



April 29, 2011

Ms. 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:

Better Markets, Inc.¹ appreciates the opportunity to comment on the above-captioned proposed rules (“Proposed Rules”) of the Securities and Exchange Commission (“Commission”). The Proposed Rules would direct the national securities exchanges to establish listing standards requiring all members of an issuer’s compensation committee to be independent board members. The Proposed Rules would also establish new standards of independence for consultants, legal counsel, and other advisers to an issuer’s compensation committee. The Commission has issued these Proposed Rules in accordance with Section 952 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act” or “Act”).

INTRODUCTION

Executive compensation policies that encouraged short-sighted and high-risk corporate behavior were undoubtedly major contributors to the financial crisis. As a recent report concluded:

Compensation systems—designed in an environment of cheap money, intense competition, and light regulation—too often rewarded the quick deal, the short-term gain—without proper consideration of long-term consequences. Often, those systems encouraged the big bet—where the payoff on the upside could be huge and the downside limited. This was the case up and down the line—from the corporate boardroom to the mortgage broker on the street.²

¹ Better Markets, Inc. is a nonprofit organization that promotes the public interest in the capital and commodity markets, including in particular the rulemaking process associated with the Dodd-Frank Act.

² *The Financial Crisis Inquiry Report*, Financial Crisis Inquiry Commission, at xix (Jan. 2011).

Even before the crisis, the Commission had begun to promulgate rules substantially improving the disclosure regime for executive compensation.³ After the crisis, calls for more fundamental reform in the area of executive compensation were widespread, and they culminated in Title IX, Subtitle E of the Dodd-Frank Act.

In the Act, Congress passed a broad series of measures aimed at correcting the structural flaws in our traditional approach to executive compensation. Those measures include shareholder votes on executive compensation, mandatory disclosure of executive compensation in relation to corporate performance, recovery of erroneously awarded compensation, and even prohibitions on certain compensation arrangements offered by financial institutions with assets over \$1 billion.⁴ In addition, Section 952 of the Dodd-Frank Act established listing standards to ensure that compensation committees and their consultants at public companies are independent from management. Those provisions are the subject of the Proposed Rules.

THE DODD-FRANK ACT

Section 952 of the Dodd-Frank Act—

- Requires each member of an issuer's compensation committee to be an independent member of the issuer's board of directors. Independence is to be defined by the exchanges after they consider certain factors, including a board member's sources of compensation and affiliations;
- Requires that compensation committees select their consultants only after considering a variety of factors that measure the independence of the consultant;
- Gives compensation committees the sole discretion to appoint, oversee, and set compensation for its consultants, and requires issuers to provide appropriate funding for payment of those consultants;
- Requires issuers to make certain disclosures in proxy statements regarding the retention of compensation consultants and any conflicts of interest raised by the work of the consultant; and
- Imposes all of these obligations by requiring exchanges to delist any issuer that fails to comply.

³ Executive Compensation and Related Person Disclosure, SEC Release No. 33-8732A (Aug. 29, 2006) (Final Rule).

⁴ Dodd-Frank Act §§ 951-957.

SUMMARY OF COMMENTS

The Proposed Rules represent a straightforward and largely reasonable implementation of the requirements set forth in Section 952 of the Dodd-Frank Act. In seven areas, however, they should be strengthened to ensure that compensation committees and their consultants are truly independent:

- The proposed rules should apply to any board members who are responsible for compensation decisions, whether or not they comprise a formal “compensation committee.”
- The proposed rules should be more specific regarding the factors that exchanges must consider when defining independence.
- The proposed rules should prohibit compensation committees from retaining non-independent legal counsel.
- The proposed rules should enumerate additional factors bearing on the independence of consultants that compensation committees must consider.
- The opportunity to cure a breach of the independence standards should be more limited.
- The proposed rules should impose additional disclosure requirements to mitigate the potential impact of the exemptions.
- The proposed rules should also broaden the disclosure requirements with respect to any conflicts arising from work performed by consultants.

COMMENTS ON PROPOSED RULES

The Proposed Rules Should Apply to Any Board Members Who Are Responsible for Compensation Decisions, Whether or Not They Comprise a Formal “Compensation Committee.”

The Dodd-Frank Act uses the phrase “compensation committee” to identify the entities that are subject to the new independence standards. Relying on this terminology, the Commission has drafted the Proposed Rules to apply only to compensation committees, not to less formal groups of board members who have been tasked with making compensation decisions. The Release explains that the rules will not apply to independent directors who oversee compensation matters in lieu of a formal board committee, because the text of the Dodd-Frank act “refers only to compensation committees.”⁵

⁵ Release at 18968.

This is an overly literal interpretation of the Dodd-Frank Act that will unnecessarily limit the scope of Congress's intended reforms. One goal of Section 952 of the Act is to promote more responsible executive compensation policies by ensuring that those who establish those policies are independent from the issuer and its officers. The application of these reforms must not hinge on technicalities surrounding the precise mechanism that a company has established for overseeing compensation matters. The need for reform is equally great whether or not an issuer has chosen to create a formal compensation committee or to allocate the same function to an assortment of directors.

This technical reading of the law will enable issuers to evade the new requirements simply by abolishing their compensation committees and delegating the same function to a group of individual directors. As noted in the Release, neither Section 952 of the Dodd-Frank Act nor the Commission's existing rules actually require public companies to establish compensation committees.⁶ Moreover, some exchange listing standards expressly give issuers the option of placing executive compensation decisions in the hands of **either** a compensation committee or a less formally organized group of board members.⁷ Limiting the scope of the Proposed Rules to compensation committees per se may therefore allow some issuers to evade the new requirements by avoiding the compensation committee structure altogether.

The Commission's narrow interpretation is surprising, since the Commission has already extended the concept of the compensation committee beyond its literal boundaries. The Release and the Proposed Rules make clear that the Proposed Rules **will apply** to "any committee of the board that oversees executive compensation, **whether or not the committee performs multiple functions and/or is formally designated as a 'compensation committee.'**"⁸ As explained in the Release, the Commission's rationale is to prevent issuers from avoiding the new compensation committee requirements by "assigning a different name to a committee that is functionally equivalent to a compensation committee."⁹ The Commission should apply the same justification to extend the definition of "compensation committee" to include a group of directors who act as a compensation committee without being formally constituted as such.

The Proposed Rules Should Elaborate on the Factors that Exchanges Must Consider When Defining Independence.

Although the Dodd-Frank Act requires compensation committee members to be independent, the statute allows the exchanges to determine the meaning of "independent."¹⁰ When defining the term, the exchanges must consider relevant factors, including (1) the board member's sources of compensation, and (2) whether the board

⁶ Release at 18968.

⁷ *Id.*

⁸ *Id.*

⁹ *Id.*

¹⁰ Dodd-Frank Act § 952(a).

member is affiliated with the issuer or its related entities.¹¹ However, unlike the analogous requirements for audit committees, the exchanges are not bound by these considerations and need only “consider” them as they define independence for purposes of membership on the compensation committee.

In the Proposed Rules, the Commission has appropriately attempted to limit the impact of an exchange’s discretion by providing that its determination of “independence” must be submitted to and reviewed by the Commission in the form of an exchange rule proposal.¹² However, the Proposed Rules would not specify any additional factors that exchanges must consider when defining the concept of independence.

To further mitigate the impact of the discretion that exchanges will exercise in determining which board members are “independent” for purposes of serving on compensation committees, the Proposed Rules should require the exchanges to evaluate **all** factors that are relevant to the issue. The independence of compensation committee members lies at the heart of the Dodd-Frank reforms on executive compensation. The Proposed Rules on this issue should therefore be strengthened to the maximum extent possible within the parameters of the statute.

The Dodd-Frank Act clearly envisions that additional factors will be incorporated into the Proposed Rules. The statute’s formulation is very broad. It states that the Commission’s rules must require exchanges to consider “relevant factors” in relation to independence.¹³ It goes on to provide that those factors must include a board member’s compensation and affiliations, but nowhere does the statute state or imply that these are exclusive considerations.

The Proposed Rules should require the exchanges to consider **all** factors that are relevant to assessing the independence of a board member. Those factors should include, in addition to sources of compensation and affiliations, personal, family, and business relationships, and all other factors that might compromise a board member’s judgment in any way on matters relating to executive compensation. In addition, as suggested in the Release, the required factors should incorporate “look back” periods of three to five years, depending on the nature of the relationships at issue.¹⁴ These provisions will help ensure that exchanges establish appropriate standards of independence that issuers must meet for their compensation committees.

The Proposed Rules Should Prohibit Compensation Committees From Retaining Non-Independent Legal Counsel.

Under the Dodd-Frank Act, a compensation committee may select a consultant, legal counsel, or other adviser only after considering a variety of factors that affect the

¹¹ *Id.*

¹² Release at 18970.

¹³ Dodd-Frank Act § 952(a).

¹⁴ Release at 18971.

independence of such advisers. The Act also gives the compensation committee exclusive authority to appoint, oversee, and determine the compensation for consultants, “independent counsel,” and other advisers.¹⁵

In the Release, the Commission expresses its view that these statutory provisions—and, in particular, the use of the word “independent” before “counsel”—would **not** preclude a compensation committee from retaining non-independent legal counsel or even obtaining advice from in-house counsel or outside counsel hired by management.¹⁶ This interpretation of the statute is inconsistent with Congress’s desire to promote the independence of compensation consultants, as well as compensation committees.

Section 952 clearly provides that compensation committees “may only select” a consultant, counsel, or other adviser “after taking into consideration” factors affecting the independence of those consultants and advisers. Thus, all consultants and advisers, including legal counsel, must be evaluated in terms of their independence before a compensation committee may select them. Although the factors are not binding on the compensation committee, this mandatory process reflects a strong Congressional policy favoring the use of independent legal counsel and other advisers by compensation committees.

To help achieve this goal, Congress also gave compensation committees the exclusive authority to appoint, oversee, and pay their consultants, without interference from the corporation.¹⁷ Contrary to suggestions in the Release, this safeguard was not intended to give compensation committees the discretion to hire **non**-independent legal counsel or other advisers. Rather, it was written to protect the ability of compensation committees to **steer clear** of non-independent advisers. The repeated references to “independent legal counsel” in this section confirm the point.

Allowing compensation committees to hire and obtain advice from non-independent counsel will negate the benefits of establishing independent committees. All consultants, including legal counsel, can have a profound impact on the policies that emerge from a compensation committee. If the Proposed Rules allow the committees to be advised by in-house counsel or counsel retained by management, then management’s point of view will infuse the work of the committee. The members of the compensation committee will, in effect, cease to be independent. This is precisely what the Dodd-Frank Act sought to eliminate.

¹⁵ Dodd-Frank Act § 952(a).

¹⁶ Release at 18972.

¹⁷ Dodd-Frank Act § 952(a).

Two scenarios illustrate the point: A compensation committee—

- (1) uses in-house counsel and asks “do you think this is the right salary for your boss who, by the way, decides your pay?” or
- (2) uses counsel retained by management and asks “do you think this is the right salary for the person who hired you and who may or may not hire you in the future?”

Accordingly, the Proposed Rules should expressly prohibit the use of non-independent legal counsel and other advisers by compensation committees.

The Proposed Rules Should Enumerate Additional Factors Bearing on the Independence of Consultants that Compensation Committees Must Consider.

The Dodd-Frank Act lists five factors relating to independence that compensation committees will have to consider when selecting consultants.¹⁸ The Proposed Rules will simply incorporate those five factors, but the list should be expanded. As in the case of the factors that exchanges must consider when defining independence, the Proposed Rules should require that compensation committees consider **all** factors that are relevant to the independence of their consultants. The Proposed Rules should also list the specific, additional factors that are suggested in the Release. They include, for example, any business or personal relationship between a compensation adviser and an executive officer of the issuer.¹⁹

Finally, as an added measure of protection against compromised independence, the Proposed Rules should include amendments to Regulation S-K that will require issuers to describe the process that the compensation committee follows when selecting its advisers under the new standards. This will provide transparency, which in turn will serve as a natural check on deviations from standards of independence.

The Opportunity to Cure a Breach of the Independence Standards Should Be More Limited.

The Dodd-Frank Act requires the Commission’s rules to give issuers an opportunity to cure any violation of the independence standards before their securities are delisted by an exchange.²⁰ To implement this requirement, the Proposed Rules would require the exchanges to establish procedures for cure before they impose a delisting sanction. The Proposed Rules would further provide that if a member of the compensation committee ceases to be independent for reasons outside the member’s reasonable control, the exchange rules may allow that person to remain on the

¹⁸ Dodd-Frank Act § 952(a).

¹⁹ Release at 18973.

²⁰ Dodd-Frank Act § 952(a).

compensation committee until the next annual meeting of the issuer or for up to one year from the event causing the disqualification.²¹

It is certainly reasonable to afford an issuer a reasonable opportunity to cure a breach of the independence standards before imposing a delisting sanction against the issuer. However, the Proposed Rules allow the offending member to remain on the committee for too long. If a member of the committee ceases to be independent, their involvement with the committee should likewise cease, so that the committee's deliberations and decisions are not compromised in fact or in appearance. At a minimum, the standard in the Proposed Rules should be strengthened to require the issuer to replace the member in question as soon as practicable.

The Proposed Rules Should Impose Additional Disclosure Requirements to Mitigate the Potential Impact of the Exemptions.

The Dodd-Frank Act exempts certain types of issuers from the compensation committee independence standards.²² In addition, the Act requires the Commission to grant the exchanges a general exemptive authority with respect to categories of issuers or particular relationships that would normally disqualify a member of the board from serving on the compensation committee.²³ When exchanges exercise their exemptive authority, they must take into account the size of the issuer, among other factors.

To limit the potentially negative impact of these exemptions, the Proposed Rules should impose additional disclosure requirements similar to the ones currently applicable to audit committees. Specifically, the rules should require any issuer relying upon any exemption to disclose such reliance in the issuer's proxy statement and in its periodic filings with the commission. Furthermore, if an issuer actually appoints a non-independent director to the compensation committee, the issuer should be required to disclose the nature of the relationship that impairs the committee member's independence, as well as the issuer's reasons for making the appointment, notwithstanding the lack of independence.

The Proposed Rules Should Also Broaden the Disclosure Requirements With Respect to Any Conflicts Arising From Work Performed by Consultants.

Section 952 of the Dodd-Frank Act requires an issuer to disclose in its proxy statements whether the compensation committee retained or obtained the advice of a compensation consultant; whether the work of the consultant raised any conflicts of interest; and if so, the nature of the conflict and how the conflict is being addressed.

²¹ Release at 18973-74.

²² Dodd-Rank Act § 952(a).

²³ *Id.*

The Proposed Rules should expand upon these disclosure requirements in two respects. First, they should include disclosure not just of conflicts of interest, but potential conflicts of interest as well. This broader scope is necessary because conflicts of interest can be amorphous and difficult to identify with precision, but nevertheless powerful in their influence. To address this problem, the disclosure obligation should extend to potential conflicts of interest, as well as more clear-cut instances of conflict.

In addition, the disclosure obligation should extend not only to compensation consultants, but also to other advisers, including legal counsel. Although the disclosure provision refers only to consultants, there is no reason to believe that Congress actually intended to omit legal counsel and other advisers from its scope. All of the other measures in Section 952 that apply to consultants apply with equal force to legal counsel and other advisers. Furthermore, there is no rationale for requiring disclosure of conflicts of interest among consultants but not among other types of advisers upon which the compensation committee relies. The Proposed Rules should address this omission by expressly including legal counsel and other advisers, along with consultants, in the shareholder disclosure provisions.

CONCLUSION

We hope these comments are helpful in your consideration of the Proposed Rules.

Sincerely,



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