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April 29, 2011

Via E-Mail
Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: *Listing Standards for Compensation Committees*, File No. S7-13-11

Dear Ms. Murphy:

AFSCME is pleased to comment on the Securities and Exchange Commission's proposed rule, "Listing Standards for Compensation Committees" (the "Proposed Rule"), which directs the national securities exchanges to prohibit the listing of any equity security of an issuer that does not comply with listing standards regarding compensation committee independence and compensation advisers. The Proposed Rule would also require additional proxy statement disclosure regarding compensation consultants. While AFSCME applauds the Commission's efforts to improve independence standards of board members who determine executive compensation, and their advisers, the Proposed Rule does not fulfill the objective of protecting shareholders from conflicts of interest which may result in excessive executive compensation.

The American Federation of State, County and Municipal Employees ("AFSCME"), is the largest union in the AFL-CIO representing 1.6 million state and local government, health care and child care workers. AFSCME members participate in over 150 public pension systems whose assets total over $1 trillion. In addition, the AFSCME Employees Pension Plan (the "Plan") is a long-term shareholder that manages $850 million in assets for its participants, who are staff members of AFSCME and its affiliates.

The Plan was the first investor to use the shareholder proposal process to push for a management-proposed shareholder advisory vote on senior executive compensation, or "say on pay," at U.S. companies. AFSCME strongly supported the inclusion of provisions improving executive compensation practices in the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"). Accordingly, we have a keen interest in how these provisions are implemented.

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We urge the Commission to use its influence to communicate to the exchanges listing standards that will best serve investors. Specifically, we believe the stock exchanges should consider defining independence to:

- Include directors whose only tie to the issuer (other than his or her directorships) is stock ownership; and
- Exclude directors who have financial, familial and employment relationships with members of the issuer's senior management.

We also encourage the Commission to fill gaps in its compensation consultant disclosure standards so that investors have full information about conflicts of interest. The Commission's rules should define a conflict of interest involving a compensation consultant to include consideration of the ratio of fees received by the consultant or her firm for executive compensation consulting to fees received for other kinds of consulting services. Issuers should also be required to consider equity ownership and other incentive pay arrangements within a consulting firm that could provide incentives for cross-selling of non-executive compensation consulting services. The Commission should require that consideration of both of those factors be disclosed in the proxy statement.

<u>Compensation Committee Independence</u>

Strong independent board oversight of executive compensation is vital to help ensure that compensation decisions are in the best long-term interest of companies and their shareholders. The Proposed Rule would direct the national stock exchanges to develop a definition of independence applicable to compensation committee members after considering "relevant" factors.

The Proposed Rule specifies two factors for the exchanges to consider in formulating their listing standards: (i) the source of compensation of a director, including any consulting, advisory or other compensatory fee paid by the issuer to such director; and (ii) whether the director is affiliated with the issuer, a subsidiary of the issuer, or an affiliate of a subsidiary of the issuer. While these factors are not unimportant—indeed, they are already reflected in the NYSE and Nasdaq listing standards on director independence--we believe that they are incomplete.

In the release proposing the Proposed Rule (the "Proposing Release"), the Commission relates concerns raised by some commenters that the independence definition to be adopted by the exchanges not preclude directors affiliated with significant investors from serving on the compensation committee, on the ground that such directors' interests are well-aligned with those of other shareholders. We agree that directors whose primary identification is with shareholders are good choices for the compensation committee. We would be disappointed if directors elected after being nominated by shareholders using the Commission's proxy access procedure (now on hold pending resolution of a legal challenge), for which AFSCME was a leading advocate, were prevented from serving on compensation committees by virtue of a deemed affiliation with ownership.

However, the presence of other ties, in addition to shareholdings, should not be ignored in determining the independence of directors who own or are affiliated with owners of significant stakes. Private equity and venture capital firms may engage in significant transactions with an issuer, which could reduce alignment with other shareholders. The Commission should convey to the exchanges the need to consider all such ties.

We concur with the suggestion in the Proposing Release that the exchanges might conclude that factors "linked more closely to executive compensation matters, such as relationships between the members of the compensation committee and the listed issuer's executive management, should be addressed in the definition of independence." In our view, relationships between directors and members of senior management or their families are at least as likely to impair objectivity on executive compensation as relationships between directors and the company.

Thus, financial relationships between the CEO and the director, such as the director's receipt of compensation for providing services to the CEO or the director and CEO co-owning property, should thus be considered "relevant" factors when it comes to compensation committee membership. Compensation committee interlocks, in which the CEO of Company A sits on the compensation committee of Company B's board and the CEO of Company B sits on the compensation committee of Company A's board, can interfere with directors' ability to represent shareholder interests in setting pay and should also be classified as relevant factors.

Compensation Advisers

The Proposed Rule would make two kinds of changes related to compensation advisers. First, it would direct the national stock exchanges to prohibit the listing of an equity security of an issuer that does not comply with a new listing standard, to be formulated by the exchanges, on the retention of compensation advisers. Second, it would propose new Commission disclosure requirements relating to compensation consultants.

The Proposed Rule specifies that listed issuers' compensation committees must be required by listing standard to consider certain independence-related factors (the "Factors") prior to selecting compensation advisers, though the exchanges are free to specify additional factors. A compensation committee need not choose a consultant that is independent under the Factors.

Several of the Factors are well-supported by research and experience on compensation consultant conflicts of interest. The ownership of the issuer's stock by the compensation consultant or her firm is somewhat problematic, though. This Factor seems more suited to a determination of auditor independence than compensation consultant independence. Ownership of company stock might be expected to create greater alignment between a consultant and the company's shareholders and potentially reduce incentives to make recommendations that benefit management at shareholders' expense. (With auditors, whose decisions could reduce a company's reported revenues or earnings, this alignment is potentially more problematic.)

The Factors included in the Proposed Rule fail to include the ratio between the fees received by a firm for executive compensation consulting, on the one hand, and non-executive compensation consulting, on the other. In our view, this ratio—which shows the incentives facing a consulting firm—is the most important indicator of compensation consultant independence for investors. The 2007 Oversight Committee study found that fee ratios skewed toward other kinds of consulting were associated with higher levels of pay. If executive compensation consulting is a loss leader designed to allow cross-selling of other services, executive compensation consultants will feel significant pressure not to alienate a company's management. (A similar phenomenon was described in the post-Enron discussions regarding auditors' provision of non-audit services to companies where the audit was a loss-leading foothold for cross-selling.) Because smaller engagements may be viewed as a way to obtain larger ones, we do not believe that any numerical threshold or *de minimus* exclusion should apply here.

If a compensation committee retains a full-service firm, issuers should be required to consider whether the employees providing executive compensation consulting own stock or hold options (or similar equity-based instruments) in the firm, or have other incentive compensation arrangements in which they benefit from the sale of non-executive compensation consulting services. Either would be expected to shape the consultants' incentives in the direction of greater management-friendliness.

The Commission has proposed to broaden the disclosures required by Item 407(e)(3) of Regulation S-K, which currently requires certain disclosures regarding the use of compensation consultants. We support these proposed changes, which require disclosure about compensation consultants even if their (or their firms') only non-executive-compensation engagement involves consulting on broad-based plans or providing non-customized data. We urge the Commission to extend fee disclosure to those situations as well because not doing so gives shareholders an incomplete picture of the incentives of consultants and their firms. As well, we believe that the Commission should eliminate the $120,000 *de minimus* threshold for non-executive compensation consulting currently embedded in the fee disclosure requirement.

The Proposed Rule would require issuers to disclose the nature of any conflict of interest involving a compensation consultant whose advice the compensation committee obtained and how that conflict is being addressed. To provide guidance regarding the definition of "conflict of interest," the Proposed Rule incorporates the Factors into Item 407(e)(3). For the reasons set forth above, we urge the Commission to add the ratio between fees paid for executive compensation and non-executive compensation consulting work, as well as equity ownership and incentive compensation arrangements of executive compensation consultants, to the Factors.

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We are pleased to have this opportunity to make AFSCME's views known to the Commission. If you have any questions, please do not hesitate to contact Lisa Lindsley at (202) 429-1275.

Sincerely,

GERALD W. McENTEE
International President