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April 20, 2015

Mary Jo White, Chair
c/o Mr. Brent J. Fields,
Secretary
U.S. Securities and Exchange Commission
100 F Street N.E.
Washington DC 20549-1090

Re: Disclosure of Hedging by Employees, Officers and Directors

Reference: File Number S7-01-15

Dear Chair White,

On behalf of more than 350,000 members and supporters of Public Citizen, we appreciate the opportunity to comment on the proposed U.S. Securities and Exchange Commission's (SEC or Commission) regulation titled "Disclosure of Hedging by Employees, Officers and Directors" (17 CFR parts 229 and 240).

> In summary, we support the Commission's proposed rule. The text of the Dodd-Frank Wall Street Reform and Consumer Protection Act statute is clear. The proposed rule essentially restates the statute. However, because the rule consists of a restatement of the statute it is difficult to justify the five years that has elapsed since Congress approved the statute mandating this rule. As such, we express frustration with the conspicuous lack of progress in completing this and the other executive compensation and financial reforms required under the Wall Street reform law. The Commission does not have the discretion to ignore congressional directives that some commissioners may oppose.

Overview

The Dodd-Frank Wall Street Reform and Consumer Protection Act contains a number of provisions in Title IX designed to make executive compensation practices transparent to investors. Inappropriate compensation practices figured at the center of the 2008 financial crisis: mortgage originators who were paid by the volume instead of integrity of loans polluted the financial system with toxic assets, mortgage securitizers paid with lucrative fees ignored these dangers as they sold these assets to outside investors, traders received rich rewards for fatal risk-taking, and senior bankers-- even those whose firms subsequently failed such as Bear Stearns and Lehman Brothers-- nevertheless pocketed tens of millions of dollars in compensation.[1] Numerous pathologies of the crisis attest to the central role of bad compensation policies.[2]

To help address this, the Dodd-Frank law contains several provisions dealing with compensation. One of the shortest, simplest and most straight forward is Section 955. It requires companies to disclose whether they permit hedging. During the financial crisis, some bankers themselves hedged their compensation, protecting themselves from the most severe effects of their collective mismanagement. More than a quarter of Goldman Sachs 475 partners hedged their compensation from 2007 to 2010.[3]

The importance of hedging disclosure is self-evident. Companies provide stock-based compensation in order to align the interests of employees with those of investors. Stock-based compensation is intended to motivate the employee to promote company prosperity, which is reflected in a rising stock price, which lifts compensation. Hedging delinks those interests. Many companies, including banks, now ban hedging, at least by their most senior employees. [4] A survey found that 95 percent of companies already disclose hedging policies, and the vast majority of these policies involve a ban.[5] Many observers believe hedging should be banned altogether, including proxy advisory firms ISS and Glass Lewis.[6]

While Section 955 does not ban hedging, it calls for disclosure, a minimal advance.

Analysis of Proposed Rule

Section 955 provides that the Commission "require each issuer to disclose . . . whether any employee or member of the board of directors . . . is permitted to purchase financial instruments (including prepaid variable forward contracts, equity swaps, collars, and exchange funds) that are designed to hedge or offset any decrease in the market value of equity securities."

To implement this statute, the Commission proposes the following rule: A firm shall "disclose whether [it] permits any employees or directors . . . to purchase financial instruments (including prepaid variable forward contracts, equity swaps, collars, and exchange funds) or otherwise engage in transactions that are designed to or have the effect of hedging or offsetting any decrease in the market value of equity securities."

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[1] "The Wages of Failure," by Lucian Bebchuk, et all, Harvard Law School, (November 2009), available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1513522
[2] See, for example, the report of the Financial Crisis Inquiry Commission, available at: http://fcic.law.stanford.edu/
[3] "Stock-hedging lets bankers skirt efforts to overhaul pay," by Eric Dash, New York Times (February 2011), Available at: http://dealbook.nytimes.com/2011/02/05/stock-hedging-lets-bankers-skirt-efforts-to-overhaul-pay/?_r=0
[4] "Stock-hedging lets bankers skirt efforts to overhaul pay," by Eric Dash, New York Times (February 2011), Available at: http://dealbook.nytimes.com/2011/02/05/stock-hedging-lets-bankers-skirt-efforts-to-overhaul-pay/?_r=0
[5] Compensation Advisory Partners survey, (December 2014), available at: http://www.capartners.com/news/204/61/2014-Proxy-Season-Changing-Practices-in-Executive-Compensation-Clawback-Hedging-and-Pledging-Policies
[6] Smith Anderson Securities Alert, February 18 2015, SEC Proposes new Rule Requiring Disclosure of Equity Hedging Policies," first paragraph under "Practical Considerations." http://www.smithlaw.com/newsletter-104.html

As the wording of the proposed rule is nearly identical to the statute, we believe the Commission has fulfilled its rule-making obligation fairly.

Commissioners Michael Piwowar and Daniel Gallagher criticized the proposed rule when the Commission issued it for comment. They urge that hedging disclosure should not apply to "employees that cannot affect the company's share price." Commissioners Piwowar and Gallagher are further concerned that smaller companies will find such disclosure burdensome and even "compel" them to "adopt policies prohibiting hedging." We disagree with their position.

First, the statute does not discriminate among employees. It states that the disclosure applies to "any employee." Commissioners Piwowar and Gallagher acknowledge this when they allow that "the statute technically covers these employees." Second, we disagree with the premise of their concern. All employees contribute to the prosperity of a company and all employees therefore have a corresponding ability to affect share price, especially with poor performance or even rogue behavior. Third, the commissioners' apparent concern with "regulatory burden" is easily answered via disclosure. The proposed rule simply requires publishing a few sentences. Should firms decide that some senior employees be barred from hedging, while some junior employees could be permitted, this is solved with disclosure. Last, implicit in the commissioners' concern that companies may be "compelled" to change their pay practices is an acknowledgement that hedging should be prohibited.

Disguising inconvenient or even embarrassing information is precisely what the SEC is mandated to prevent.

SEC Rulemaking Pace

That the SEC's proposed rule is essentially a restatement of the statute begs the question as to why the Commission expended nearly five years from enactment of the Dodd-Frank law to the time that it will consider implementation of the law's mandate. It cannot be that the statute required this amount of time to decipher. The Commission has promulgated far more complicated rules. It cannot be that the Commission lacks the staff resources to advance such a simple rule. Other financial regulatory agencies have implemented rules at a far faster pace. Public Citizen and other observers have demonstrated the SEC's comparative lack of progress.[7]

Instead, we are left to conclude that a majority of the five commissioners believe it is within their purview to ignore Congressional mandates.

Commissioners Piwowar and Gallagher leave little doubt as to their opposition to central Dodd-Frank provisions.[8] In their most troubling complaint about the proposed hedging disclosure rule,

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[7] See "Efficiency Nut," by Bartlett Naylor, Public Citizen, (June 2014), available at: http://www.citizen.org/sec-rulemaking-efficiency-report. Also see "Regulatory Tracker," a Davis Polk service, available at: http://www.davispolk.com/dodd-frank/regulatory-tracker/

[8] Commissioner Gallagher likened Dodd-Frank rule-making to "shoveling manure." See ThinkAdvisor, available at: http://www.thinkadvisor.com/2014/10/31/dodd-frank-rulemaking-like-shoveling-manure-secs-g

they explain they oppose the rule because they find it "a prioritization of the Commission's work that we do not share." Even if their technical questions are satisfied in the final rule, they indicate they will vote against the final rule (they say they are "quite concerned") because they contend the staff should have worked on other tasks. Such a position is farcical and is a dereliction of their duty as a congressionally-created body with the mission of protecting investors.

The quibbles of Commissioners Gallagher and Piwowar regarding details or priorities can only be construed as reverse-engineered efforts to accommodate a larger goal to delay if not derail implementation of a congressional command.

But these two individuals do not constitute the majority of the Commission. Commissioners Kara Stein and Luis Aguilar call for strong and expeditious implementation of these pay reforms. They publicly express frustration with the glacial pace of rulemaking.

This leaves Chair White. As the sole manager of the SEC's schedule for rulemaking, the chair bears ultimate responsibility for ensuring progress.

The unjustifiably slow emergence of the hedging disclosure rule epitomizes our broader concern with inaction on the Title IX provisions regarding compensation. The number of compensation reforms the Commission has adopted is precisely one—the say-on-pay provision mandated in Section 951. The others remain fallow.

- Section 953(a), requiring disclosure of pay and performance connections, remains un-proposed.
- On Section 953(b) regarding the CEO/median pay ratio disclosure, the simplest of all Dodd-Frank rules, the Commission lingered three years before finally proposing language and allowed itself a year to finalize it. That year has now elapsed with the Commission delaying its expected completion date by another year.
- Section 954, requiring firms to claw back compensation tied to results that are subsequently shown to be in error, remains un-proposed.
- Section 956, a critical reform requiring regulators to ban incentive pay arrangements that encourage inappropriate risk-taking by banks and investment advisers, is years overdue. It has not yet been finalized despite a statutory deadline of July 2011. In part, this delay is due to a reasonable decision by participating regulators to strengthen the rule proposed in 2011. We support this decision. However, we are concerned that the re-proposal has not yet been issued. Several regulators have signaled important improvements from a previously proposed rule, including Federal Reserve Board Governors Jerome Powell, Stanley Fischer and Daniel Tarullo.[9] New York Federal Reserve Bank President William Dudley also offered an intriguing idea about linking pay to compliance with the law. The SEC, however, has not yet signaled its state of progress in assessing and recommending improvements to the rule. We encourage the SEC to carefully examine the areas of the

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[9] See for example, speech by Jerome Powell, available at: http://www.federalreserve.gov/newsevents/speech/powell20150120a.htm. Also see "Decimate Wall Street," by Bartlett Naylor, Huffington Post, available at: http://www.huffingtonpost.com/bartlett-naylor/decimate-wall-street_b_6029372.html

rule under its jurisdiction, including both broker-dealers and investment advisers, and work with other regulators to re-propose the rule.

The SEC's inaction makes it difficult to distinguish indecision about policy from opposition to the Dodd-Frank statute's mandates. In most cases, as with the current hedging disclosure rule, there is little for the Commission to decide. The chair must simply press the "go" button.

Congress responded to the financial crisis of 2008 with the Dodd-Frank law. In many ways, we view this law as a half measure, a dilution owing to the prodigious lobbying effort of the same Wall Street industry that caused the crash. The compensation reform measures in Title IX are, for the most part, timid. The hedging disclosure provision is an example. Where the average investor should demand that the government ban hedging that nullifies the entire goal of equity-based compensation, the law simply requires disclosure.

The Commission should move this proposal to a final rule expeditiously, and also advance the other compensation reforms. Otherwise, we are left to wonder if the SEC, charged with protecting investors against Wall Street abuse, may instead be an enabler of that abuse, a concern shared by other important investor advocates.[10]

For questions, please contact Bartlett Naylor at [redacted], or [redacted].[11]

Sincerely,

Public Citizen

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[10] Letter from Public Citizen et al, available at:
http://www.consumerfed.org/pdfs/150310_investorprotection_letter.pdf
See, for example, Insurance industry coverage, available at:
http://insurancenewsnet.com/oarticle/2015/03/13/sec-must-prioritize-investor-protection-consumer-groups-say-a-605413.html#.VSQ74xBmP6E

[11] Peter Perenyi contributed research, analysis, and drafting for this comment.