure subject to the accounting restatement.

**Recommendation #3:**

The SEC should confirm that a Recovery Policy will apply only to incentive compensation that is awarded or becomes vested based on financial performance measures that are subject to an accounting restatement, and will not apply to incentive compensation (including stock options and other stock awards) that is not based on such measures.

**Concern #4: *Applying §954 To Stock Options And Other Stock Awards*** – Because §10D(b)(2) singles out stock options as being within the scope of incentive compensation that should be subject to a Recovery Policy, there is a question about whether a Recovery Policy should extend to the enhancement in an award's value that is solely attributable to increases in the fair market value of the underlying shares.

For example, suppose an executive receives a grant of stock options to buy 100 shares at \$10 per share for reasons that are not based on financial performance measures. One year later, the executive engages in a simultaneous exercise and sale when the issuer's stock price reaches \$30 per share. The executive would have a cash gain equal to \$20 per share, or \$2,000 in total for 100 shares. Suppose also that a financial restatement is announced within the two-year period after the stock options are exercised (and thus within the three-year look back period), and the issuer's stock price soon falls back to \$10 per share. Should the Recovery Policy extend to the \$2,000?

**Recommendation #4:**

As recommended above, the SEC should clarify that §10D(b)(2) requires the recovery of incentive compensation, including stock options and other stock awards, only where an executive is awarded or becomes vested in the compensation due to erroneous data relating to a financial restatement. The SEC also should clarify that the Recovery Policy will not apply to stock options or other stock awards such as restricted stock or restricted stock units that vest solely on the passage of time.

In addition, the SEC should confirm that the Recovery Policy does not apply to changes in value reflecting fluctuations in the market price of the issuer's stock. Any connection between the erroneous data that relates to the restatement of an issuer's financial statements, and the fluctuating value of the issuer's stock would be purely tangential and speculative. It is clear from litigation relating to lost stock option profits as well as 401(k) stock-drop litigation, that market fluctuations do not occur in a vacuum relating to financial restatements, and that recovery risks for executives should not be extended that far. Such a leap into fluctuating market values seems clearly beyond the anticipated scope and express terms of §10D(b)(2), and ought to be clarified as being outside the required scope of a Recovery Policy.

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We would be pleased to have further discussions with respect to these issues. In that regard, if you have questions, please contact me at (202) 289-6700.

Sincerely,

A handwritten signature in cursive script that reads "Lynn D. Dudley". The signature is fluid and elegant, with the first letters of each name being capitalized and prominent.

Lynn D. Dudley  
Senior Vice President, Policy