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September 9, 2009

Ms. Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Release No. 33-9052, File Number S7-13-09

Compensation Discussion and Analysis Disclosure

SEC Proposal: Add discussion on how a company's compensation program may create risks

Dear Secretary Murphy:

Below are our comments on a proposed change and answers to some of the questions the SEC presented about it. These comments are separate from our comments dated August 21, 2009, on proposed changes to the summary compensation table.

Having companies analyze their compensation policies from a risk perspective could improve the approach companies now take. While this introspective review by a company could be beneficial, turning this process into required securities disclosures and useful information for investors creates challenges. This is compounded by the materiality standard the SEC uses in its proposal.

Materiality Language In Release And Proposed Rule

In footnote 30 in the release the SEC explains that "If a company had a policy against providing compensation that encouraged imprudent risk-taking, but actually provided compensation that encouraged such behavior and the effect *may be material* [my emphasis] on the company, disclosure under the new provision would be required."

The language in Proposed Item 402(b)(2) of Regulation S-K (pages 112-114) begins by stating "To the extent that risks arising from the registrant's compensation policies and overall actual compensation practices for employees generally *may have a material effect* [my emphasis] on the registrant, discuss the registrant's policies or practices of compensating its employees, including non-executive officers, as they relate to risk management practices and/or risk-taking incentives." It then goes into details on the specific situations and issues that could be discussed.

Under the classic definition of materiality from the Supreme Court case of *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438 (1976), "a fact is defined as material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote."

The SEC in the final release should more directly explain whether this is the material standard it wants companies to use in determining whether to make these disclosures and why the currently detailed disclosures that companies now provide on the specifics of their incentive compensation do not provide enough information for investors to consider the risks they create.

Below is a series of questions that the SEC should also consider addressing in its release with the final rule, along with responses to some of the items on which the SEC requests comment:

1. Does this new disclosure concern materiality as it relates only to the risk (1) that employees or executives may make excessively risky decisions for the sole purpose of increasing their compensation, or also to the risk (2) that they may make false or misleading statements and disclosures or manipulate financials to increase the value of their compensation (e.g., before an upcoming stock grant vesting or the end date of a cash bonus period)?

2. The belief that a particular type of compensation (e.g., stock options, restricted stock, or cash bonus) encourages excessively risky decisions without regard to the long-term consequences requires that companies agree with two assumptions:

    a. The executives or employees making the decisions are motivated only by their own short-term financial self-interest. They therefore do not consider what is best for their reputation, the company, their fellow executives and employees, and their community.

    b. The executive would have made a different decision in the absence of that form of compensation.

    Can a company say that their incentives do not lead to "excessive or inappropriate risk-taking by employees" merely because they disagree that there is any causal link (rather than just a correlation) between compensation incentives and risk-taking? Or must every company go through an internal review before it reaches this conclusion about its compensation program?

3. What happens if a company determines in good faith that its compensation does not encourage excessive risk-taking and thus analyzes this risk as immaterial, but the decisions that executives make later prove disastrous for the company? Is there now a securities disclosure risk in the company's earlier, unintentionally inaccurate or omitted disclosure?

4. The SEC's proposed rule is concerned about compensation that accidentally encourages "imprudent risk-taking." How is a company to identify this type of risk prospectively, rather than retrospectively after a decision proved disastrously wrong? For example, what if the decision itself is not "risky," but implementation of it proves difficult, the assumptions for the decision prove in time to be flawed, or other companies in its industry made similar decisions? Is that still an "imprudent" risky decision?

5. For a decision to be labeled "risky," is there a materiality standard for how much damage a decision can cause if it not just fails but causes harm to the company and thus would be important for disclosure to investors?

6. The analysis of the impact different types of compensation have on decision-making has its roots in psychology, now known as behavioral economics and behavioral finance. A person's views on risks, losses, gains, and overall financial success or failure as relate to decision-making are personal and specific to each individual. For example, some executives would be most concerned about decisions that could cause an X% drop in their net worth, while others would be more upset about not making a decision that could result in an X% increase in it. Will companies now be required to have their key decision-makers undergo psychological testing? Will they have to reveal any similar type of testing that their executives have taken on their personalities and decision-making styles?

   See an article in *The New Yorker* dated July 27, 2009, "Cocksure: Banks, battles, and the psychology of overconfidence" by Malcolm Gladwell (best-selling author of the books *Tipping Point*, *Blink*, and *Outliers*). He believes that bankers/Wall Street executives and traders have personality types that get them into trouble because of their overconfidence.

7. For companies using certain types of stock grants (e.g., options, restricted stock, performance shares), an individual's decision-making can vary depending on how the company stock is performing at the time of the decision. This is also true for any payout (e.g., cash bonus) based on internal financial goals when the individual is aware of the likelihood of reaching the target before making the decision. See an article on myStockOptions.com by Professor Steven Huddart of Penn State University: "Psychological Factors Affect Your Stock Option Exercise Decisions." He writes: "[P]eople tend to avoid risks when their current situation is above their reference point (i.e., your company's current stock price is higher than the reference point) and tend to take risks when the stock is below their reference point (i.e., your company's current stock price is below the reference point)." Therefore, would a company's disclosure need to change according to its stock price (e.g., it suddenly shot up or dropped substantially)?

SEC Request For Comment

Some of the questions the SEC requests comments on are addressed in the above items, which we suggest the SEC should discuss in its final release on the rule. The SEC asks for comment on whether this new requirement should apply to all companies or just specific types or industries. Given that this risk-based analysis will be new for most companies, and given the amount of disclosure on it that the SEC is suggesting, the SEC should initially either (1) limit this requirement to large accelerated filers, (2) apply it to a smaller slice of issuers across industries, or (3) consider a new SEC disclosure filing specific to risk management.

In addition, consulting firms are developing various approaches companies could use for this type of analysis (the SEC may want to review memos that compensation consulting firms have prepared on recommended analyses). These approaches by compensation and risk management professionals are still in development, and as yet are based more on theory than actual experiences and quantitative data. Before requiring this type of

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analysis and potentially voluminous disclosure by all companies, the SEC can review these initial disclosures, the actual cost and benefit for companies, and their usefulness for investors, and then reassess the need for modifications to its rule before requiring it from all public companies.

The SEC also asks for comment on its list of specific situations and issues that could "trigger discussion and analysis" of a company's compensation policies and practices. Companies should explain those specific features of its short-term cash bonus, long-term cash incentives, and stock/option awards appearing in the Summary Compensation Table which it believes *discourage* overly risky decisions (and misleading public announcements) that could endanger the company's long-term viability and that *encourage* longer-term decision-making. These types of provisions include clawbacks for compensation wrongly earned, share retention requirements at exercise for stock options (at vesting for restricted stock and performance share awards), and long-term company stock ownership requirements (e.g., hold-until-retirement or hold-through-retirement programs) for senior executives and other key decision-makers. A similar recommendation is made by Jesse M. Brill (Chair, National Association of Stock Plan Professionals; Chair, CompensationStandards.com) in his letter dated August 18, 2009.

Alternatively, instead of the materiality standard the SEC uses for the rule and all the specific situations and issues the SEC suggests it wants discussed, the SEC should take a more principles-based approach at first. Companies should affirmatively state their position on how they view the relationship between compensation incentives and risk that can endanger the company, then explain the risks they perceive (if any) and the compensation practices and procedures they have in place to mitigate them. The materiality analysis overly complicates the core issue of whether and how a company views the link between its compensation philosophy, its practices, and risk management.

Please call or email me if you have any questions about the items above or need clarification. Thank you.

Sincerely,

Bruce Brumberg, Esq.
Editor-in-Chief, myStockOptions.com