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September 14, 2015
Electronic Comments Via-email

Mr. Brent J. Fields
Secretary, Securities and Exchange Commission
100 F. Street, NE
Washington, DC 20549

Re: File No. S7-12-15; Listing Standards for Recovery of Erroneously Awarded Compensation

Dear Mr. Fields,

Pearl Meyer is pleased to submit comments to the Securities and Exchange Commission on its proposed release (the Proposal) containing guidance to implement the provision under Section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the DFA or Act) with respect to the Listing Standards for Recovery of Erroneously Awarded Compensation (also referred to herein as the “clawback provision”).

By way of background, Pearl Meyer is one of the nation's leading independent compensation consulting firms, serving Board Compensation Committees as advisors and assisting companies in the creation and implementation of innovative, performance-oriented compensation programs to attract, retain, motivate and appropriately reward executives, employees and Board Directors. We help Boards and Committees establish and maintain sound governance practices, particularly as this relates to executive and Director pay decision-making. Since its founding in 1989, Pearl Meyer’s compensation professionals have advised hundreds of organizations in virtually every industry, ranging from Fortune 500 companies to smaller private firms and not-for-profit organizations.

We appreciate the opportunity to comment and share our views. We have engaged in extensive discussions with our clients to better understand the implications of the proposed rules in case-specific instances, and have incorporated many of our findings in this letter. We note, however, that Pearl Meyer is submitting this commentary on its own behalf, and not on behalf of any specific client. Please contact us at [redacted] if you have any questions.

Sincerely,

Dave Swinford

David N. Swinford
President and CEO
Pearl Meyer
[redacted]

Overview

The legislative text of the clawback provision is brief and open to interpretation. The Act requires the SEC to direct the exchanges to prohibit listing of (and delist) any company that does not adopt, implement, and disclose clawback policies as dictated by the exchanges and SEC. The specific text covers two items:

- Disclosure of a company's clawback policy; and
- Recovery from any current or former executive officer of incentive-based compensation received in the three years prior to a restatement in an amount equal to the excess of what would have been paid to the executive officer under the accounting restatement.

At the outset, we commend the Commission in its efforts to interpret the intent of Section 954 which was enacted nearly five years ago. While we acknowledge that the Commission was in some respects bound by the need to issue guidance pursuant to the legislative mandate, we urge the Commission to reconsider the prescriptive nature of the Proposal, particularly in light of the vast improvement in corporate governance (including voluntarily adoption of tailored clawback policies) over the past few years that has occurred organically and in the absence of regulation.

In short, we believe that the SEC has taken a relatively simple and common sense concept – repay what should never have been paid in the first place (a position with which we are in 100% agreement) – and created a voluminous set of regulations that will result in additional cost, complexity and unintended consequences. A far better methodology would have taken a principles-based approach. While we do not disagree that recoupment is appropriate in cases where payments should not have been made due to erroneous financial reporting, we believe the SEC has produced a rigid set of rules requiring public companies to go beyond the mandates of the Act.

Our responses below are organized by topic, rather than itemized Requests for Comment, but we believe the substance of this letter addresses the most critical questions raised by the Commission.

A Principles-Based Approach That Permits Board or Committee Discretion Is More Beneficial to Boards, Executives and Shareholders Alike

We believe that Section 954 could have been implemented by allowing companies more flexibility to adopt clawback policies that are appropriate and consistent with their corporate governance principles. The DFA was enacted in the midst of an unprecedented fiscal crisis, with many targeting excessive executive pay as the culprit. At that same time, very few, if any, companies maintained a clawback policy that went any further than the mandates of the Sarbanes-Oxley requirements.

Five years ago it appeared that companies needed a prescriptive and rigid mandate to clawback excessive compensation that should not have been earned leading up to the fiscal crises. Fast forward five years and the governance and disclosure landscape has dramatically changed – partly driven by Institutional Shareholder Services (ISS) and other institutional shareholders looking favorably on companies adopting and disclosing clawback policies in advance of rulemaking, and partly by motivated Committees that are determined to do the right thing – that is, prohibit executives from retaining compensation that they should never have earned.

Approximately 85% of Fortune 500 companies have already adopted executive clawback policies which have been specifically tailored by Committees in a way deemed appropriate for the business that they represent. We believe that the current corporate environment in combination with these companies' own newly adopted clawback policies should be sufficient to fulfill the intent of Section 954.

Most of the policies that have been voluntarily enacted to date retain some level of discretion in the Board or the Committee to decide whether to pursue a clawback. However, under the Proposal, except in extremely limited circumstances – companies may not exercise any discretion not to pursue a clawback. Penalties for failure to comply include delisting. The Proposal will penalize those companies that voluntarily adopted a policy tailored to their circumstances by forcing those companies to rescind their existing policies and authorize new policies to become compliant – an extremely expensive and time-consuming activity.

Again, while we are 100% in favor of the notion that executives should not be entitled to retain compensation that should not have been earned, Pearl Meyer strongly supports a principles-based approach and believes that business strategies and executive compensation program design are unique to each organization and should be tailored to specific circumstances. A company's Board or Committee are responsible for management, and the rigid approach in the Proposal discounts the Board's and Committee's expertise as to what may be in the best interests of the company and its shareholders. The Proposal renders the job of Boards and Committees administrative at best – that is, calculating direct costs and comparing them to the amount required to be recouped.

A better approach would allow Committee discretion in approaching the clawback, and require disclosure about the exercise of such discretion. In this way, shareholders remain informed and have a say on the clawback policy – if they don't like the discretion afforded, they can vote against Directors or on compensation-related matters. We note that parts of the Proposal do in fact allow such discretion (e.g., methodology for recouping compensation) and we urge the SEC to adopt a similar approach with respect to the rest of Section 954 in its final rules. The unintended consequences (discussed below) of the overly burdensome approach in the Proposal are vast and can be avoided with a simple, principles-based approach.

A few examples of areas we believe Boards or Committees should have discretion to enforce include cases where executives are subject to pre-existing legally binding contracts, where individuals were only executive officers for a portion of the three-year look back, or where indirect costs (not just direct costs) exceed benefit of enforcement. In such cases, Boards and Committees should be entitled to use their judgment to assess whether enforcement of the clawback is actually beneficial to the company and shareholders, or, conversely, whether enforcement would jeopardize the long-term health, retention and recruitment, reputation or shareholder value of the company.

TSR/Share Price Adjustments

The Proposal covers incentive-based compensation tied not only to financial accounting measures, but also to stock price and total shareholder return (TSR), and requires companies to make "reasonable estimates" as to how a restatement would have impacted stock price or TSR. Arriving at this reasonable estimate will necessitate extensive research, testing, and expense to understand how stock price and TSR would have been impacted by a restatement, and there are countless assumptions that go into the "but for" price of the stock. The Proposal provides almost no guidance or parameters as to how to arrive at such valuations. In fact, the Proposal takes eight pages to discuss the complexities. If adopted as is, the Proposal will be a windfall for the plaintiffs' bar as any "reasonable estimate" will be fair game for challenge, and executive officers will also likely dispute these estimates if subject to a clawback. We urge the SEC to provide more definitive guidance or examples of how this provision is to be applied in order to provide some safe harbor against additional litigation and cost.

Impact on Program Design

The Proposal requires companies to recoup compensation granted, earned or vested based on attainment of “financial reporting measures”, TSR and stock price, but not compensation based on strategic measures (e.g., a merger or divestiture), operational measures (e.g., completion of a project), fixed pay (e.g., salaries) or equity that vests over time (e.g., time-based restricted stock or fair market value stock options). As drafted, the Proposal serves as a disincentive for companies to provide incentive-based compensation that is likely to trigger clawback rules, which will have the unintended consequence of creating misalignment between executive officer and shareholder interests. The Proposal may result in higher base salaries, heavier reliance on time-based equity vehicles, and heavy reliance on performance-based measures that are exempt from the rule (i.e., strategic, operational or even discretionary results). Ironically, only three months before release of the clawback Proposal, the SEC released the pay-for-performance (PFP) Proposal which emphasized the importance of TSR as a performance measure. Unfortunately, the mixed message is use TSR as a performance measure if PFP disclosure is important, but don’t use TSR if you are at risk of not being able to attract executive talent due to clawback exposure. The two sets of rules leave companies in a Catch 22 scenario in designing their programs, which ultimately should be determined by corporate governance and strategy rather than disclosure optics.

In our experience, the past five years have marked an exponential improvement in aligning executive pay and company performance. The Proposal – which incentivizes fixed pay and time-based equity to limit executive officer exposure – undermines this trend. We would recommend that stock price and TSR not be included in the definition of incentive compensation to abate – at least partially – this conundrum.

Impact on Recruitment

The Proposal prohibits companies from indemnifying executive officers in connection with the clawback rules, which may have an adverse impact on a public company’s ability to hire executive officer level talent as these individuals will now be subject to clawbacks regardless of their culpability in the restatement of financials. Again, if Boards or Committees retained discretion to enforce clawbacks where it deems appropriate, this risk may be greatly diminished.

Impact on Scope of Section 16 Officers

Inclusion of all Section 16 officers, without Committee discretion to enforce, may have the unintended consequence of redefining duties of executive officers in order to limit those covered by the clawback rules. Inclusion of Section 16 officers should be driven by company strategy and corporate governance, not by clawback exposure. Again, we believe if clawback rules are adopted using a principles-based approach, Boards and Committees could assess which officers are actually exposed to accounting or finance matters related to the restatement.

State Wage Laws

We understand that the Act does not preempt state contract law. The Proposal fails to address issues associated with state creditor and wage protection issues, which would prevent enforcement of the clawback in certain jurisdictions. In addition, creditor/bankruptcy laws may protect the assets of the executive if the executive is or becomes insolvent. While the Proposal contains a carve-out for impracticality created by violations of home country laws for non-US entities, it completely ignores the state law problem. We believe clear guidance is needed as to how companies should structure their clawbacks in light of state laws, with exceptions being made similar to those provided to Foreign Private Issuers (FPIs).

Data Tagging Will Not Provide Shareholders with Valuable Information

Data tagging in XBRL format will cause yet additional work and cost for our clients even after adopting and disclosing new clawback policies. We are opposed to this requirement not only due to increased cost, but also because we do not think the data that will be pulled contains any useful information to be used on a comparative basis. If the Proposal is adopted as is, we anticipate that most clawback policies will become boilerplate in nature, and we fail to understand how comparison of one clawback policy to another will provide shareholders with anything useful or even interesting.

Unintended Consequences

As noted throughout, the rigid approach in the Proposal may have serious unintended consequences. To recap, the Proposal will cause:

- Inappropriate change in program design;
- Flow of talent out of public sector and difficulties recruiting executive talent;
- Lawsuits; and
- Additional administrative burdens and costs that will not be counterbalanced against any helpful information for shareholders.

Many of these challenges could be reduced if Committees and Boards were able to exercise discretion in enforcement to cases where it is in the best interest of shareholders to do so.