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September 10, 2010

Chairman Mary L. Schapiro
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549

Re: **Comments on Dodd-Frank Wall Street Reform and Consumer Protection Act: Title IX Executive Compensation**

Dear Chairman Shapiro:

On July 27, the SEC invited the public to submit comments on various aspects of The Dodd-Frank Wall Street Reform and Consumer Protection Act that call for rulemaking or studies by the SEC.

Towers Watson is a leading global professional services company that helps organizations improve performance through effective people, risk and financial management. Among our various practices, we are a leading provider of executive compensation consulting services.

Recently we have written several articles that contain questions about various aspects of Dodd-Frank that pertain to executive compensation and comments suggesting ways to resolve these issues. Specifically, these comments relate to:

- Section 951 pertaining to shareholder approval of executive compensation and golden parachutes (and the interplay between such approvals)
- Section 953(b) pertaining to disclosure of the relationship between the total pay of the CEO and median total pay of other employees
- Section 954 pertaining to recovery of erroneously awarded compensation (so-called “clawbacks”)
- General issues about the applicability of the Title IX executive compensation provisions to companies based outside of the United States.

We have attached copies of these articles for your review and consideration. Separately, we plan to submit further comments on other aspects of Title IX related to executive pay.

If you have questions about any of our comments, we would be pleased to respond.

Sincerely,

Russell E. Hall

Russell E. Hall

Steve Seelig

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September 10, 2010

William Kalten

Stephen Douglas

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Answers to Commonly Asked Questions About the New Pay Comparison Disclosure Under the Dodd-Frank Act

By William Kalten and Russ Hall, Towers Watson

August 30, 2010

The Dodd-Frank Wall Street Reform and Consumer Protection Act includes a number of executive compensation and corporate governance provisions that have significant implications for publicly traded companies, including new say-on-pay and clawback requirements. (For an overview of Dodd-Frank's provisions affecting executive pay, see "Executive Compensation Reforms Enacted," *EC Bulletin*, July 22, 2010.)

Among the law's provisions is a new disclosure requirement that has prompted a host of questions from companies. This provision requires companies to disclose a comparison of the CEO's pay to the median pay of all other employees. This article offers preliminary answers to some of the most common questions that have been raised about this new disclosure rule and offers some comments and suggestions that we hope the SEC's staff will consider when issuing interpretative guidance.

Among the law s provisions is a new disclosure requirement that has prompted a host of questions from companies.

Q1. What is the purpose of the new pay comparison disclosure requirement?

A1. The disclosure is designed to illustrate the disparity between CEO pay and rank-and-file employee pay within each company. Whether such a comparison is truly meaningful to investors, however, is debatable. Among other issues, there's no way (without significantly more information) to reliably compare ratios between companies. For example, companies in different industries will pay their employees at different levels. And, even within the same industry, companies located in different geographical areas will pay their employees at different levels. As a result, this disclosure does not provide much meaningful information to investors regarding differences in executive to employee pay ratios from company to company.

Q2. When does this requirement take effect?

A2. No effective date is specified in the law, suggesting that the effective date has been delegated to the Securities and Exchange Commission (SEC) under its rule-making authority. Detailed guidance will be needed to implement this provision, and SEC Chairman Mary Schapiro has indicated that, given the complexity of this disclosure requirement, the rules are not likely to be in place for the 2011 proxy season.

Comment: *Unless the SEC is able — within the constraints of the legislative language and any amendments — to greatly simplify reporting burdens, companies will have to commit quite a bit of time and resources to comply with the new requirement. The compliance burden will be especially onerous for companies with highly decentralized operations and no central recordkeeping system, such as many global companies. It would be unnecessarily burdensome to expect all companies to develop this information as early as the 2011 proxy season.*

Q3. What information will be required to be disclosed?

A3. Dodd-Frank requires public companies to disclose:

- The median of the annual total compensation of all employees of the company, other than the CEO
- The annual total compensation of the CEO
- The ratio of these two amounts

Note that the law does not specify how the ratio is to be expressed. SEC guidance will be critical in this regard.

Q4. What compensation must be used for purposes of this disclosure?

A4. The law requires that companies follow the definition of total compensation contained in Section 229.402(c)(2)(x) of Title 17 of the Code of Federal Regulations in effect on the day before the law's enactment.

Thus, if read literally, total compensation must be calculated in accordance with the proxy rules for the Summary Compensation Table used to determine total compensation. This is a calculation that is not normally performed for individual employees other than the named executive officers. It includes elements of pay, such as the annual change in pension value and the value of perquisites (unless the total is under $10,000), that are likely to be burdensome and costly to calculate when applied to a company's entire workforce, rather than to a handful of senior executives.

Also note that, since the law refers to the Summary Compensation Table rules on the day before the law's enactment (July 20, 2010), any future changes to those rules would require companies to perform two sets of calculations for named executive officers.

Comment: *We hope the SEC will attempt to reduce the potential administrative burden that companies face in complying with this requirement. For example, companies could be allowed to exclude certain elements of pay (e.g., pension benefits, perquisites) with respect to employees other than the CEO. Arguably, this would not undermine the spirit of the rule since any rank-and-file pay exclusions would only increase the disparity between CEO and other employee pay. However, the SEC may not feel it has the authority to grant such relief. In that case, a technical correction would be needed to simplify the calculations required for this disclosure.*

Q5. For which employees must compensation be calculated?

A5. The calculation is required for "all employees of the issuer." This phrase would appear to include non-U.S. employees. Calculating total compensation for non-U.S. employees will pose a number of issues, including the availability of data and the need for currency conversions. Also, it's unclear how useful this information will be since pay and benefit levels vary dramatically from country to country based on a number of factors, including local laws and cost-of-living differences.

The calculation also appears to include part-time employees, for whom compensation presumably would need to be annualized. Even so, part-timers will almost certainly be paid less than full-time employees, and their inclusion will likely skew the ratio. Given the issues associated with gathering data and performing calculations with respect to these categories of employees and the potential for distorted pay ratios, it seems appropriate for the SEC to exclude them from the calculations. Here again, however, the SEC may conclude that it lacks authority under the statute to provide for such exclusions.

Also unclear is whether employees of the issuer's subsidiaries and other affiliates would need to be included in the calculation. The current proxy rules do require disclosure of compensation paid (to NEOs) by subsidiaries.

Comment: *We hope the SEC will seriously consider excluding certain categories of employees from the definition of "all employees of the issuer":*

- Non-U.S. employees
- Part-time employees
- Employees of subsidiaries or affiliates

Calculating total compensation for non-U.S. employees will pose a number of issues, including the availability of data and the need for currency conversaions.

Q6. As of what date must this calculation be performed?

A6. To calculate the ratio, it will be necessary to fix the employee group as of a particular date. The statute does not specify the date that should be used. The last day of the prior year would seem an obvious choice. However, unless the SEC adopts some simplifying rules, that date may not allow enough time to gather the necessary data and perform all the required calculations.

Comment: *To facilitate first-year calculations, we suggest the SEC delay the first reporting requirements until the 2012 proxy season at the earliest. Also, the date used to fix the employee group should provide sufficient time for employers (especially those with large organizations) to gather and process the required information by the filing due date.*

Q7. Must CEO pay really be compared to the *median* employee pay (as opposed to some other measure)?

A7. Yes. Since the median is less sensitive to extremes (outliers) that can skew the average and since more people earn low salaries than high salaries, the median is viewed by statisticians as a more reliable measure with respect to income distributions. This may have been why it was chosen by Congress instead of the mean (i.e., average).

Q8. In what filings must this disclosure be made?

A8. The disclosure is required in any filing of the issuer described in Section 229.10(a) of Title 17 of the Code of Federal Regulations. In other words, the law requires this ratio to be disclosed not only in the proxy statement, but also in registration statements, annual reports and other filings. As a result, this disclosure might be required several times a year. This seems unnecessary and was not likely the intent of Congress.

***Comment:** We hope the SEC will interpret the law narrowly and require the disclosure only in the proxy statement, allowing other filings to reference the proxy.*

Q9. Will the SEC permit companies to provide additional explanatory disclosures?

A9. The statute requires disclosure of only the ratio of CEO pay to the median pay of all other employees. However, some companies may want to provide additional information that puts this number in context. We do not anticipate the SEC would object to this type of information being included in the disclosure.

***Comment:** We hope the SEC will affirmatively allow companies to include additional information, where helpful, to clarify their disclosures regarding the ratio of CEO pay to other employees' pay.*

Q10. Can the SEC exempt categories of companies (e.g., small issuers)?

A10. Dodd-Frank does not specifically permit the SEC to exempt categories of issuers from this requirement, although it grants this authority with respect to other provisions.

Next Steps

Although the law charges the SEC with responsibility for interpreting this provision, the statutory language isn't always conducive to all of our suggestions. There have been discussions in Congress about a narrow technical corrections bill, which might address some of the issues surrounding this disclosure requirement. However, such a bill likely would not gain traction until sometime next year, at the earliest. As a result, companies will want to express their views and concerns about this requirement during the SEC rule-making process.

About Towers Watson

Towers Watson is a leading global professional services company that helps organizations improve performance through effective people, risk and financial management. With 14,000 associates around the world, we offer solutions in the areas of employee benefits, talent management, rewards, and risk and capital management.

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Mandated Clawbacks Will Create New Tensions Between Executives and the Board

By Marshall Scott and Steve Seelig, Towers Watson

September 7, 2010

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 is widely viewed as the "say on pay" legislation, but its requirement that companies adopt a clawback policy will cause significant consternation and contention in corporate America as such policies are adopted over the next several months — and litigated for years to come. Under the new law, listed companies will be required to "develop and implement a policy regarding clawbacks of erroneously awarded incentive-based compensation" paid to executive officers that would be triggered by an accounting restatement. The law will force virtually every publicly traded company to change the focus of existing clawback provisions, including those developed in response to Sarbanes-Oxley (SOX), from "acts of commission" by executives to recoveries triggered solely because of an individual's status as an executive officer, regardless of whether the acts that led to the restatement were within the executive's control.

This article examines some of the thorny definitional questions the statute raises, any of which the Securities and Exchange Committee (SEC) may resolve via regulation. More troubling, though, are the legal and practical implications companies will need to confront quickly. Most of these are not susceptible to easy resolution, and may only be resolved through litigation. What's more, as with virtually all attempts to regulate executive pay, Dodd-Frank holds the potential for unintended consequences as companies and executives negotiate new pay programs and revisions to existing programs consistent with the statute and sound pay policies.

The law will force virtually every publicly traded company to change the focus of existing clawback provisions.

Background

For most public companies, the new law will impose a clawback design that is different from what they now have in place to comply with SOX or the Troubled Asset Relief Program (TARP) requirements, or what may have been adopted voluntarily. The following table provides a comparison of the clawback rules in SOX, TARP and Section 954 of Dodd-Frank:

	SOX	TARP	Dodd-Frank
When a clawback is triggered	Accounting restatement due to material noncompliance with securities laws as a result of misconduct	Any materially inaccurate performance metric criteria or financial statement (including statements of earnings, revenues or gains) that are later found to be materially inaccurate	Accounting restatement due to material noncompliance with any financial reporting requirement under the securities laws
What is clawed back	Amounts received as incentive-based compensation and profits realized from stock sales	Any bonus, retention award or incentive compensation paid	Erroneously awarded incentive-based compensation (including stock options) in excess of the amount that would have been paid under the accounting restatement
Who is subject to a clawback	CEO and CFO — but not other executive officers — of publicly traded companies	Senior executive officers (five most highly paid) and any of the next 20 most highly compensated employees	All current and former executive officers
Time period covered	Applies to compensation paid within the 12-month period following the misstated financial statement Can be enforced at any time after the payment	Clawback rights must be exercised at any time after the material inaccuracy is discovered unless it is unreasonable to do so (e.g., if the expense of enforcing the rights would exceed the amount recovered)	Applies to compensation paid during the three-year period preceding the date the company is required to prepare the accounting restatement

The key differences between Dodd-Frank clawbacks and those most companies already have in place are that the new law requires clawbacks without any misconduct on the part of the executive, and appears to afford the company no discretion as to whether to enforce the clawback.

The key differences between Dodd-Frank clawbacks and those most companies already have in place are that the new law requires clawbacks without any misconduct on the part of the executive, and appears to afford the company no discretion as to whether to enforce the clawback.

Questions the SEC Should Answer About Dodd-Frank Clawbacks

A host of questions are raised by the statute, which is accompanied by no legislative history to guide regulators and courts in interpreting the clawback provisions. Many of these questions may be resolved via regulations. There is no explicit deadline for the SEC to complete its rulemaking, although it's expected that final rules will be completed before the end of this year. However, it seems unlikely that the listing exchanges will complete the resulting amendments to their rules and gain the SEC's approval of those changes before the 2011 proxy season. Keep in mind that current SEC disclosure rules require companies to articulate their clawback policy in the Compensation Discussion and Analysis portion of the proxy, so companies most likely will be required to disclose their new policies beginning with the 2012 proxy.

Following are questions we expect the SEC to address during the regulatory process:

- **Who are executive officers?** Dodd-Frank says the new clawback policy will apply to "executive officers," which appears to adopt the definition of Section 3(7) of the Securities Exchange Act. This definition includes presidents, vice presidents (division or function), others who perform similar policy-making functions and executives of subsidiaries who also perform policy-making functions — a much broader group than the named executive officers in the proxy. Among other grandfathering questions, the SEC will need to define an effective date to determine whether companies' clawback policies under Dodd-Frank must apply to any former executive officers, including those who departed before the law's effective date (July 21, 2010).

- **What is material noncompliance?** This is a threshold question companies must answer before even considering the question of what constitutes incentive compensation. For example, a change in accounting standards would seem not to trigger the clawback. However, a change in how an auditor interprets accounting standards might trigger a clawback, even where there were no actual issues regarding whether the company had adequate controls in place over its financial system. Clearly, Congress recognized that not all financial restatements would require clawbacks. The SEC may very well leave this determination up to the discretion of the company in enforcing the clawback policy.

- **Who may or must enforce the refund obligation?** Under Sarbanes-Oxley, the SEC enforces any clawbacks for material noncompliance with securities law as a result of misconduct. Under Dodd-Frank, however, it appears that the company is required to enforce the clawback pursuant to its policy. The question then becomes whether this enforcement would be a board or compensation committee responsibility, or one that falls to the company itself.

- **Can discretion be exercised in enforcing the clawback?** Under the TARP guidelines, companies are not required to exercise a clawback if it's unreasonable to do so — for example, if the expense of enforcing the clawback would exceed the amount likely to be recovered. The new law is silent on the use of discretion. The SEC might decide that since any compensation recouped would be an asset of the company, companies should be permitted wide discretion in exercising their right to seek recovery. But granting discretion to enforce clawbacks could pose other issues. For example, if a committee or board does not act or fails to pursue a claim vigorously, could a shareholder bring a derivative action to enforce the clawback? This would provide a new avenue for challenging a company's compensation practices.

When companies would be required to make their clawback policies first enforceable is a fundamental question under the new law.

- **Would existing contracts be grandfathered?** When companies would be required to make their clawback policies first enforceable is a fundamental question under the new law. Would existing employment or equity award contracts be grandfathered? Would the clawback apply to compensation paid from the date the policy is made effective, regardless of contract terms? SEC guidance will be needed on these issues.

- **What compensation is subject to being clawed back?** The statute provides that regardless of when the restatement takes place, the compensation subject to recovery is measured for the three-year period before the restatement is "required." The SEC may interpret this to mean that a restatement is "required" as of the date the financials are stated incorrectly. This presumably would mean that if, in 2017, a company decides to restate its 2014 financials, the clawback would apply to compensation paid for 2011, 2012 and 2013.

  If the SEC interprets the statute this way, it would be possible that an executive could lose out on equity gains many years later. Expanding on the example above, suppose an executive exercised stock options during 2017 that were granted during 2011 based on strong share price performance totally unrelated to the erroneous financial statements. Will the SEC interpret the statute to require that any gains earned on those options be clawed back, or will the agency create a narrower rule that somehow ties the amount to be clawed back directly to the erroneous financial statement?

  What's more, how would the amount to be clawed back be determined? It's conceivable that the SEC could craft a rule that determines the amount to be clawed back based on the gross (pretax) amount received by the executive. This could create some difficult tax issues that might not be resolved in the executive's favor under the current tax code (i.e., the possibility of any tax refund is beyond the statute of limitations).

- **How is incentive compensation defined?** Incentive compensation comes in all shapes and sizes, often with some portion measured based on financial measures and some based on nonfinancial or qualitative measures (e.g., customer satisfaction). The SEC may craft regulations that permit the company to separate the elements of compensation that are incentive compensation from those that are not, based on how they are defined by company policy. As for stock options, the SEC may define the amount subject to clawback based on the grant date being within the three-year period before the erroneous financials were issued. Alternatively, the SEC could create a mechanism to adjust the grant-date exercise price to reflect the erroneous financials.

- **Would the SEC regulate indemnity clauses?** With the advent of the golden parachute, excise tax under Sections 280G and 4999 of the tax code, many companies adopted "gross up" provisions designed to make executives whole for any excise tax incurred at a change in control. The SEC will need to address the possibility for similar "make whole" treatment in its Dodd-Frank clawback regulations. Specifically, the SEC will need to decide if it has the legal authority to prevent companies from entering into similar agreements to indemnify executives whose compensation is clawed back due to no fault of their own. Even if the SEC determines that it lacks the authority to prohibit such indemnifications, companies would need to disclose the existence of these agreements in their proxy statements.

- **What about compensation in mergers and acquisitions?** Applying a clawback following an M&A transaction poses added complications in that it's common for the two organizations and their auditors to have very different notions of proper financial statement presentation. This raises the question of whether executives of the acquired entity should have an exclusion period under the clawback rules for restatements originating before the transaction or for a limited time after.

Possible Unintended Consequences

As with other laws seeking to regulate executive pay, the Dodd-Frank clawback requirement seems certain to have some unintended consequences. One source of potential problems will be how the requirement for a clawback policy as an exchange listing requirement interacts with existing employment agreements or stock award contracts governed by state law. Unlike federal pension law, the Dodd-Frank statute does not preempt state contract law. However, as a practical matter, a company would have little choice but to impose a clawback provision or risk being delisted (or, possibly, seeking an injunction to avoid delisting).

This will create an inherent conflict between the company's interests and those of the executives because few, if any, existing employment contracts, compensation plans or award agreements include a clawback provision based on a no-fault financial restatement. And, going forward, executives will be well aware that incentive compensation will be subject to potential clawbacks, and will endeavor to negotiate employment agreements that minimize the downside. It's too early to predict how this tension will play out, and it's always possible that executives will simply accept the clawback policy without much debate. But it's equally possible there may be significant changes in executives' demands during employment contract negotiations and in the discussions that take place at the time of a restatement as executives seek protection from the possibility of losing a portion of their pay. Here are just some of the issues companies may confront:

- **Will executives seek a quid pro quo for existing agreements?** Companies will need to be prepared for immediate negative reactions from executives with no responsibility for preparing the financial statements. The question is whether these executives will seek some quid pro quo in the form of enhanced compensation opportunities to balance against the risk of a no-fault clawback. Executives may also seek more fixed pay or to base more of their incentive compensation on nonfinancial performance measures that would not be subject to a clawback. Complicating matters might be how broadly "good reason" termination triggers are defined in existing agreements, since adoption of a Dodd-Frank clawback policy could trigger a walk-away right for some executives. This would give the executive additional leverage to negotiate new compensation plan terms.

- **What might happen when a clawback provision is exercised?** Putting aside the legal question of whether a clawback can be enforced under state law, companies seeking to enforce clawback provisions may find themselves having to make retention awards, such as time-based restricted stock, to retain or compensate innocent executives. If the SEC prohibits indemnities in such cases, these retention grants would likely need to be structured to be clearly attributable to future services rendered.

- **How might incentive compensation designs change?** Once the Dodd-Frank clawback rules take effect, companies and compensation committees may feel pressure to change the design and structure of compensation programs to subject executive officers to less clawback risk. Possible changes could include:

    - A pay mix that skews to a reduced emphasis on incentive compensation (and stock options) and to more salary, time-based restricted stock or deferred compensation

Going forward, executives will be well aware that incentive compensation will be subject to potential clawbacks and will endeavor to negotiate employment agreements that minimize the downside.

- The use of more discretion (either implicitly or explicitly) in delivering pay (for example, annual grants of time-based restricted stock could be issued at the discretion of the compensation committee, which may be informed, but not determined by, actual performance; such an approach might be preferred where the company is otherwise reducing the percentage of incentive compensation in its pay mix and adding a performance-based component to its restricted grant practices)

- Basing incentive compensation more on operational performance, rather than financial performance (one approach might be to increase levels of incentive compensation that are not financially based so as to assure a viable level of bonus income [e.g., target] based on nonfinancial operational goals or metrics)

- Banking bonuses based on financial measures so that companies hold back compensation that could be subject to a clawback (but note that "bonus banks" have been slow to catch on even in financial services, despite support for the concept from industry regulators; for this reason, companies might need to consider providing a matching contribution, perhaps subject to vesting conditions and paid in company stock, as a sweetener to executives required to defer payments)

- Greater use of debt, or debt that is convertible into equity, in the compensation structure

- **What might newly hired executives ask for?** Newly hired executives who are wary of the accuracy of the financial statements of a new employer may request more guaranteed compensation, rather than accepting financially based incentive compensation or stock options upon accepting a new job. These individuals may demand some time to learn the organization and get comfortable with the company's accounting practices before agreeing to traditional incentive compensation.

TOWERS WATSON

More Dodd-Frank FAQs: "Say on Parachutes" and Foreign Companies

By Russ Hall and Stephen Douglas, Towers Watson

September 10, 2010

The Dodd-Frank Wall Street Reform and Consumer Protection Act has prompted numerous questions about the new say-on-pay requirement and other rules for executive compensation and corporate governance. Among them are questions about the extent to which the law's provisions apply to foreign-based companies whose stock is traded in the U.S. Companies are also asking questions about the circumstances in which advisory votes on golden parachutes are required when shareholders are asked to approve a change in control.

This article offers preliminary answers to these questions, and offers some comments and suggestions that we hope the Securities and Exchange Commission (SEC) staff will consider when issuing interpretative guidance. (For an overview of Dodd-Frank's provisions affecting executive pay, see "Executive Compensation Reforms Enacted," *EC Bulletin*, July 22, 2010. For more Dodd-Frank FAQs, see "Answers to Commonly Asked Questions About the New Pay Comparison Disclosure Under the Dodd-Frank Act," *EC Bulletin*, August 30, 2010.)

The Dodd-Frank Wall Street Reform and Consumer Protection Act has prompted numerous questions about the new say-on-pay requirement and other rules for executive compensation and corporate governance.

Relationship Between Say on Pay and Say on Parachutes

Q1. There's been a lot of attention to the new say-on-pay requirement, but relatively little thus far on the new say-on-parachute provisions. When and under what circumstances would a company need to conduct a say-on-parachute vote, and is it possible for these provisions to sometimes overlap?

A1. The say-on-parachutes provision potentially applies for shareholder meetings on or after January 21, 2011, at which shareholders are asked to approve an acquisition, merger, consolidation, proposed sale or other disposition of all or substantially all of the issuer's assets. In general, it calls for shareholders to cast an advisory vote to approve a company's "agreements or understandings" with named executive officers concerning the type and amount of compensation that will be related to the transaction. However, the law exempts from the say-on-parachute requirement any agreements or understandings about compensation that have been subject to a previous say-on-pay vote.

Because parachutes must already be disclosed in the proxy, we believe companies will not have to conduct special say-on-parachute votes at the time of transactions in cases where they received majority support for their most recent say-on-pay votes as long as there have been no material changes to their parachute agreements since the time of the earlier vote. But it's less clear (and would be useful for the SEC to provide guidance) in cases where companies failed to receive majority approval for an earlier say-on-pay, vote or where amendments had been made to agreements or understandings about change-in-control compensation that were not material and/or applied only to individuals other than named executive officers.

Comment: *It would be useful for SEC regulations to clarify that say-on-parachute votes are required only in cases where the company has adopted new or materially amended parachute arrangements for named executive officers at the time of the change in control or subsequent to an earlier say-on-pay vote. It would also be helpful for the SEC to establish a materiality standard for such amendments and to specify what companies must do in cases where the earlier say-on-pay votes had failed to gain majority support.*

Dodd-Frank's Applicability to Foreign-Based Companies

Q2. Do the law's executive compensation and corporate governance provisions expressly apply to foreign companies?

A2. With one exception, these provisions do not expressly address their application to foreign companies. Dodd-Frank specifically excuses foreign private issuers from the requirement for compensation committee independence. However, to qualify for this relief, foreign companies must annually disclose to shareholders the reasons why they lack independent compensation committee members.

Q3. What's the likelihood that the other Dodd-Frank provisions relating to executive compensation will apply to foreign-based companies?

A3. Foreign-based companies that qualify under SEC rules as "foreign private issuers" are exempt from many of the SEC and U.S. stock market rules related to executive compensation that apply to domestic companies. For example, foreign private issuers are not subject to the normal proxy pay disclosure rules applicable to domestic companies. Instead, they are required only to make comparatively modest disclosures about executive pay in the annual reports they file with the SEC. Similarly, foreign private issuers are excused from most of the NASDAQ and NYSE corporate governance requirements, including the need for shareholder approval of their equity compensation plans, and can instead follow their home country practices.

A foreign private issuer is a company organized under the laws of a jurisdiction outside the U.S. with a majority of its shareholders residing outside of the U.S. It's also possible for a foreign company to qualify as a foreign private issuer even if most of its shareholders reside in the U.S., provided it meets certain other conditions.

Foreign-based companies that qualify under SEC rules as "foreign private issuers" are exempt from many of the SEC and U.S. stock market rules related to executive compensation that apply to domestic companies.

We suspect the new Dodd-Frank additions to the proxy disclosure rules will not apply to foreign private issuers given that the proxy disclosure rules generally do not apply to foreign private issuers. These disclosures are:

- Say on pay and say on parachutes
- The relationship between executive compensation and the company's financial performance
- A comparison of CEO pay and the median annual pay of all other employees
- Whether employees and/or board members are permitted to hedge against a decrease in the value of a company's shares

Note that the third requirement listed above (requiring a pay comparison between the CEO and other employees) is required to be disclosed not just in a company's proxy but in certain other SEC filings, including the annual report. Since foreign private issuers do file annual reports, it is therefore possible that, in contrast to the other proxy-based requirements, a foreign private issuer might be subject to this one. However, given that foreign private issuers can otherwise provide very limited individualized pay disclosures in their annual reports (if not required by their home country), it's still possible that the SEC will waive this requirement for such issuers.

It's somewhat less clear whether foreign private issuers will be subject to the new Dodd-Frank requirements incorporated into the listing rules of U.S. stock markets. As indicated above, Dodd-Frank specifically excuses foreign private issuers from its requirement for compensation committee independence, subject to an annual disclosure requirement. The other Dodd-Frank listing requirements relate to:

- Independent consultants and advisors to the compensation committee (but keep in mind that the related requirement to disclose in the proxy whether the compensation committee retained a compensation consultant, whether the consultant's work raised any conflicts and, if so, how these were resolved probably won't apply to foreign private issuers, since the proxy rules generally don't apply to these issuers)
- Clawbacks of executive compensation

Obviously, since the statute itself does not address the application of all but one of these requirements to foreign companies, we can only speculate at present about the likely outcome.

Comment: *We hope the SEC generally excuses foreign private issuers from the Dodd-Frank requirements described above. This seems consistent with the broad exemptions currently in place for such issuers and with the principles of international comity (i.e., respecting and recognizing the laws of other countries) that presumably provide the underpinning for those current exemptions. We also note that current U.S. stock market rules require foreign private issuers to summarize the significant ways in which their corporate governance practices differ from those required by the U.S. market on which they trade. We presume this requirement will be modified to reflect the Dodd-Frank requirement to provide annual disclosure of the reasons when foreign private issuers do not have an independent compensation committee.*