Memorandum

To: Public Comment Files on Dodd-Frank Implementation

Title IX -- Executive Compensation

From: Kayla J. Gillan, Deputy Chief of Staff

Office of the Chairman

Re: Meeting with Representatives from the Center on Executive Compensation

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On October 8, 2010, I met with Tim Bartl (Sr. Vice President and General Counsel) and Charles Tharp (Executive Vice President for Policy), from the Center on Executive Compensation, to discuss the provisions of the Dodd-Frank Act that involve executive compensation disclosure.

Messrs. Bartl and Tharp provided me with copies of several documents, all of which are attached. The discussion focused on the issues and positions identified in the Center's September 1, 2010 letter to the public comment file on this same subject (included in attachments).

Center On Executive Compensation

September 1, 2010

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

RE: Comments on Executive Compensation and Governance Provisions in Title IX, Subtitle E of the Dodd-Frank Wall Street Reform and Consumer Protection Act

Dear Ms. Murphy:

The Center On Executive Compensation is pleased to submit comments to the Securities and Exchange Commission ("Commission") providing its perspective on how the Commission should interpret the executive compensation and corporate governance provisions in Title IX, Subtitle E of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"). For the most part, these provisions of the Dodd-Frank Act are unprecedented in their vagueness and breadth, and we urge the Commission to take a practical and Board-centric approach to implementation.

The Center On Executive Compensation is a research and advocacy organization that seeks to provide a principles-based approach to executive compensation policy from the perspective of the senior human resource officers of leading companies. The Center is a division of HR Policy Association, which represents the chief human resource officers of over 300 large companies, and the Center's more than 70 Subscribing Companies are HR Policy members that represent a broad cross-section of industries. Because senior human resource officers play a unique role in supporting the compensation committee chair, we believe our views can be particularly helpful in understanding the important role that carefully constructed executive compensation packages play in ensuring a strong link between pay and performance. Our comments are focused on a practical approach to ensuring that the Commission's implementation of Dodd-Frank Act does not impose significant unintended consequences.

I. Executive Summary

The executive compensation and corporate governance provisions of the Dodd-Frank Act are unprecedented in their breadth and vagueness. The Center believes that in its proposed release or releases implementing these sections, that the Commission should seek practical and workable approaches that reinforce a board-centric view of corporate governance and a company-specific approach to performance-based compensation. The following summarizes the Center's most important views on the issues under consideration in Dodd-Frank.

Say on Pay. The Center urges the Commission to develop guidance quickly so that issuers, particularly those with annual meetings in January and February can understand their obligations

under the law. We suggest that the Commission give companies flexibility in structuring the resolutions implementing the periodic nonbinding vote on pay, as it did for TARP companies. More importantly, with respect to the advisory vote on whether say on pay votes should happen annually, biennially or triennially, boards should have the flexibility in whether to offer a vote on all three frequencies or an up-or-down vote on the alternative (e.g., one year) selected by management.

Disclosure and Vote on Change-in-Control Arrangements. The Center recommends that the Commission implement the disclosure requirements applicable to change-in-control arrangements by including in the proxy statement related to the merger, etc., the relevant information from the post-termination disclosures already required under section 402(j) of Regulation S-K in annual proxy statements. In addition, the Center believes the SEC should clarify that a separate shareholder vote is necessary only if the structure of the change-in-control arrangements have changed since the last periodic say on pay vote.

No-Fault Clawback Policy. The Center believes that clawback policies are an important corollary to pay for performance and to risk mitigation. We also believe that to be effective, the clawback policy articulated in Section 954 of the Dodd-Frank Act requires careful consideration of how incentive compensation arrangements are structured so that the proposed release reflects those practicalities. Specifically:

- The Center believes that the clawback policy articulated in the statute applies only to incentive compensation based on financial information required to be reported under the securities laws." Based on this definition, the Center urges the Commission to exclude time-vested stock options and restricted stock from this definition.
- The Center also recommends that the Commission explicitly recognize the role of Board discretion in executing clawbacks of incentive compensation covered by the mandate, especially: where discretion was used in making the award; where the cost of recoupment exceeds the amount to be clawed back; and in determining how to recoup the excess compensation over what would have been received.

Our comments include several examples of common incentive arrangements and address implementation issues, such as the need for the new standards to apply prospectively with sufficient transition.

Disclosure of Pay Versus Performance. The Center believes the Commission should provide flexibility in defining compensation "actually paid," consistent with principles-based disclosure, rather than taking a uniform approach. Companies that grant long-term incentives based on the prior year's performance may view the total annual planned compensation value as compensation "actually paid." By contrast, companies that do not believe that the accounting estimates in the Summary Compensation Table reflect the pay for performance linkages underlying the Board's decisions may disclose how compensation realized in the reporting year links to long-term performance. We also believe that companies should compare compensation "actually realized" to financial performance as determined by the financial metrics used in their incentive plans, but that companies should be allowed to include this in an overall assessment of pay and performance if they choose to do so.

Pay Ratio Disclosure. The Center believes that the pay ratio requirement in section 953(b) of the Dodd-Frank Act makes accurate compliance extremely difficult, if not impossible for global employers because it requires them to individually calculate the pay for "all employees," however defined, using the SEC's requirements for the named executive officers. Within the framework of the statute, we urge the Commission to limit the calculation to full-time U.S. employees and to simplify the calculation to the greatest extent possible. Because of the difficulty of calculating the median under the Commission's executive rules, we urge the Commission to make the ratio a furnished, rather than filed disclosure.

The Center's detailed comments on these issues follow.

II. Shareholder Vote on Executive Compensation Disclosures

Section 951(a) of the Dodd-Frank Act mandates that corporate issuers hold nonbinding shareholder votes on executive compensation once every three years and requires a separate shareholder vote to determine the frequency of such "say on pay" votes. In sum, the Center believes the Commission should interpret this requirement as follows:

- The Commission should be mindful of the influence of proxy advisory firms over shareholder votes such as say on pay and should ensure that advisory firms employ sound methodologies that result in accurate and unconflicted recommendations to institutional investors.
- Issuers should have flexibility in structuring the text of the nonbinding say on pay resolution, so long as the statutory requirements are met.
- Companies should have the flexibility in structuring the shareholder vote on the frequency of say on pay resolutions, either as an up-or-down nonbinding vote on a frequency (one, two or three years) chosen by management or as a vote allowing shareholders to choose whether votes should be held every one, two or three years.
- The statute should be read to prohibit shareholder resolutions seeking a different frequency of say on pay votes. The statute already requires a periodic shareholder vote on the frequency (at least every six years), and the rule of construction in new section 14A(c)(4) should not be read as allowing such resolutions.
- Companies should not be required to file preliminary proxy statements in 2011 merely because they have a say on pay resolution on the ballot.

These issues are discussed in detail in the following paragraphs.

A. Mandatory Say on Pay and the Expanded Influence of Proxy Advisory Firms

As the Commission begins to consider its approach to implementing Section 951 of the Dodd-Frank Act, the Center urges the Commission to be mindful of the impact of proxy advisory firms on the executive compensation process, and the need for these firms to transmit accurate, unconflicted analysis to institutional investors. Many commentators have expressed concern that advisory firm methodologies may cause investors to favor "cookie cutter" pay packages at the

expense of company-specific performance-based compensation approaches.[1] Likewise, inaccurate analyses may impact investor proxy votes. For example, Center On Executive Compensation research among its subscribing companies suggests that as much as 10 percent of final reports from proxy advisory firms contain significant inaccuracies that were not corrected.

Because institutional investors can rely on the analysis of proxy advisory firms in making their voting determinations, the advisory firms wield considerable influence over their voting determinations. Although say on pay is an advisory vote, it will still have substantive implications because of the impact a substantial percentage of votes against a say on pay can have on compensation committees. For example:

- Academic research has shown that a negative recommendation on a management proposal can reduce the support of institutional investors by up to 20%;[2]
- Recent statistics from proxy solicitation firm Innisfree M&A found that clients of Institutional Shareholder Services, the largest proxy advisory firm, typically control 20-30% of outstanding shares of mid-cap or large-cap companies, and Glass-Lewis clients typically control 5 to 10%;[3] and,
- A 2010 survey of 251 companies by TowersWatson found that 59% of respondents believed that proxy advisors have significant influence over pay decision making processes at U.S. companies.[4]

If a proxy advisory firm recommendation is based on a flawed methodology or inaccurate information, executive compensation could be affected considerably at some companies. The purpose of a shareholder advisory vote should be to obtain the views of shareholders on executive compensation practices, not to further cement the influence of proxy advisory firms over executive compensation. We urge the Commission to take action, through its review of the proxy voting process, to more closely oversee and regulate the industry so that analyses are unbiased, reports are accurate, and votes are not improperly influenced.

B. Give Companies Flexibility in Structuring Say on Pay Resolutions

The Center believes that the Commission should provide companies with flexibility in how they structure the text of the nonbinding resolution on pay, so long as the statutory requirements are met. The statute requires the resolution be simply "to approve the compensation of executives" as disclosed in the Commission's executive compensation disclosure rules in Item 402 of Regulation S-K. The Center recommends that the SEC follow an approach similar to the one it adopted for companies subject to a say on pay vote under TARP, which allowed companies considerable flexibility to discuss why shareholders should approve the resolution.

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[1] *See, e.g.,* Jeffrey Gordon, "Say on Pay: Cautionary Notes on the UK Experience and the Case for Shareholder Opt-In," 46 Harvard J. on Leg., 323 (2009); Peter C. Clapman, "Next Steps? Be Careful What You Wish For," Directors and Boards, July 2008.

[2] *See, e.g.,* Jennifer E. Bethel and Stuart L. Gillan, "The Impact of the Institutional and Regulatory Environment on Shareholder Voting," Financial Management, Vol. 31, No. 4 (Winter 2002).

[3] Yin Wilczek, Bounty Program to Cramp Corporate Boards; ABA Speakers Discuss Governance Provisions, Daily Report for Executives (BNA), Aug. 10, 2010, at EE-4.

[4] Towers Watson Press Release, "Few U.S. Companies Well Prepared for Executive Say-on-Pay Legislation, Towers Watson Survey Finds," June 29, 2010.

C. The Frequency Vote Should Allow an Up or Down Vote, Not Merely A Multiple Choice Approach

New sections 14A(a)(2) and (3) require a separate management resolution allowing shareholders to vote to determine whether say on pay votes will be held every one, two or three years. The vote is to occur in the first year say on pay is applicable and at least every six years after that. The Center believes that Board flexibility in implementing the "frequency vote" is important to a board-centric approach to governance and is not inconsistent with the statute. We believe that the Commission should allow boards to decide whether there should be an up-or-down vote on a management recommended frequency (i.e., management could offer a resolution that recommends that the shareholder vote should occur every year, and shareholders would vote up or down on the resolution) or whether shareholders would be provided with a choice among having a say on pay vote every one, two or three years. For legal, practical and procedural reasons, we believe that allowing a choice is the preferable approach as opposed to mandating that shareholders be only allowed to choose among one, two or three years.

The Frequency Vote Is Nonbinding. One important reason the Commission should adopt flexibility on the frequency vote is that a plain reading of the statute indicates that the frequency vote is nonbinding, just as the actual say on pay vote is, and we recommend that the Commission confirm the plain language reading in its proposed rules. The rule of construction in new section 14A(c) states "The shareholder vote referred to in subsections (a) and (b) *shall not be binding* on the issuer or the board of directors of an issuer" and section 14A(c)(1) states that the vote "*may not be construed as overriding a decision by such issuer or Board of Directors.*" Because the frequency vote is advisory, management should be allowed to propose a selected frequency and have shareholders support, oppose or abstain from it, as well as provide for a choice among three alternatives.

The Center also believes that it is important that in its regulations implementing the mechanics of the say on pay and frequency votes, the Commission distinguish between the language of the statute in describing the votes and their actual impact. Section 14A(a)(1) states that the say on pay resolution is "to *approve* the compensation of executives," but read together with Section 14A(c),which states that the vote is nonbinding, it is clear that shareholders are not actually approving executive compensation but providing their general views on executive compensation. Similarly, with respect to the frequency vote, section 14A(a)(2) states that the proxy shall include a "separate resolution subject to shareholder vote to *determine*" whether say on pay votes will take place annually, biennially or triennially. Because the frequency vote is nonbinding, shareholders are not actually determining the frequency but providing their input on frequency, with a decision to be made by management, and this should be made clear in the implementing release.

A Management-Determined Resolution Is Consistent With Existing Commission Rules. The Commission's current rules provide that shareholders may not have a choice on a shareholder resolution other than to vote for, vote against, or abstain. The Center believes that new Section 14A(a)(2), should be read as being consistent with the rules and as giving management a choice between applying the existing rules, allowing companies to choose among one, two or three years or providing shareholders a choice from among the options. From a

practical perspective, allowing a "multiple choice" approach makes it possible, if not likely, that none of the three alternatives will win a majority of votes, leaving the direction to management uncertain. Even though it is possible shareholders will not support a management resolution seeking an up or down vote on frequency, a rejection would give management clear direction as to the will of the shareholders.

The Commission Should Ensure That the Proxy Voting Industry Can Handle a Three-Way Vote. In addition, the Commission should seek comment from the proxy distribution and tabulation firms in its proposed implementing release whether these firms will have their proxy cards and computer systems ready for the first shareholder meetings after say on pay takes effect on January 21, 2011.[5]

Management Should Be Allowed to Recommend a Vote Frequency. Regardless of how the say on pay resolution is framed, just as with any management resolution, management should be allowed to recommend the frequency of the say on pay vote it would prefer and provide its reasons for that choice. From a practical side, management is in the best position to recommend how frequently say on pay votes should occur based upon the nature of their business cycles, strategies and the related compensation program designs which reflect those considerations. For example, it may be that a company in an industry with long lead times may recommend a less frequent say on pay vote, but one with shorter cycles may propose a shorter frequency for the shareholder vote.

D. The Statute Should be Read to Prohibit Shareholder Resolutions Seeking Alternative Voting Frequencies

The Center believes that new section 14A should be read as preempting shareholder proposals seeking more or less frequent votes on say on pay than management has implemented. The statute has put in place a system for obtaining shareholder input on the frequency of the vote and specifies that shareholders be given the opportunity to vote on the frequency at least every six years. Thus, the Center believes that the combination of a mandated vote on pay and the mandate that shareholders be allowed to vote on the frequency of the vote fully occupies the space on this issue. Any subsequent shareholder resolutions in this area should be considered "substantially implemented" as a result of the statutory requirements.

Allowing for annual shareholder resolutions asking companies to change the frequency of the shareholder vote (either more or less frequently) is redundant and overly burdensome, given the cost of assessing the propriety of a resolution, engaging the proponent, fashioning a response and then publishing the resolution in the annual proxy. Moreover, because there is evidence that institutional investors disagree over the best frequency of a say on pay vote,[6] it is possible that in

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[5] An informal review of Center Subscribers showed that five out of 67 companies that are U.S. publicly traded companies have annual meetings scheduled between January 21, 2011 and March 15, 2011, or just over seven percent of total Subscribers. Extrapolating this figure to the roughly 1,600 corporations deemed large accelerated filers, there would be roughly 119 companies holding annual meetings during that period.

[6] *See, e.g., "Say on Pay" Rolls Forward, But Some Investors Wary*, Reuters, July 22, 2009, *last viewed at* http://www.reuters.com/article/idUSTRE56L52O20090722 (stating the United Brotherhood of Carpenters "has proposed holding say-on-pay votes every three years rather than annually, and only at the largest U.S. corporations. It says this would give investors more time to assess pay plans, which must be reviewed individually because

any given year, a company could receive two resolutions seeking alternative time frames (e.g., a company that has chosen to hold a say on pay vote every two years could receive resolutions seeking say on pay votes every year or every three years).

In addition, nothing in the statute prevents a company from proposing a resolution on the frequency of say on pay more often than every six years. If a company determines that there is a groundswell of support among shareholders for changing the frequency of the vote, it can choose to offer a resolution proposing a different frequency.

The Center believes that this interpretation is consistent with the rule of construction in section 14A(c)(4), which states that the shareholder vote "may not be construed to restrict or limit the ability of shareholders to make proposals for inclusion in proxy materials *related to executive compensation.*" The Center believes that shareholder proposals seeking a more or less frequent vote on executive compensation are not "related to executive compensation" as contemplated by the statute because they do not seek to address a specific aspect of compensation. Instead the resolution is related to the process of the Board, specifically, how frequently the company will hold a statutorily mandated vote.

In addition, the SEC has long allowed exclusion of shareholder proposals under Rule 14a-8 that would conflict with a management proposal. The staff's analysis recognizes that the Board would not know how to respond if, for example, conflicting proposals each receive a majority vote.[7] Allowing shareholder proposals in this case would appear to create the potential for such conflicts.

In sum, the Center believes that the Commission should exclude shareholder proposals seeking a different frequency of the say on pay vote than that implemented by the company. The statute provides a clearly established process requiring the company to reevaluate the views of shareholders on the frequency of the say on pay vote every six years. In addition, the Center believes that the exclusion of such votes is permissible under the section 951 rule of construction.

E. The Commission Should Not Require Companies to File Preliminary Proxy Statements

The SEC should not require companies to file a preliminary proxy statement in 2011, merely because they have a say on pay resolution on the proxy. This is consistent with the interpretation the SEC took for TARP companies, and it should apply equally in this case. Because the say on pay requirement will apply to nearly all publicly held companies in 2011, the preliminary proxy filing requirement would shorten the amount of time companies have to tailor their disclosures in advance of the first say on pay vote. Moreover, as a practical matter, it is difficult to imagine that the staff would have the time or resources to review more than a very small percentage of preliminary statements filed.

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policies on calculating an executive's salary, bonus, stock options, perks and retirement benefits vary widely."); AFSCME and Walden Asset Management Press Release, "More Than 50 Companies Voluntarily Adopt "Say on Pay" as Institutional Investors Continue to Press for an Advisory Vote," March 2, 2010, *last viewed at* http://www.afscme.org/press/27802.cfm. ("Investors pushing for annual advisory shareholder votes on executive compensation today announced that more than 50 companies have now voluntarily adopted giving their shareholders *an annual advisory vote* on executive compensation, colloquially known as "Say on Pay.") *emphasis added.*

[7] Rule 14a-8(i)(9).

III. Disclosure and Shareholder Vote on Certain Golden Parachute Payments

Section 951(b) of the Dodd-Frank Act requires public companies who enter into a merger, change-in-control, purchase, etc., to provide additional disclosure "in a clear and simple form" of any agreements or understandings the company has with the NEOs of either company (whether present, deferred or contingent). It also requires a separate nonbinding shareholder vote on the change-in-control arrangements where the arrangements have not been previously included as part of a say on pay vote.

A. Additional Disclosure Requirement Should Incorporate Approach From Existing Post-Termination Payment Disclosure

The Center believes the Commission should address the additional disclosure requirement by simply incorporating the current disclosures for post-termination payments in Section 402(j) of Regulation S-K, which companies currently are required to include in their annual proxy statements, in proxy statements related to merger or change-in-control agreements. The current disclosures address the statutory requirements and provide for consistency in reporting annual compensation and compensation in the event of a merger/change-in-control. This approach also will make it clear to shareholders whether there have been material changes in the structure of change-in-control agreements, thus enabling them to determine whether a separate shareholder vote on the change-in-control payments is warranted.

B. Shareholder Vote Should Only Be Required If Structure of Payments Has Changed Since Last Say on Pay Vote

The Center believes the SEC should clarify that a separate shareholder vote is necessary only if the structure of the change-in-control arrangements have changed since the last periodic say on pay vote. There should not be a separate vote merely because the value of the change-in-control agreement changes due to stock price fluctuations or changes in performance levels affecting other metrics. Otherwise, the statute's requirement that a separate vote be held only when there have been changes in the agreements or understandings related to the change-in-control arrangement would be meaningless. A contrary interpretation – i.e., that a say on pay vote be held any time the amounts of executive compensation payments that are projected to result from a change-in-control agreement differ from previously disclosed amounts require a separate shareholder vote each time there is a merger, acquisition, or combination.

Finally, in the event where only certain elements of a change-in-control agreement are added or changed, the shareholder vote should focus on the elements that have been changed.

IV. No-Fault Clawback Policy

Section 954 of the Dodd-Frank Act requires the SEC to promulgate rules directing the securities exchanges and securities associations to develop listing standards requiring companies to adopt and disclose a no-fault clawback policy. Specifically, the policy to be disclosed must provide, in the event of a material restatement, for the recoupment of incentive compensation that is "based on financial information required to be reported under the securities laws" from current and former executive officers of the company, if such compensation is in excess of that

which would have been paid in view of the restatement. This mandate raises a number of issues, including:

- which compensation is "based on financial information required to be reported under the securities laws;"
- the mechanics of determining the amount to be recouped in the event of a material restatement;
- the role of board discretion in executing the recoupment policy, particularly where board discretion was applied in originally awarding the incentive compensation; and
- the need to provide companies with sufficient lead time to implement a policy before the clawback mandate takes effect.

Each of these examples is discussed below.

A. Clearly Delineate Compensation Subject to the No-Fault Clawback Policy

The linchpin of the requirement in section 954 of the Dodd-Frank Act is that companies are required to disclose and enforce a policy that provides for recoupment of incentive compensation that is "based on financial information that is required to be reported under the securities laws." Thus, if incentive compensation is "based on" financial results that are reported under the securities laws, it is potentially subject to recoupment. Consistent with principles-based disclosure and recognizing the complexity of issues that are created by the language of the statute, the Center believes that in its proposed release the Commission should differentiate incentive compensation that is subject to the recoupment requirement from compensation that is not subject to it. This will enable Boards of Directors and Compensation Committees charged with enforcing it to better understand their obligations.

Financial information that is required to be reported under the securities laws includes measures such as revenue, net income and earnings per share. It also may include non-GAAP measures such as earnings before interest, taxes, depreciation and amortization and return on net assets.

Incentive information that is not required to be disclosed under the securities laws includes stock price, total shareholder return (which is based on the change in share price plus dividends over a period of time) and operational performance measures specific to the business such as market share and customer satisfaction. Such measures are not financial information that is filed with the SEC and therefore would not be subject to clawback under section 954.

The Center believes that it is important for the Commission to understand how incentive plans are structured, so that it may factor this information into its proposed regulations. Although compensation arrangements vary widely, depending upon the company, industry, competitive condition and global focus, below we present five hypotheticals, illustrating four common types of compensation arrangements:

(1) Purely formulaic incentive plans, based on financial metrics, that pay out in cash;

(2) Formulaic incentive plans in which a pool is funded based on the achievement of objective financial measures, but the board has discretion whether to allocate the entire bonus pool toward incentives, where a recoupment would not be required;

(3) Identical to (2), except the facts change so that recoupment is required;

(4) Formulaic long-term incentive plans based upon financial performance with overlapping awards; and

(5) Nonqualified stock option grants, that are not granted or vested based upon performance.

Annual and Long-Term Cash Incentive Measures Based Upon Financial Metrics. The implementation of the recoupment policy is easiest when dealing with incentive plans that are purely formulaic, based exclusively on financial measures, and paid out in cash. In that situation, the clawback is the excess of what was actually received compared to the amount that would have been received under the formulaic plans had the financial statements been correct.

Example 1: Formulaic Incentive Plan With Incentives Based on Financial Metrics

- Annual bonus is based on achievement of targeted level of net income.
- The performance for 2009 equaled 105% of the targeted level of net income.
- The incentive formula increases payout by 3% for each 1% by which performance exceeds the target.
- The payout at 100% performance is 50% of salary.
- The payout based on the performance results would be 115% of the targeted payout.
- 115% of 50% of salary would produce an annual incentive payout of 57.5% of salary.
- Assume the performance results for 2009 had to be restated in 2011 and the impact was to reduce net income to 90% of the targeted level of performance.
- The incentive formula reduces payout by 3% for each 1% by which performance falls short of target.
- The incentive payout on the restated earnings would have been 70% of the targeted payout of 50% and would have produced an incentive payout of 35% of salary.
- The amount of annual incentive that would be clawed back would be the difference between what was paid (57.5% of salary) and that which would have been paid on the restated earnings (35%), which would equal 22.5% of salary.
- Assuming the executive had a salary of $500,000, the bonus amount to be clawed back would equal $112,500 (the difference between an incentive of $287,500 at 57.5% of salary and an incentive of $175,000 based on 35% of salary).

Formulaic Incentive Plans Where Financial Measures Fund a Bonus Pool. Where the financial measure funds a pool which is distributed based upon financial and non-financial measures, the application of the clawback policy will differ based upon whether the Board and/or the Compensation Committee had discretion in determining how much of the pool to allocate for incentives and whether the Board and/or the Compensation Committee has discretion in

determining the individual awards.[8] Assuming the Board or Compensation Committee had discretion in determining the amount of the bonus pool to allocate to individual awards and the individual awards are determined based upon some measures that require the judgment of the board (rather than formulaic), a material restatement could require the Board to revisit its decisions. Examples 2 and 3 illustrate the pool concept and the role of Board discretion:

Example 2: Incentive Pool Approach With Restatement; Recoupment Not Required

- The annual incentive pool is generated based upon a percentage of net income, and at targeted level of net income for 2009 the pool would be sufficient to provide incentives equal to the sum of the incentive targets for the participating executives.
- The amount of incentive payout any individual would receive is based upon his or her individual performance against non-financial objectives in the areas of (1) talent development, (2) productivity and cost-savings, (3) operational performance measures and (4) modeling the desired company culture and promoting ethical behavior (weighted 25% each).
- In total the payouts to executives cannot exceed the incentive pool, but there is no requirement that the board allocate the entire pool to incentive payments.
- For 2009, the company hit 100% of the net earnings target, and the incentive pool was generated on that basis.
- The board allocated 95% of the pool for incentives.
- No executive received an incentive payment directly based upon the achievement of the net income target. Some executives received incentive payments above their targeted incentive; some received less than their targeted level of incentive and some received their targeted level of incentive. The amount received by an individual executive was based on the assessment of performance in the four areas listed above.
- Assume the performance results for 2009 had to be restated in 2011, and the impact was to reduce net income such that the incentive pool equaled 98% of the sum of the incentive targets for the participating executives.
- At this restated level of performance the bonus pool was sufficient to cover the actual amount of incentives paid (98% pool, 95% actually paid out).
- In this situation there does not appear to be a need to recoup any of the incentives paid unless the board determines it would have made different individual incentive decisions in view of the restated earnings.

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[8] If the Board does not have discretion (i.e., the bonus pool and the individual awards are formulaic), the clawback would be applied similar to Example 1 for the portion of the award based on the restated financial performance.

Example 3: Incentive Pool Approach; Recoupment Required

- Same as Example 2 but the restated earnings would have produced an incentive pool equal to 90% of the sum of the incentive targets for the participating executives.
- The Board has three options regarding how to recoup the 5% that exceeded the amount allocated to the incentive pool.
  - Ratably reduce all executive incentives by 5% (non-discretionary recoupment although the incentive paid to each individual was based on board discretion);
  - Discretionary recoupment on an individual-by-individual basis (the same way the bonus amounts were awarded) such that the total amount recouped equaled the 5% overpayment (discretionary recoupment);
  - Recoupment is left to the discretion of the board, pursuant to the company's recoupment policy.

The Center believes that the Commission should recognize the need for Board discretion in such situations. Thus, the Board should have the ability to decide to use any of the three options, so long as its rationale is explained in the company's next proxy statement.

Overlapping Long-Term Awards and the Impact of a Material Restatement on Target Setting. Long-term incentives are often three-year awards granted annually so that the awards are overlapping. In this situation a material restatement, and any required recoupment could affect up to four cycles of long-term incentive grants (the three outstanding performance cycles, plus the basis for setting the next award depending on whether the financial measures included in the restatement affect the long-term incentive program and also serve as the base year for setting performance targets for the next award). Example 4 illustrates the mechanics of this model:

Example 4: Overlapping Long-Term Incentive Awards

- Assume that Performance Unit Awards are granted annually and have the following design:
  - Units are denominated as a dollar amount (e.g., $100,000 value for achieving targeted performance).
  - Performance in excess of the targeted level of performance increases the payout by 3% for each 1% by which targeted performance is exceeded.
  - Performance that falls short of target reduces the payout by 3% for each 1% shortfall in performance versus targeted level of performance.
  - The performance metric is cumulative earnings per share (EPS) over the three-year performance period.
- Since the awards are granted annually, and given that the performance period is three years, a participant will have 3 overlapping awards outstanding at any given time.
- Therefore, a given year will be included in three separate award cycles and, depending how performance targets are set, may serve as the base year upon which the performance targets for a 4th award cycle are set.

- Outlined below is an example of the outstanding awards under a performance unit program:

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              2007      2008      2009      2010      2011      2012
2007 Award:   2007-------2008------2009
2008 Award:             2008------2009-----2010
2009 Award:                       2009-----2010---2011
2010 Award:                                 2010---2011-------2012
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- Assume that in mid-2010 the company materially restates downward the earnings for 2009, thereby reducing 2009 EPS.
- The impact of the restatement would be to reduce the performance for the 2007, 2008 and 2009 award cycles.
- The restatement would also lower the base year upon which the board set the EPS targets for the three-year award cycle beginning in 2010.
- The 2007 awards would have been paid out to the participants and therefore the company would have to initiate recoupment for the excess payment that was based on the pre-restated 2009 EPS.
- The 2008 and 2009 award periods would not yet have been completed and therefore the potential payout of the performance units would be automatically reduced. No recoupment would be required.
- The board should also revisit the targeted cumulative EPS goals for the performance cycle beginning in 2010 to determine if the goals would have been set at a lower level had the board been aware of the restated EPS for 2009 at the time the goals were set.

Performance-Granted and Performance-Vested Equity Awards. Section 10D(b)(2) of the statute states that the clawback policy applies to "incentive-based compensation (including stock options awarded as compensation)." The Center believes this language should be read as requiring that the clawback policy applies to (1) incentive-based compensation as defined under the Commission's disclosure rules that is based upon information required to be reported under the securities laws; and (2) stock options that are awarded as compensation and that are incentive-based compensation as defined under the Commission's disclosure rules where the incentive is based on financial information required to be reported under the securities laws. This approach makes the clawback language in section (b)(2) consistent with the reporting language in (b)(1), which requires companies to disclose the policy of the company on recoupment of incentive-based compensation under the securities laws.

Applying this interpretation, the Center believes that performance-granted and performance-vested equity awards can be incentive compensation subject to the recoupment mandate, if the above definitions are met. Unlike nonqualified time-vested stock options, restricted stock or restricted stock units, which are not considered incentive compensation under the Commission's

rules, performance-granted or performance-vested stock options, for example, are incentives that are often granted based on financial performance or other performance measures.

Time Vested Stock Options. Stock options generally take one of two forms: (1) performance-based stock options for which the granting or vesting of the award is based on the achievement of financial performance, as discussed above or, (2) time-vesting stock options for which the award is based on considerations other than financial performance and the vesting of such awards is based on the passage of time and is not contingent on achieving financial performance objectives. Stock options that vest merely on the basis of time are not considered incentive compensation under the SEC's disclosure rules and therefore should not be subject to a mandatory clawback. Many companies determine the level of stock options granted to an individual based on the executive's level, tenure and expected performance level, which are not linked to financial performance. In this case the following example should apply:

Example 5: Stock Option Awards

- Stock option awards are determined on an executive-by-executive basis.
- The actual award received is a function of salary grade, title, performance and potential.
- The determination of the performance of an individual executive for purposes of granting stock option awards is not tied directly to the financial results of the overall company.
- The option awards granted in 2006 have vested but the executives have not exercised the stock options.
- Assume the results for 2006 were restated in 2009 and the net income of the company was reduced by 1%.
- Correspondingly, the stock price dipped on the day of the restatement by 10% and has recovered over subsequent weeks but the recovery in stock price has trailed the overall movement of the market and the stock price appreciation of industry peers.
- In view of the fact that there has been no gain to the executives since the options have not been exercised, and in view of the fact that the size of the grant was not influenced by the net income of the company, no recoupment is warranted.
- An alternative stock option design would be a stock option that vests on the basis of achieving financial targets. In this case, the number of stock options that would not have vested based on the restated financial performance outlined above would be subjected to recoupment due to the material restatement.

In sum, the Center believes that the better way to interpret the clawback language in section 954(b)(2) is to consider any incentive compensation that is awarded, granted or vested based on financial measures required to be reported under the securities laws as subject to recoupment. Conversely, vehicles such as time vested stock options, restricted stock and restricted stock units should not be considered incentive compensation, and if the granting of such awards was not based on the restated financial performance, it is therefore not subject to the clawback

requirement. However, if the granting of individual stock option awards is based on the restated financial performance, the number of shares awarded would be subject to the clawback based on the excess of the award over that which would have been awarded based on the restated financial performance.

B. The Commission Should Provide for Board Discretion in Executing the Recoupment Policy

In implementing the clawback requirement, the Commission should recognize the role that Board or Compensation Committee discretion plays in setting executive compensation, and explicitly provide for Board and Compensation Committee discretion in the determination of the amount to be recouped and how that recoupment is to be executed. This interpretation recognizes that Board discretion often plays a role in how incentive compensation is awarded and allows the Board to make determinations to ensure that the recoupment is in the best interests of shareholders.

The Level of Discretion Used by the Board/Committee in Determining Amount to Be Clawed Back Should Be the Same as That Used in Making Original Grant. Boards should be given the same level of discretion to determine the amount to be clawed back as was used in making the initial compensation decision. As illustrated in the examples above, this may involve discretion under section 162(m) incentive plans in which financial performance funds a pool to be used for the distribution of compensation to NEOs or other executive officers. Committee discretion may also be used in applying other financial criteria used to make individual awards.

Board or Committee discretion is also increasingly an element of a company's risk mitigation system. Affording the Compensation Committee discretion allows it to reduce (or add) incentive payouts, when the committee takes the entirety of the circumstances into account. In addition, long-term incentive grants, whether granted on a value or a number of shares basis, are often made based on a formula, to which Committee discretion is applied in determining the actual grant.

Discretion Not to Claw Back Where the Cost of Executing the Clawback Would Outweigh the Benefits to Shareholders. The Center believes that in addition to discretion as discussed above, the Commission should recognize that Boards should have discretion in determining not to execute a clawback against a current or former executive officer where, for example, the amount to be clawed back is de minimis or the Board believes that protracted litigation would be required to recoup the compensation. In cases such as this, the Center believes the Commission should explicitly recognize the Board's ability to decide not to claw back and to disclose that decision in the proxy. This is especially important with respect to executive officers in certain countries or other jurisdictions that are extremely protective of employees, where it may not be possible to recoup the entire amount. For similar reasons, in crafting its proposed release, the Commission should consider situations in which a Board would be permitted to settle a clawback for less than the full amount.

Discretion in Determining How to Recoup Compensation From a Current Or Former Executive Officer. The Center believes that since the statute is silent as to how clawbacks are to be executed, the Commission should explicitly recognize Board/Compensation Committee discretion in executing recoupment by any method the Board deems to be appropriate (and

discloses in the next proxy statement), including cancellation of unvested awards (equity and nonequity awards) and offsetting against amounts otherwise payable by the company to the executive (for example, deferred compensation) in place of having executives write a check, if the circumstances warrant. This flexibility helps to mitigate some of the procedural complexities involved in executing a clawback, including the need to file amended tax returns by both the company and the executives.

C. The Three-Year Recoupment Period Should Be Linked to the Restatement Filing Date

The Center also believes that the trigger for recoupment (i.e., when a company is "required to prepare an accounting restatement") should be when the company actually files an accounting restatement due to the material noncompliance of the company with a financial reporting requirement under the securities laws. This creates a verifiable date certain from which to determine the three-year period over which the recoupment applies. It also avoids speculation over when a company determined it should have known it was required to prepare a restatement.

The Center encourages the Commission to exclude restatements based on changes in Generally Accepted Accounting Principles from the types of restatements that trigger a recoupment. These restatements are not based on oversights or deliberate errors by the company, but rather a change in the framework for reporting. Mandating a recoupment in such circumstances does not fulfill the policy objective sought by the clawback mandate: namely, if an executive did not earn incentive compensation based on financial results, he or she should be required to return it.

D. Include Sufficient Lead Time to Implement the New Clawback Requirements

The Center urges the Commission to provide in its implementing release that the clawback policy will apply only to any new incentive compensation that is received after the effective date of the listing standards approved by the Commission. To apply the recoupment policy to compensation already granted would create excessive complexity in term of amendments required to outstanding compensation plans and executive contracts.

In addition, the Center believes that the Commission should give companies sufficient time to put such policies into place prior to the effective date of the listing standards incorporating the disclosure and recoupment obligation taking effect because of the considerable number of issues, such as plan amendments and contract renegotiation that must be addressed. We believe that a reasonable time is 12 months after the Commission approves the listing standards.

V. Disclosure of Pay Versus Performance

The Center believes that the Commission should interpret the additional disclosure required by new section 14(i)(a), entitled Disclosure of Pay Versus Performance, by taking an approach consistent with principles-based disclosure that recognizes the need for flexibility in properly portraying the unique aspects of individual company pay philosophies, programs and decisions. The statute requires companies to disclose "information that shows the relationship between compensation actually paid and the financial performance of the issuer, taking into account any change in the value of the shares of stock and dividends of the issuer and any

distributions." We believe this disclosure should reinforce the purpose of the CD&A, namely to "put into context the compensation disclosure provided elsewhere."[9]

With this in mind, the Center believes this disclosure should reflect the Board's and Compensation Committee's perspectives on compensation and financial performance in making its compensation decisions. Rather than focus on uniform disclosure, the requirement in new section 10(i) should be interpreted to focus on explaining the link of compensation "actually paid" to performance, allowing companies the flexibility to explain the committee's decisions in the context of its overall pay philosophies.

Definition of Compensation "Actually Paid." We believe that the determination of "actually paid" will vary based on how the Compensation Committee and the Board structured the performance basis of incentive compensation granted to executives. This is consistent with the requirement that the CD&A "focus on the material principles underlying the registrant's executive compensation policies and decisions and the most important factors relevant to analysis of those policies and decisions."[10]

Because much of the CD&A focuses on the amounts in the Summary Compensation Table, the intended performance linkage between pay and performance may not be clear from the amounts in that Table, depending upon the philosophy of the company, especially with respect to long-term incentives. The linkage between pay and performance is fairly consistent as it relates to salary and annual incentive because the amounts realized are reported in the same year as the corresponding performance. However, the design of long-term incentive plans can vary considerably among companies depending on the basis upon which awards are granted, performance periods, performance objectives and incentive vehicles used.

Long-term Incentives as Awards for Past Performance. For example, a Compensation Committee may grant long-term incentives as a reward for past performance. In this case, the grant date fair value estimate for long-term equity-based incentives in the Summary Compensation Table more appropriately reflects the decisions made by the Compensation Committee and the Board and thus the linkage between compensation "actually paid" and performance.

Example 1: The Company has a tremendous year in terms of financial performance and the senior executive team is granted above guideline stock option awards to reflect the accomplishments of the prior year in the total planned annual compensation value. In this case, the Compensation Committee and the Board would discuss the relationship between the financial results and the date of grant value of the stock option awards, as reported in the Summary Compensation Table, when combined with other forms of incentive compensation reported in the Summary Compensation Table, as reflecting the relationship of pay and performance. If performance had been below expectations, a lower planned grant value could result. This pay for performance philosophy is in large part backward looking in that long-term incentive grants are the result of past performance.

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[9] U.S. Securities and Exchange Commission, Executive Compensation and Related Person Disclosure, Release Nos. 33-8732A, 34-54302A, 71 Fed. Reg. 53,157, 53,164 (September 8, 2006).
[10] *Id.* at 53,242.

Alternative: Realized Compensation as "Actually Paid." By contrast, some companies are concerned that the long-term incentive estimates disclosed in the Summary Compensation Table do not completely reflect the pay for performance linkage underlying the committee's decisions. As a result, they may choose to put those amounts into context by discussing how compensation actually realized -- the compensation actually received by the executive at the end of the performance period based on the degree of achievement of the underlying performance objectives -- is the proper reflection of pay for performance rather than grant date value of the award.[11] This approach requires an explanation of how pay and performance were linked over the period the awards were outstanding and gives shareholders a sense for how such forward-looking incentive programs operate in practice.[12]

Example 2: The Company is in a turnaround situation and the Compensation Committee believes that it is important to grant a market-competitive level of long-term awards to the executive team to motivate them to improve the performance of the company. In this case the philosophy of the company is that the link between pay and performance is best reflected based upon the pay that will be actually realized by the degree to which performance goals are achieved and the long-term awards create gains to the executives. This pay for performance philosophy is forward looking in that future performance will determine the pay received from the performance-contingent awards.

Some companies have begun disclosing the realized value of long-term incentive amounts in a table, similar to the following (which is separate from example 2):

Form of Compensation	Total Received ($)	Annualized Amount	Performance Results Over Performance Period That Produced the Compensation
• **2008-10 LTIP Payout**	$3,384,275	1,128,092	The total 2008-10 Long Term Incentive Plan award was $3,384,275. Performance criteria for this award were: (1) Total return to shareholders vs S&P Industrials Index companies, weighted 50%, for which the company ranked in the top 25 percent of companies, producing a near maximum payout for this component. (2) ROIC, weighted 25%, which exceeded the targeted level by 100%, resulting in maximum payout; and (3) Cash flow, weighted 25%, which exceeded the target by 15%, which resulted in a target payout. Overall the payout represented 150.25% of target.

[11] This approach is also reflective of the way the Commission has distinguished estimates of compensation included in the Summary Compensation Table and compensation earned and paid out in the preamble to its 2006 disclosure release. *See, e.g.,* U.S. Securities and Exchange Commission, Executive Compensation and Related Person Disclosure, Release Nos. 33-8732A, 34-54302A, 71 Fed. Reg. 53,157, 53,169 (September 8, 2006) ("This table, as amended, shows the named executive officers' compensation for each of the last three years, whether or not actually paid out.") *referring to the Summary Compensation Table*); *Id.* at 53,174("No further disclosure will be specifically required when payment is actually made to the named executive officer.") *discussing the treatment of equity awards on the Summary Compensation Table.*

[12] This approach may also be useful in turbulent economic times where the accounting estimate of long-term incentive awards included in the Summary Compensation Table may vary considerably from the amounts actually realized.

The appendix to these comments includes a more complete version of this disclosure. As the two examples above demonstrate, it is important that the Commission's regulations allow flexibility for the Compensation Committee and the Board to present the pay for performance relationship in a manner that is consistent with the company's pay philosophy.

Regardless of the approach used to describe the relationship between incentives and performance, the Center does not believe that the actuarial increase in defined benefit pension plans should be included in the calculation of compensation "actually paid" because the amounts are based on credited service, age, interest rates, and historical earnings, factors not generally related to financial performance, and given that pension estimates have not yet been received by the executive and thus should not be considered pay actually paid. The Center also believes that "other compensation," should be excluded as it is not related to financial performance.

Definition of Financial Performance Should Be Company-Specific. We believe that the definition of "financial performance" should link the compensation "actually paid" to the financial metrics the Compensation Committee and the Board have incorporated into the company's incentive plans. Companies choose these financial measures because they link to short-term and longer term financial objectives intended to drive long-term shareholder value that will ultimately be reflected in stock price. We suggest that a company be required to clearly state the extent to which financial performance measures are used in determining the incentive compensation "actually paid" to named executive officers and how those amounts relate to financial performance.

Example 3: For example, a company that links its long-term incentives to financial performance may state: "our company provides a long-term incentive program for senior executives that is paid out in shares of company stock at the end of the period, based on the achievement of certain financial results. A certain number of performance share units are granted at the beginning of the three-year performance period and adjusted based on performance at the end of the period. The financial performance on which the payout is based is:

- 60% Earnings per share;
- 20% Return on Invested capital; and
- 20% Cash flow."

The company would then provide the pay (either on an estimated basis or realized pay basis) that is linked to the financial performance.

We also encourage the Commission to permit companies to incorporate into this disclosure comparison of how other, nonfinancial measures compare with performance, consistent with the Commission's existing disclosure rules, so long as the link between financial performance and compensation actually paid is clear. This approach would allow companies to describe the link between pay and the performance on which it is based, whether financial, operational or strategic. Companies that base compensation decisions or measure performance based on financial and operational measures would report the compensation decisions or compare compensation received with the achievement of those objectives, while companies that base compensation actually paid on total shareholder return would measure performance on that basis.

Example 4: Company A determines a total long-term incentive value based on the committee's evaluation of the external market and allocates that total among two long-term incentive vehicles:

- 40% time-vested stock options, which vest after three years and provide value if the company's stock price exceeds the grant price and
- 60% performance shares, which are based equally upon the achievement of earnings per share and total shareholder return measures.

In this case, only the performance shares are related to financial performance. However, rather than requiring a separate disclosure in which the company shows the link between the portion of the long-term incentive that was based on financial performance and compensation, the company should be able to disclose how each element of the long-term incentive produced or is expected to produce compensation based on performance (depending on the committee's philosophy in granting compensation as discussed above), and to highlight the elements that are based on financial performance.

Of course, as is the case under current disclosure rules, companies would not be expected to disclose non-public performance metrics that would lead to competitive harm if disclosed to competitors.

In sum, compensation is not a one-size-fits-all exercise, and companies use different approaches that fit their size, industry, strategy, competitive outlook and talent retention and development needs. The Commission should help promote clearer shareholder understanding of the decisions made by a Compensation Committee and/or the Board by implementing a principles-based approach to disclosure of the relationship between pay and performance.

VI. Pay Ratio Disclosure

The new disclosure requirements created by section 953(b) of the Dodd-Frank Act, which requires companies to calculate the median pay for "all employees," would be extremely difficult, if not impossible for large companies, especially those with substantial global operations. While the Center opposes the ratio because it does not believe it will provide any meaningful or material information that will be used by investors, the Center recognizes that the Commission has obligation to implement the language. For this reason, the Center believes that the Commission should interpret the statutory language in a way that fulfills the statutory mandate while making it practicable for corporations to comply. In sum, the Center believes the following:

- The phrase "all employees" should be interpreted to mean all full-time U.S. employees because of difficulty in aggregating and calculating disparate pay data from dozens of locations and systems;
- Total compensation for non-NEO employees should exclude certain items, including pension values and other compensation; and
- Because of the difficulty in aggregating the information globally, companies should be able to present a reasonable, good faith estimate, and the amounts should be considered as "furnished" rather than "filed."

Our rationale for each of these recommendations is discussed below.

A. "All Employees" Should Be Interpreted as "All Full-Time U.S. Employees"

The Center believes that the SEC should propose reasonable and workable interpretation of section 953(b) that takes into consideration the practical ability of companies to calculate the "median of annual total compensation." The critical part of the section states that an issuer is required to disclose "the median of the annual total compensation of all employees of the issuer except the CEO," using the same calculations the company uses to determine total pay under the SEC's proxy disclosure rules. Because the definition of median means "midpoint," depending on how the phrase "all employees" is defined, companies could be required to calculate pay as specified by the proxy rules for each individual employee globally and then determine the median of those values. For large employers, this means they will have to accurately calculate pay for tens of thousands and in some cases, hundreds of thousands of employees to determine the median. For some companies it will be nearly impossible to develop this number with the same accuracy that applies to NEO pay disclosures.

For many global employers, compensation data is housed in dozens of computer systems, and the data may not be sufficiently accurate for SEC disclosure purposes. The following examples of the number of employees and systems affected illustrate why this is a difficult and costly challenge for global employers and why the Commission should adopt a narrow interpretation of the provision:

- Company A: over 200,000 employees operating in over 60 countries has data housed in over 100 different systems;
- Company B: 33,000 employees in 35 countries and had data in roughly 75 systems;
- Company C: 107,500 employees in 52 countries with 115 pay systems and over 100 vendors.

In each of these situations, the company would be required to develop and coordinate a consistent calculation for each employee in all countries and then ensure that the results were accurate. In addition to the challenges of computing employee compensation as required under the Commission's executive compensation disclosure rules, the global compensation data would need to be translated into U.S. dollars, and those amounts could fluctuate considerably based upon unpredictable exchange rates. Moreover, unless the Commission makes the ratio a "furnished number" the data disclosed will need to be sufficiently accurate that company CEOs and CFOs could sign off on the disclosures as required under section 302 of Sarbanes-Oxley.

Because of these difficulties, and recognizing that the phrase "all employees" is not defined in the legislation or the legislative history, the Center urges the Commission to use its interpretive discretion to define "all employees" as "all full-time U.S. employees." This approach provides greater consistency because the comparison is being made within one geographic market, and nearly all U.S. employers would be able to readily obtain basic compensation information, which would not be the case if the phrase were interpreted to include all global employees. Limiting the disclosure to full-time employees eliminates the need to determine which employees are eligible for the disclosure and simplifies data collection without substantially affecting the calculation.

B. The Commission Should Exclude Pension Values and All Other Compensation Amounts for Non-NEO Employees

Section 953(b) requires companies to calculate compensation as is required for the named executive officers. No public company currently calculates each employee's total compensation as it calculates total pay on the Summary Compensation Table for the named executive officers, because disclosure of executive pay has a different purpose than internal accounting. With this in mind, the Center urges the Commission to eliminate the calculation of the actuarial increase in pension benefits and all other compensation for the purposes of the pay ratio. As a practical matter, few rank-and-file employees are likely to have such amounts, but eliminating them from the calculation would avoid the requirement that employers have to check for them with respect to each employee.

C. The Pay Ratio Should Be Considered a Furnished, Rather Than Filed Number

Even if the scope of the disclosure is limited as discussed above, the Center believes that the Commission should make the total median pay of all employees and the pay ratio disclosure a furnished rather than filed number, due to the complexities in developing an accurate calculation. Making the ratio a furnished number would not affect any of the executive compensation disclosures, including the disclosure of CEO compensation under the Commission's executive compensation rules. This approach would, however, encourage employers to provide a reasonable good faith calculation of the ratio while recognizing the substantial resources required to develop the median total compensation for all employees that would be sufficiently accurate for CEO and CFO certifications. Because of the difficulties described above, many companies have stated anecdotally, that they may only be able to provide an estimate. Making the ratio "furnished" rather than filed is a reasonable solution that also satisfies the policy objectives of the legislation.

In sum, the Center opposes the pay ratio disclosure requirement. However, we understand that the Commission must implement the law as passed by Congress. We urge the Commission to adopt a narrow interpretation which would satisfy the intent of the provision while mitigating the extraordinary expense employers would be required to bear to create the information, which very few shareholders would find useful.

Conclusion

The Center On Executive Compensation appreciates this opportunity to provide comments on our suggested approaches to regulation under the pay and governance provisions of the Dodd-Frank Act. If you have any questions about these comments, please contact me at tbartl@execcomp.org.

Sincerely,

Timothy J. Bartl
Senior Vice President and General Counsel

Attachment: Pay for Performance at a Glance Disclosure

cc: Securities and Exchange Commission
Hon. Mary L. Schapiro, Chairman
Hon. Kathleen L. Casey, Commissioner
Hon. Commissioner Elisse B. Walter, Commissioner
Hon. Commissioner Luis A. Aguilar, Commissioner
Hon. Commissioner Troy A. Paredes, Commissioner

Securities and Exchange Commission -- Division of Corporation Finance
Ms. Meredith Cross
Ms. Paula Dubberly

Center On Executive Compensation

The Pay Ratio Disclosure Mandate in Dodd-Frank: Examples of the Burdens on Global Companies

Section 953 of the Dodd-Frank Wall Street Reform and Consumer Protection Act would require employers to disclose in their proxy statements and other securities filings the ratio of median employee pay, excluding the CEO, to CEO pay. The requirement is perhaps the most burdensome executive compensation requirement in the bill, as few large public companies have the ability to accurately calculate this ratio. The following examples demonstrate the burden and the extreme difficulty – if not impossibility of calculating the ratio as currently structured.

Company A

Number of Employees Globally: 42,000
Number of Countries: 60
Number of Pay Systems: 10-15

Company B

Number of Employees Globally: 360,000
Number of Countries: 19
Number of Pay Systems: More than 10

Company C

Number of Employees Globally: 78,900
Number of Countries: 40
Number of Pay Systems: Over 40

Company D

Number of Employees Globally: 137,000
Number of Countries: 68
Number of Pay Systems: Over 1,000

Company E

Number of Employees Globally: 33,000
Number of Countries: 35
Number of Pay Systems: About 75

Company F

Number of Employees Globally: 107, 500
Number of Countries: 52
Number of Pay Systems: Over 115 and over 100 vendors

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Center On Executive Compensation

About the Center On Executive Compensation

A Principled Voice on Pay Practices

Hosted by HR Policy Association, the Center On Executive Compensation is dedicated to developing and promoting principled pay practices and advocating compensation policies that serve the best interests of shareholders and other corporate stakeholders. The Center believes that a sound, reasoned approach is in the best interest of all the key constituents as changes to executive compensation are debated. The following provides an overview of the Center's role in the executive compensation debate, an explanation of the need for the Center, and a summary of its core principles.

The Role of the Center The Center on Executive Compensation is an advocate for the principled pay practices described below. Specifically, the Center:

- Provides senior HR executives with a stronger voice in executive compensation matters;
- Offers a thoughtful and principled voice on the proper design and governance of executive compensation from the corporate perspective;
- Advocates sound practices and policies at the national level that appropriately bridge the pay-for-performance philosophies of companies with the concerns of key stakeholders;
- Educates the public and policy makers about the sound corporate governance practices embraced by the vast majority of U.S. corporations and how their executive compensation programs align with shareholder and other stakeholder interests;
- Issues timely commentary on current trends and changes being considered in the executive compensation arena, in order to help promote a more balanced point of view; and
- Conducts research and provides it to the public in order to help inform the executive compensation dialogue.

The Need for the Center The ongoing debate over executive compensation is focused on the most appropriate ways to structure executive compensation so that performance incentives are aligned with results. For the most part, the means and methods used have been appropriate and effective. More than 1,700 publicly traded companies are acting responsibly and consistent with sound corporate governance standards to the benefit of their shareholders, employees and the communities they serve.

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However, serious exceptions with equally serious consequences have occurred to the detriment of shareholders, employees and other stakeholders. In response, Boards of Directors, senior corporate executives, Congress, regulatory agencies and shareholder organizations have rightly taken action to strengthen corporate governance standards, enforce more rigorous pay-for-performance practices, reinforce Board responsibility for executive compensation and improve disclosure. The net result of all these changes is that significant improvements have been made in executive compensation.

Still, scandals continue to prompt both scrutiny and debate by regulators, legislators, watchdog groups and pension funds over governance and pay practices of publicly held companies. In the absence of a cohesive and reasoned corporate point of view, some of these well-intentioned efforts have, unfortunately, resulted in unintended consequences that have led to distortions in pay packages, greater expenses and a harmful erosion of the overall reputation of corporate America and its executives.

In today's emotionally charged world of executive pay, the Center On Executive Compensation believes that a reasoned voice on the proper design and governance of executive compensation is needed to ensure that today's cure for yesterday's curse does not become tomorrow's crisis.

The Center's Principles Headquartered in Washington, DC, the Center was created to ensure that the Association was supporting the critically important work of its members—the senior human resource executives of leading companies—and providing them with a stronger voice in the executive compensation debate.

The Center believes that properly designed and managed incentive programs are key factors in promoting economic performance and the corresponding benefits that flow to shareholders, consumers, employees and society in general.

The Center promotes executive pay and governance principles that are aligned with the best interests of shareholders and other stakeholders. Specifically, the Center believes that compensation arrangements should be:

- fully compliant with the applicable laws and regulations;
- independently informed and approved;
- appropriately customized to the company's culture, strategy and industry;
- transparent and accessible; and
- fair and reasonable.

More information on the Center and its program of work can be found on its website at www.execcomp.org. If your company is interested in subscribing to the Center, please contact Tim Bartl at tbartl@execcomp.org or call him at 202-408-8181.

Center On Executive Compensation
Advisory Board

Center On Executive Compensation **Policy Brief**

Executive Compensation Disclosure Requirements in Senate Financial Reform Bill Would Discourage Long-Term Financial Performance

Section 953 of H.R. 4173 Would Require Flawed Comparison Between Total Pay and Short-Term Financial Results and Between CEO and Median Employee Pay

Section 953 of the Senate-passed financial reform bill (H.R. 4173) would effectively mandate the disclosure of the relationship of pay to short-term financial performance and thus encourage pay practices that contradict linking executive compensation to long-term results. The new requirement is contrary to recent SEC rules, sound risk management and pay for performance concepts, and it is likely to encourage companies to focus on formulaic compensation arrangements rather than those that emphasize long-term, sustainable performance based on financial, strategic and operational objectives. The disclosure of pay for short-term performance requirement should be removed from the legislation to avoid these unintended consequences. If the requirement is retained, at a minimum, the language should be amended to provide a comparison between executive compensation and not only financial, but also operational and/or strategic performance, to mitigate the unintended consequences to better reflect the long-term basis on which pay arrangements are structured. Section 953 would also require companies to disclose in their proxies the ratio of average employee pay to CEO pay. This requirement would provide no meaningful information to shareholders but would require companies to incur astronomical administrative costs in calculating median annual employee pay across global operations and multiple pay systems. This provision should be removed in its entirety.

Executive Compensation Plans Blend Short-Term and Long-Term Elements to Promote Long-Term, Sustained Growth Compensation plans for the senior executives reported in proxy statements typically include salary and annual incentives, which reflect performance over one year, and long-term incentives, the actual value of which is determined based on performance over three years or more. According to Equilar, Inc., long-term incentives made up 62 percent of the total pay package for S&P 500 CEOs in 2009, while salary comprised 12 percent and annual incentives comprise 23 percent. Annual incentives focus on financial performance over a year, firm-wide operational goals, such as innovation, environmental compliance and workplace safety that have taken on more prominence based on recent crises, and individual performance. Long-term incentives typically focus on the financial performance and returns to shareholders over a three-to-five-year period, as well as achievement of long-term strategic goals. Combined, short- and long-term performance results in share price appreciation and the longer-term creation of shareholder value. Well-designed incentive programs help produce financial performance by encouraging executives to put programs in place to grow the company, *e.g.*, developing corporate systems, innovations and company capabilities to compete successfully in today's global economy.

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New Disclosure Would Encourage Boards to Focus on Short-Term Financial Results Section 953 requires the SEC to expand its proxy disclosure requirements to include "a clear description of any compensation required to be disclosed" under the SEC's existing rules, including "information that shows the relationship between executive compensation actually paid and the financial performance" of the company. Recognizing that disclosure drives behavior, and because pay disclosures already focus on key areas of company performance for the most recent year, the effect of the section will be to encourage boards of directors and their compensation committees to focus on linking reported pay disproportionately to short-term financial results. Neither the legislation nor the legislative history states that the comparison should be actual pay to long-term financial performance. This requirement will encourage management to enhance short-term financial performance rather than incentivizing the creation of sustainable long-term value for shareholders. Ironically, it reinforces, rather than reverses, the short-term approach to compensation which many lawmakers and compensation critics have claimed led to the financial bubble and meltdown that the overall reform legislation is trying to remedy.

Focus on Short-Term Performance Contradicts Sound Risk Mitigation Practices A myopic focus on financial performance is also counter to sound risk management which seeks to balance financial performance with the quality and sustainability of performance. Excessive short-term compensation has been criticized by everyone from the Obama Administration to the Financial Stability Board. Likewise, the Aspen Institute Principles on Long-Term Value Creation, signed by such disparate organizations as the Council of Institutional Investors and The Business Roundtable, state that compensation should "support[] long-term value creation" by promoting "the long-term, sustainable growth of the firm rather than exclusively short-term tax or accounting advantages to either the firm or employee." Focusing exclusively on financial performance will negate the progress made in balancing incentives and risk, and thus moderating potentially "excessively risky behavior." Decisions made by senior executives often have an impact only over the long-term, and their compensation arrangements reflect that time horizon. Requiring a focus on short-term financial performance would encourage executives to take actions that increase short-term financial performance potentially at the risk of long-term performance.

Focus on Pay Versus Financial Performance Will Emphasize Formulaic Pay Approaches Rather Than Those Relying on Compensation Committee Judgment By mandating disclosure of the direct relationship between compensation and financial performance, the section emphasizes a formulaic approach to compensation and renders the compensation committee's judgments in linking pay and results superfluous. An exclusive focus on financial performance is based upon a faulty assumption that compensation is intended only to drive short-term financial performance, rather than the long-term competitiveness of the firm and its growth and sustainability. Companies seeking only near-term financial results have no incentive to invest in long-term research and development, seek only the locations for production that involve the lowest cost and otherwise take steps to reduce the near-term cost of the company. Moreover, the Board's role is to assess whether formula-based pay is reasonable and make adjustments if pay and overall results are not linked. The legislation's focus is the equivalent of substituting a spreadsheet for the compensation committee's reasoned judgment.

Disclosure of Pay Versus Stock Performance Rejected by the SEC in 2006

Section 953 encourages companies to graphically represent the link between short-term pay and financial performance. The graphical approach contradicts a recent SEC regulatory decision on the matter. In its 2006 revision of the executive compensation disclosure rules, the SEC recognized that disclosure had become too reliant on a comparison of pay versus financial performance. It removed the "performance graph," which compared executive compensation to company stock price performance from the compensation section of the proxy. Instead, the SEC adopted the Compensation Discussion and Analysis which is "an overview providing narrative disclosure that puts into context the compensation disclosure provided elsewhere" (essentially the pay tables). The CD&A is designed to "explain material elements" of how a company is actually compensating their named executive officers and how the elements of pay relate to each other. In rejecting the performance graph, the SEC staff stated:

> The disclosure in the Compensation Discussion and Analysis regarding the elements of corporate performance that a given company's policies consider is intended to encourage broader discussion than just that of the relationship of executive compensation to the performance of the company as reflected by stock price. Presenting the Performance Graph as compensation disclosure may weaken this objective.

In sum, as discussed above, condensing an explanation of the pay for performance link to a single graph could lead to inaccurate conclusions regarding whether that link has been achieved.

Proposed Change Would Require Illogical Comparison of Prior Year's Performance to Future Potential Pay, Rather Than Compensation Realized

Ironically, the majority of compensation "actually paid" as defined by the bill does not involve compensation that executives can spend (such as cash or shares of stock). Instead, it refers to the total compensation number in the proxy statement's summary compensation table, which mixes actual compensation (e.g., salary) with an accounting estimate of stock-based compensation, typically earned over three years. These future estimates may not actually be earned because they are contingent upon *future* company performance which typically will not be known until three years after the incentives are granted. The pay actually realized through long-term stock-based compensation may be lower or higher than the estimate disclosed as part of the total compensation number in the Summary Compensation Table and thus result in a much different picture of whether pay and performance are linked. Boiled down to its essence, the proposed pay for performance disclosure requires companies to combine actual and future potential compensation under the label "actual pay" and compare that amount to performance in the last fiscal year. This comparison is illogical and will not produce an accurate determination of whether pay and performance are indeed linked.

If Additional Disclosure Is Mandated, It Should Focus on How Actual Pay Is Related to Actual Performance

Financial performance is but one aspect of a corporate investment strategy and therefore is only one element of an overall compensation strategy. If the pay for performance disclosure in Section 953 is retained in the financial services reform bill, at a minimum it should be expanded to focus on how executive compensation is related to financial, operational and strategic performance. An even better solution would be to require pay

realized during a reporting year to the performance which generated it. That would enable a more linear comparison between actual pay (not the accounting value of stock and stock options) and actual performance.

Disclosure of Pay Ratios Will Not Improve Disclosure or Pay Practices But Will Waste Corporate Resources Section 953 of the bill would also require all publicly held companies to disclose the median total annual compensation of all employees of the company, other than the chief executive officer, and the ratio of that amount to the CEO's compensation. The disclosure would provide little useful information to investors because different industries have differing executive pay levels, as well as differing pay for nonexecutive employees. These differences are based on the skills required to perform the job, the number of high and lower paid employees and the level of executive compensation for that industry. Other than confirming that there are such differences, the ratio would not enhance investors' understanding of whether executive compensation is appropriate, and it would certainly not enhance comparability among executives.

Beyond the lack of insightful information, companies would face an immense administrative burden of preparing the pay ratios. For purposes of this requirement, total annual compensation is defined as the amounts included in total compensation of the Summary Compensation Table, and few companies tabulate total compensation for nonexecutives in this way. A 2006 survey conducted by Professor Robert L. Clark of North Caroline State University found that only 20 percent of respondents indicated that they keep the information necessary to calculate total compensation for highly compensated employees – much less all employees -- in a single database, and 70 percent of respondents said that they neither had the requisite systems in place to calculate total compensation as required by the SEC and that it would a substantial burden to do so.

In addition, companies would be required to tabulate compensation data for all employees globally. As one survey respondent indicated "Our biggest concern would be in trying to identify and accurately value the total compensation package for a number of employees in foreign countries," which would include calculating exchange rate differentials and country-specific requirements and practices.

In sum, the pay ratio disclosure requirement mandates a considerable administrative burden without providing any substantial useful benefit.

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Center On Executive Compensation

Compensation Committee Checklist for Assessing Incentives and Risk

As Board Compensation Committees consider and finalize executive compensation arrangements for 2010, they will seek to confirm that the company's incentive programs are appropriately structured for the company and discourage executives from taking "excessive risk." Many Committees will also voluntarily disclose how their compensation programs address the subject of risk. The Center On Executive Compensation, a research and advocacy organization that provides a principles-based perspective on executive compensation matters, has created the following checklist to help guide Compensation Committees on these issues. The questions that form the basis of the checklist are provided below and in greater detail on the subsequent pages.

1. **Do the performance criteria and corresponding objectives represent a balance of performance and the quality and sustainability of such performance?**
2. **Is the mix of compensation overly weighted toward annual incentive awards or is there a balance of annual and long-term incentive opportunities?**
3. **When compared to a carefully chosen peer group, is the relationship between performance and incentive plan payouts within the range of competitive practices?**
4. **Is there a relationship between performance criteria and payouts under the annual incentive award consistent with targeted performance under the long-term incentive awards?**
5. **Are the long-term incentive performance measures or equity devices overly leveraged and thereby potentially encourage excessively risky behavior?**
6. **Is there a requirement that a meaningful portion of the shares received from incentive award payouts be retained by the participants?**
7. **Has the Board of Directors adopted a recoupment policy which provides for the clawback of incentive payouts that are based on performance results that are subsequently revised or restated and would have produced lower payouts from incentive plans?**
8. **Does the Compensation Committee discuss the concept of risk when establishing incentive performance criteria and approving incentive payouts? Are such discussions recorded in the minutes of the Committee meeting? Does the Compensation Discussion and Analysis articulate how the company's incentive plans mitigate risk?**

Role of the Compensation Committee in Assessing Excessive Risk

The Center On Executive Compensation believes that the Compensation Committee is in the best position to assess the appropriate relationship between the risk inherent in compensation arrangements and how that level of risk corresponds to the overall business strategy and competitive environment of the company. The Compensation Committee is responsible for establishing company-specific performance goals and potential incentive payouts that will motivate and reward performance supporting the long-term success of the company. The following checklist is offered to aid Compensation Committees in assessing the extent to which the design and administration of executive compensation encourages or reinforces excessive risk-taking by management.

1. **Do the performance criteria and corresponding objectives represent a balance of performance and the quality of such performance?**
    - The committee should evaluate whether performance criteria under annual and long-term incentive plans include measures of performance (such as financial or managerial goals) and measures of the quality of that performance (such as return measures or measures of sustainability of performance).
        - For example, incentive plans may focus on performance such as revenue, market share or other growth measures, and profitability, return on invested capital, or other measures of efficiency and return.
    - This dual approach mitigates the potential that executives will aim to achieve increases in measures such as sales or growth while not focusing on the ultimate value creation or sustainability of such performance.
2. **Is the mix of compensation overly weighted toward annual incentive awards or is there a balance of annual and long-term incentive opportunities?**
    - Does the annual incentive make up more than 50 percent of the total compensation opportunity?
        - To avoid placing too much focus on achieving short-term results, the annual incentive should not comprise a disproportionate share of the total annual executive compensation opportunity (base salary, annual incentive, estimated value of long-term incentive).
            - Too much emphasis on short-term results may jeopardize long-term performance

2. Is the mix of compensation overly weighted toward annual incentive awards or is there a balance of annual and long-term incentive opportunities? (Continued)

- Recognizing that each company will be slightly different, the median division among the elements of compensation for Fortune 500 companies are
  - Salary ≈ 15-20 percent
  - Annual Incentive ≈ 15-20 percent
  - Long-Term Incentive ≈ 60-70 percent
- Annual incentive in excess of 50 percent of annual compensation opportunity should trigger additional Compensation Committee scrutiny and potentially re-allocation of the annual pay opportunity to other components of the pay package.

- Does the annual incentive plan have unlimited payout potential?
  - The annual incentive plan should limit total payouts and the range of payouts should be set at a reasonable level, as determined by the Compensation Committee, to avoid encouraging decisions that maximize short-term earnings opportunities (swinging for the fences) at the expense of long-term viability.
- Do the annual incentive plan criteria and administration mitigate excessive risk?
  - It may be advisable to provide the Compensation Committee discretion in the incentive plan to adjust above-target payouts downward in the face of excessively risky behavior and discuss why this discretion was exercised in the proxy statement.

3. When compared to a carefully chosen peer group, is the relationship between performance and incentive plan payouts within the range of competitive practices?

- The range of performance, and corresponding payouts, should be within a realistic range of results as compared to the performance of the company's peer group.

4. Is there a relationship between performance criteria and payouts under the annual incentive award consistent with targeted performance under the long-term incentive awards?

- While the annual and long-term incentive plans play different roles in the compensation plan, it is important that annual and long-term incentive plan objectives, metrics and targets are aligned to ensure that both types of awards encourage consistent behaviors and sustainable performance results.

5. Do the long-term incentive performance measures or equity devices potentially encourage excessively risky behavior?

- Do the long-term incentive performance measures require excessively risky behavior to realize target or above target payouts? (e.g., do the targets require performance at so high a level that executives would take improper risks to achieve them?)
- Do the performance criteria and vesting periods of long-term incentive awards overlap and thereby reduce the incentive to maximize performance in any one period?
  - With overlapping awards, an attempt to increase short-term performance may jeopardize company performance in future years and thus payouts under other outstanding awards.
- Does the mix of long-term incentive awards meet the Committee's pay for performance objectives?
  - The Compensation Committee should determine the specific mix of long-term incentive awards that serve the best interests of the shareholders and the company, and may include:
    - performance-vested performance shares or units (which reward the attainment of key financial objectives)
    - time-vested or performance-vested restricted stock or restricted stock units (which may aid in the retention of key talent)
    - stock options or stock appreciation rights (which provide value only if share price appreciates thereby producing direct gains to shareholders).

6. Is there a requirement that a meaningful portion of the shares received from incentive award payouts be retained by the participants?

- Require meaningful stock ownership requirements to link executives' interests to shareholders' interests
- In the Compensation Committee's discretion, require executives to hold a percentage of net equity received as a continuing link between shareholder and management interests.
- The level of share ownership should build over the executive's career
  - As the executive approaches a targeted retirement date the compensation committee may determine it advisable to approve a phased-diversification plan.
  - If the Compensation Committee determines appropriate, ownership may be also be required for some period after retirement
    - consistent with Internal Revenue Code Section 409A, which requires "key executives" to delay payout of deferred compensation for six months' after departure.
  - Holding requirements should not be so great as to potentially encourage overly conservative management decisions that would harm shareholder value.

7. Has the Board of Directors adopted a recoupment policy which provides for the clawback of incentive payouts that are based on performance results that are subsequently revised or restated and would have produced lower payouts from incentive plans?

- Adopt a strong clawback provision to provide for recoupment in the event of a material restatement.
- The Compensation Committee, in its discretion, should determine when the need for a clawback is triggered, to whom the clawback should apply and the mechanism for recouping incentive payments.

8. Does the Committee discuss the concept of risk when establishing incentive performance criteria and approving incentive payouts? Are such discussions recorded in the minutes of a Committee meeting? Does the Compensation Discussion and Analysis articulate how the company's incentive plans mitigate risk?

- In addition to competitiveness and the linkage of pay and business strategy, the relationship between business risk and incentive compensation should be a key consideration in setting performance criteria, the corresponding mix of awards and the range of incentive plan opportunities.

- The Compensation Committee should meet with the company's principal financial officer and/or corporate risk officer prior to approving financial incentive criteria and meet with him/her periodically to facilitate a complete understanding of how the company's financial performance interacts with its strategy and compensation programs.

- Company proxy disclosures should briefly explain how incentive designs mitigate risk to help demonstrate how risk is considered and addressed by the Committee in approving incentive plans.

Center On Executive Compensation

Pay for Performance at a Glance: A Simpler, Clearer Model for Explaining CEO Compensation in Proxy Statements

Companies Urged to Adopt Two Tables Providing Snapshot of the Link Between Actual Pay and Actual Performance at the Front of the CD&A

Companies, shareholders, investors and activists all generally agree that executive pay should be linked to performance and that this link should be clearly disclosed. Yet, the U.S. Securities and Exchange Commission's disclosure rules, particularly the total compensation number in the Summary Compensation Table, do not foster a clear understanding of this link. The total number in the Summary Compensation Table mixes current actual compensation with future potential compensation, confusing whether a company has paid for performance and the criteria to earn compensation under long-term incentive grants.

Because the pay for performance link is expected to receive increasing attention from regulators, institutional investors, proxy advisory services and the media, without a clear, logical approach for explaining the linkage, stakeholders are likely to draw the wrong conclusions. Rather than wait for the SEC or investor activists to drive changes in disclosure practices, the Center On Executive Compensation is urging its Subscribers and other forward thinking companies to adopt its "pay for performance at a glance" approach at the front of their Compensation Discussion and Analyses (CD&As). By adopting a standardized approach to disclosing the pay-for-performance relationship, companies, acting in concert, can establish the de facto standard for the disclosure of executive pay and rectify many of the incorrect and misleading assertions by pay critics and the media.

The Center's model would provide for two tables at the front of the CD&A, following a short executive summary:

- The first table would disclose actual pay earned in the reporting year and the corresponding performance that earned it;
- The second table would disclose the estimated potential future pay from long-term incentives, compared with the performance required to earn the estimates.

Under both tables, the explanation of performance would also include a brief description of why the incentive plans and levels are best suited to the company and its overall business strategy, without divulging confidential information.

The Rationale for Clearer Pay for Performance Disclosure in the Proxy

Changes in disclosure regulations and best practice are accelerating the push for better, simpler and shorter pay for performance disclosure. The SEC's current

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executive compensation disclosure rules require companies to disclose what their pay plans provide and why they were adopted. However, triennial proxy statement reviews by the SEC staff mandated by Sarbanes-Oxley routinely result in comments seeking greater explanation of the rationale behind a company's pay programs. Even then, compensation disclosures in large company proxies routinely exceed 25 pages, with many topping 35 pages. The sheer length of these documents requires a compelling executive summary at the front of the CD&A to clearly and succinctly communicate a company's pay philosophy and approach.

Recent pay developments are reinforcing the need for clearer and understandable explanations of why companies have adopted pay programs. Increasingly, disclosure regarding how the potential for excessive risk in incentives in the CD&A is mitigated is becoming a best practice. Moreover, the threat of a mandated annual nonbinding shareholder vote on pay ("say on pay"), which is typically premised on pay for performance, makes a compelling synthesis of what a company paid and why essential.

Companies With Clearer Disclosure Have an Advantage. As various pressures mount for clearer disclosure, companies that can tell their pay for performance stories succinctly will have an advantage in the marketplace with regulators, institutional investors, proxy advisory services and activists. These interests are less likely to "red flag" a company simply because they do not understand the pay program. Clearer disclosure is also likely to encourage better engagement by those institutional investors who seek to discuss pay issues with the company. Not only is improved disclosure likely to lead to better compliance, it may streamline interaction with stakeholders.

The Current Summary Compensation Table Mixes Actual and Future Potential Pay

The purpose behind the Pay for Performance at a Glance Approach is that the Summary Compensation Table does not give an accurate picture of pay and performance, leading interested parties to potentially wrong conclusions. As noted above, the total number in the Summary Compensation Table:

- Mixes current actual pay (salary, bonus, and payouts of annual and long-term cash incentive program awards) with future potential pay (grants of restricted stock/RSUs, options, and long-term incentive plan payments), which currently represent a pro-rata portion of the financial accounting estimate of the future pay.
- Combines the payouts of short- and long-term cash incentive awards in one column, requiring stakeholders to calculate the respective amounts from other disclosures in the current and prior years' proxy statements in order to match the pay with the appropriate time frame for performance.

The Summary Compensation Table

Name/Position (1)	**Fiscal Year** (2)	**Salary** (3)	**Bonus** (4)	**Stock Awards** (5)	**Option Awards** (6)	**Non-Equity Incentive Plan** (7)	**Chg in Pension Value** (8)	**All Other Comp** (9)	**Total** (10)
		Actual	Actual	Potential	Potent'l	Actual	N/A	Actual	Mix
		Pay	Pay	Pay	Pay	Pay		Pay	

Because of this mix of reporting to come up with a total compensation number, the table:

- Distorts the relationship between actual pay and actual results by comparing a mix of past and future potential pay to past results (absent substantial calculations) and
- Confuses the relationship between potential future pay and the performance that would be required to earn the estimated pay.

Without a different message to counter the inaccurate conclusions that could result by using the numbers in the Summary Compensation Table, stakeholders will continue to rely on the total compensation number.

The changes proposed by the SEC to the disclosure of equity on the Summary Compensation Table, while a welcome development, do not address the mix of current and future pay in the table. Instead, they remove anomalies associated with the accounting approach, and provide a more consistent estimate of future payments. While the SEC may address this issue at some point in the future, it is not expected to do so in the near term. For this reason, companies are encouraged to adopt the following disclosures in the CD&A.

The "Pay for Performance at a Glance" Model

The Center On Executive Compensation believes that in the near term clearer disclosure of the pay for performance link will become a best practice, and it could become a regulatory requirement, if say on pay becomes law. For these reasons, the Center is urging its Subscribers and all proactive companies to incorporate the two following tables at the beginning of their CD&As as part of a brief executive summary of the pay program. Each table would disclose the pay for the CEO only, because the CEO's pay typically receives the greatest amount of attention, and typically sets the tone, if not the framework of pay for the other named executive officers.

Table 1: Actual Pay in the Reporting Year Compared to Performance. The first table would report the actual pay received by the CEO in the reporting year, including

- salary;
- annual incentives;
- payouts of long-term equity (restricted stock, RSUs, stock options, etc.) or cash incentive plans;
- total compensation received in the reporting year;

Each of the rows of the table would describe the location of these elements in the Summary Compensation Table, and the columns would provide the total amount, annualized amount (if a long-term award), and a description of what was awarded and why. The purpose of the "annualized amount" column is to facilitate comparability of total pay for CEOs between different companies, given that long-term incentive periods and stock option exercise periods and restricted stock vesting periods may differ among companies. Because these amounts are typically earned over several years, the annualized amount may more accurately represent what is earned in the reporting year.

Salary Disclosure. The salary disclosure element would describe how the company sets the salary level in reference to the company's peers (e.g., at the 50th percentile). It would also disclose whether there was a change from the prior year, why the change was made and the total salary.

Annual Incentive Disclosure. The annual incentive disclosure would reiterate the performance measures on which the annual incentive was based. It should disclose performance actually achieved as a percentage of targeted performance. Where practicable, companies should also disclose information about the executive's level of performance. Such disclosure should not be made if disclosing performance targets would be competitively harmful.

Long-Term Incentive Payout Disclosure. The long-term incentive disclosure would provide the earnings from long-term incentive plan payouts that the executive received in the reporting year and the annualized gain. The disclosure would provide the total payout, the incentive measures on which performance payouts received in the prior year were based, and the time period over which the incentives were earned. The table would also discuss the performance actually achieved in relation to targeted performance. The value of performance share payouts would also be reported here.

Stock Option Exercises. As with long-term incentive payouts, the table would report the amount of compensation realized for the reporting year from stock option exercises. The narrative in the table would report the total gains upon the exercise of stock options, the stock price appreciation which generated the gains, and the period over which the options were outstanding. The annualized amount would be reported in a separate column, as explained above.

Restricted Stock Vesting. Similarly, the value of the amount realized through the vesting of restricted stock would be reported, and an annualized amount would be listed in a separate column because the total amount was earned over multiple years, not just the year in question. The narrative in the table would disclose the appreciation in stock price over the period as well as the vesting period.

Other Compensation. To provide completeness of disclosure, perquisites and other non-performance-based compensation would be disclosed in the Summary Compensation Table, but would not be included in the discussion of performance-based compensation.

Total Actual Compensation Earned in the Prior Year. The amounts from the individual elements of actual pay would be totaled, thereby providing a snapshot of the actual pay earned during the prior year, the performance generating such pay, and the time period over which pay was earned. An annualized total would also be provided so that the amount actually earned in the current year is disclosed.

Table 2: Potential Future Incentive Pay Compared to Future Performance. The second part of the Center's proposal is aimed at clearer disclosure of long-term incentives granted in the reporting year. Since such awards are contingent upon future service and performance, the Center believes that they should not be combined with current actual pay, as is currently done in the Summary Compensation Table. Instead, the FAS 123R estimates of the equity granted in the current year should be disclosed,

along with performance required to achieve those estimates, in a separate table. This allows shareholders to evaluate whether long-term incentive grants are reasonable in light of the performance required to achieve them without mixing actual pay with estimated future potential pay. There are four elements to this disclosure:

- An explanation of the meaning of the values in the Summary Compensation Table.
- A performance award disclosure.
- A stock and stock options disclosure
- The total estimate of the future value of performance-based awards.

Each of these is discussed below.

Describe What the Summary Compensation Table Values Mean. The first element of the disclosure is a short narrative that explains that the values in the stock and options tables are accounting expense estimates related to the years over which the awards vest. This description would carefully explain that the numbers in the table do not reflect actual earnings, but are estimates of potential future earnings if performance is achieved. It should state that actual earnings will be determined only when the awards vest, if at all.

Performance Awards Disclosure. A second disclosure under future pay and performance addresses performance awards, such as performance shares, performance share units, and performance-vested restricted stock and restricted stock units. For these types of awards, the company would list the performance that would need to be achieved under each form of award to reach the estimated payout for each year in which an award is outstanding in the Summary Compensation Table.

Descriptions of the performance would vary by company because of differences in the equity devices used. For example, in describing performance based on relative total shareholder return, the company would describe how the performance relates to the company's peer group, such as at, above or below the median of the peers. As with the annual incentive disclosure, specific financial targets should only be disclosed if they are already disclosed elsewhere or if such disclosure would not result in competitive harm.

Stock Options Disclosure. Companies would provide a similar disclosure for stock options. The disclosure would list the grant date of the options, and the grant date stock price. For each tranche, the company would report the required increase in stock price over the grant date price that would produce the estimate shown as an expense for the award in column 6 of the Summary Compensation Table. To give a good estimate of performance, the company should also list the total increase in shareholder value of the potential stock price increase if performance is achieved. For example, if the Black-Scholes value is 40 percent of the stock option award, the stock would have to appreciate by 40 percent over the vesting period to make this a true reflection of future pay.

Total Financial Accounting Estimate of Awards. The disclosure would include the total estimate of each type of long-term incentive award. Performance-based award estimates would be valued at target performance and for stock options and restricted stock the grant date fair value accounting estimate would be disclosed.

This approach makes it clear that the equity-based incentives are an estimate rather than actual pay. However, the approach also gives shareholders a clearer view of the level of performance required to receive the compensation and thereby makes explicit the pay for performance linkage of equity-based incentives.

Benefits of the "Pay for Performance at a Glance" Approach

The "Pay for Performance at a Glance" concept provides several benefits that companies and their compensation committees should consider as they start planning for the 2010 proxy season. The tables provide a template for helping companies explain how current and future pay and performance actually relate, and thus helping companies to tell their pay for performance stories. Thus, the approach helps reinforce compliance with the SEC's disclosure rules. In addition, the explanations provided can help reframe the debate away from the total number in the Summary Compensation Table.

The approach is likely to be helpful in demonstrating proactive compensation practices on the issues of risk mitigation. For example, an explanation of risk mitigating design features of incentives could be included in the description of the performance that generated pay, such as having caps on incentives. A company could also reference the share of total compensation comprised of long-term incentives rather than annual pay or discuss how stock ownership guidelines or retention requirements apply to vested restricted stock or stock options exercises.

By disclosing the pay for performance link and separating actual from future potential pay, the model is likely to streamline engagement with major institutional investors as well as activist investors. Pay numbers are coupled with clear explanations of the performance that generated them, which may be particularly helpful in years in which long-term incentives pay out due to strong early-year performance, even though the current year's performance is lower. In addition, the approach may allow companies to shorten their CD&As by placing the explanation of the CEO's pay package in a table, rather than a narrative.

Companies Urged to Adopt Pay for Actual Performance in Their 2010 Proxies

It is likely that with many pay changes still in the works, including the potential of mandated say on pay for all companies, that the SEC will ultimately require clearer disclosure of how pay and performance are connected. The Center believes that its approach is one that the SEC would consider using if it becomes the de facto standard -- that is, it is viewed as having credibility among companies and investors.

To build this credibility and support, the Center is encouraging its Subscribers and all members of the HR Policy Association to incorporate the disclosure in their 2010 proxies. The SEC's Division of Corporation Finance has encouraged companies to use supplemental tables in the CD&A to explain their pay arrangements, and the Center's approach is consistent with SEC rules. At a minimum, we urge you to prepare the

disclosure and show it to your compensation committee and judge whether it provides them with a more complete understanding of your pay programs. The Center will continue to advocate for the approach with the SEC, other policymakers and to the public at large.

Conclusion

The increased focus on executive compensation will lead to more intense scrutiny of the relationship between pay and performance. By adopting these relatively simple approaches to disclosure, companies can make that connection clearer for shareholders, while providing a useful contrast between the information in the Summary Compensation Table and what executives actually earned.

Sample First Paragraph of a CD&A Executive Summary Using the Pay for Performance at a Glance Approach

Executive Summary

The company has a pay-for-performance philosophy that seeks to link the interests of the named executive officers with those of the shareholders and that guides the Committee's decisions regarding executive compensation. Despite an unfavorable economic environment in the second half of the year, in 2008, the company still generated positive earnings and posted an increase in cash flow. Long-term results were also positive and on par with peer companies.

To assist shareholders in assessing the extent of the pay for performance link, the company has provided two supplemental tables, one that shows how actual pay compares with actual performance and another that shows the future performance required to realize gains from the long-term incentives awarded. These tables differ from the Summary Compensation Table (page X) in that the Summary Compensation Table is a mixture of actual pay realized in 2008 and the accounting expense for long-term incentives that are contingent upon future performance. The Summary Compensation Table also includes elements considered compensation under SEC rules which are not directly related to performance, specifically items included in "All Other Compensation" and the actuarial increases in pension value and nonqualified deferred compensation earnings. The tables are not intended as a replacement for the Summary Compensation Table, and while no approach to explaining the link between compensation programs and performance is perfect, the company believes the following tables provide greater clarity into the relationship.

Table 1 provides information as to the actual levels of compensation realized during 2008 by Mr./Ms. (Name), the company's Chief Executive Officer, and a description of the performance results that generated the realized compensation. In the case of long-term incentive payouts, gains on stock options exercised and restricted shares that vested during the year, these awards were earned over multiple years but were realized in 2008. For this reason, Table 1 provides both the total compensation realized and the annualized amount of compensation ratably attributable to 2008 and the other years between the grant date and 2008. Because the ratable amount is not known until the year in which the award is realized, and this is the first year the company has used this format, the ratable portion for years before 2008 is not reflected in previous years' compensation. Going forward, the company intends to use the actual pay framework annually, which should enhance the comparability of realized pay year-to-year.

Table 2 shows long-term incentive awards granted in 2008 that must be earned over future years and describes the performance requirements that must be satisfied to realize value from these awards. If the future performance objectives are not achieved, if service requirements are not satisfied or if the value of the company's stock does not appreciate, the awards will not result in compensation to the executive. Table 2 allows shareholders to assess the structure of future incentives in support of sustained future contributions to creating shareholder value.

Table 1: Comparison of Actual Pay Received in 2008 to Actual Performance*

Form of Compensation	Period Covered	Total Received ($)	Annualized Amount ($)	Performance Results Over Performance Period That Produced the Compensation
Salary	2008	$1,000,000	$1,000,000	The company generally targets salary for all executives at the 50th percentile of peer group companies. Based on this analysis, no adjustment was necessary for 2008.
Annual Incentive	2008	$1,800,000	$1,800,000	The annual incentive paid to NEOs is based on EBITDA, which measures economic profit and is a good measure of short-term performance; free cash flow from continuing operations, which reflects the company's ability to generate cash; and other corporate objectives, which are not disclosed due to competitiveness concerns. 2008 EBITDA increased by 11.4% over the prior year and exceeded the targeted level of performance. Free cash flow from continuing operations increased by 7% over 2007, totaling $3.3 billion and exceeded target. The Compensation Committee determined that accomplishment of other targeted corporate objectives fell short of expectations and thus resulted in no payout.
Long-Term Incentive Payout	2006-2008	$6,450,000	$2,150,000	The Long Term Incentive award was earned over the three-year performance period, 2006-2008, and produced a total payout of $6,450,000, or $2,150,000 per year. Performance criteria for this award were: (1) EPS growth, weighted 50%, which exceeded the targeted level; EPS reflects the company's profit per share and is a measure of the after-tax returns generated by the company. (2) Opening new markets in key strategic regions, weighted 25%, which was not achieved at the targeted level, and (3) Total return to shareholders compared against peer group companies, weighted 25%, for which the company ranked 7th out of 15 peer companies, producing a payout at target. Overall the payout represented 105% of target.
Equity Compensation				The gains upon exercise of stock options in 2008 were $8 million, based upon stock price appreciation between 2000 and 2008. During that time, the stock price appreciated from $15 to $35 per share, reflecting the company's strong growth and profitability. Because the $8 million was earned over the 8 years the award was outstanding, the annualized gain (i.e., the gain spread equally over the period the options were held), is $1 million for each year the options were outstanding, reflecting the amounts earned over the performance period.
Stock Option Exercises	2000-2008	$8,000,000	$1,000,000	
Restricted Stock Vesting	2006-08	$4,500,000	$1,500,000	Similarly, the value of the restricted stock that vested in 2008 was $4.5 million, and was earned over the three-year period from 2006 and 2008. Because the total gain was earned based on stock over the three-year vesting period, the annualized gain (i.e., the gain spread equally over 2006, 2007 and 2008) is $1.5 million per year. The company uses restricted stock to retain our top talent and to further align their interests with those of shareholders.
Total Actual Compensation Earned in 2008	2000-2008	$21,750,000**	$7,450,000**	See explanations under the Salary, Annual Incentive and Long-term Incentive boxes above. For amounts earned over more than one year, the annualized amount represents the pro-rata portion attributable to 2008. It includes the annualized gain for LTIP payout, stock option exercises and restricted stock, as well as total annual salary and annual incentive.

Note: This Table differs substantially from the Summary Compensation Table required by the U.S. Securities and Exchange Commission and is not meant a substitute for that table.

* Sample disclosure for illustrative purposes only.

** Total Actual Compensation does not include the value of perquisites, as they are not related to performance. Total perquisites for the year were $450,000.

Table 2: Comparison of Future Potential Pay to Estimated Future Performance*

The numbers in the stock awards and option awards columns of the Summary Compensation Table do not reflect what the named executive officers actually earned in 2008. Instead, the numbers are estimates of the accounting expense recognized for those awards in the current year. In contrast, the values presented below are based on the estimates of the company's total accounting expense if performance is achieved, as listed in the Grants of Plan-Based Awards Table. At the vesting date, the compensation earned by the executive may be nothing or it may be greater than the estimates in the Proxy Statement, based on the executive's and the company's performance, and the value of the equity.

The Table that follows explains the performance that is required to be achieved to earn the estimated values of stock awards and option awards granted in 2008 and listed in the 2008 Grants of Plan-Based Awards Table.

Year of Award	Type of Long-Term Incentive Award	Performance Period/Vesting Period	Performance Criteria	Financial Accounting Expense Estimate	Description of Linkage Between Performance Criteria/Objectives and the Creation of Shareholder Value
2008	Performance Shares	2008-2010	• 50% Earnings Per Share Growth	• Total estimated pay from EPS at target** = $XX	EPS is a key measure of the profitability and after-tax returns generated by the company. The target EPS level is set by the compensation committee applying its judgment based on factors including market competitiveness and its expectations for company performance.
			• 50% Company's Total Shareholder Return compared to the median TSR of peer group companies	• Total estimated pay from TSR** = $XX	Total Shareholder Return demonstrates our ability to create value compared with our peer group competitors.
2008	Restricted Stock	2008-2010	• Value of the shares, which vest after three years	• Total grant date fair value = $XX	The company uses restricted stock to retain its NEOs, all of whom started their positions with the company within the last four years, and to further align their interests with those of shareholders.
2008	Stock Options	2008-2010	• Share price appreciation	• Total grant date fair value = $XX	Stock options align the interests of management with shareholders through share price appreciation. Under company policy, executives are also required to retain 50% of the shares remaining upon exercise of a stock option after paying taxes and exercise costs, further continuing the alignment. To realize compensation equal to the accounting expense shown in the Summary Compensation Table for this award, the price of our company's shares would need to appreciate by 33% over the grant date stock prices of $9.44 during the vesting period. All shares vest after four years.

Note: This Table differs substantially from the Summary Compensation Table required by the U.S. Securities and Exchange Commission and is not meant a substitute for that table.

* Sample disclosure for illustrative purposes only. Each company's disclosure would have to be customized to its incentive plans.

** The Center believes the SEC Division of Corporation Finance staff's recent interpretation requiring performance-based awards to be shown on the Grants of Plan-based awards at maximum rather than at target would create unnecessary confusion and inconsistencies with other reporting. For this reason, the Center has reported performance-based awards at target levels

Agenda

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Center on Exec Comp Proposes Tables to Avert Confusion

Article published on June 14, 2010
By Katie Wagner

Leaders at the **Center on Executive Compensation** have created disclosure tools[1] they think will enable companies to more clearly tell their pay-for-performance stories to shareholders.

Specifically, the center is recommending that companies include one or two additional compensation tables in the executive compensation section of their proxy statements to supplement their summary compensation tables. One table would show pay realized during the year covered by the proxy statement. The second table would describe the accounting estimate for LTI grants made the previous year along with a description of the performance that must be achieved to earn that pay.

"Right now, in the summary compensation table you get a mix of actual pay and accounting expenses, which is not actual pay," says **Charles Tharp**, executive VP for policy at the center, which is an offshoot of the HR Policy Association. "We think today shareholders confuse the numbers that are used in the table with the actual amount of pay received by an executive in a given year."

Recently, the SEC returned to requiring companies to base the value of equity-based compensation reported in the summary compensation table on the aggregate grant date fair value of equity granted during the previous year.

"We want to make sure that there is a very transparent and data-based discussion of pay for performance in the proxy statement," Tharp says. "The other thing we are hoping for is that there be a standardized approach for looking at pay for performance... [W]e want companies... to

Eaton's New Compensation Table

Alexander Cutler – Chairman and Chief Executive Officer

Comparison of Realized Compensation to Performance
Element of Compensation: Long-Term Cash Incentive
Period Earned: 2006 - 2009
Target: $1,800,000
Amount Received: $575,000
Performance Results Over the Period Earned: In 2006, Earnings Per Share and Cash Flow Return On Gross Capital objectives for the 2006 - 2009 Executive Strategic Incentive Plan grant were established. Actual results delivered a payout at 25% of target which was then multiplied by Mr. Cutler's individual performance rating to determine his final reward.

Source: Page 19 of Eaton's 2010 proxy statement; Note: This is a portion of information from Eaton's version of one of the tables recommended by the Center on Executive Compensation.

show what [their] CEO actually earned, not what was granted to the CEO, and to describe the performance that produced that payout."

This picture of the total value of pay that a CEO took home in a given year in one place could make it easier for the public to understand and compare actual changes in the executive's compensation from year to year.

Some companies, such as **Eaton**, have already included in their proxy statements at least a version of one of the tables proposed by the center.

This table, according to the center, should include the value of each kind of actual pay received by the CEO in the reporting year and a narrative that describes the performance that earned each type of pay. Eaton's table[2] includes the values and descriptions of the performance that resulted in payouts of base salary, annual and long-term incentive compensation, exercised stock options and vested restricted shares.

In reporting stock options, according to the center's guidance, the table should include the combined value of the gains on all options exercised during the reporting year and a narrative that explains how much each of the exercised options appreciated during the years that they were held.

The other table is similar to the CEO's section of the grants of plan-based awards table in that it includes the accounting estimates of long-term incentives granted in the reporting year to the CEO. What differentiates it from the grants of plan-based awards table is that it also provides descriptions of the performance that must be achieved in order for the CEO to actually receive payments equal to the values of the accounting estimates, explains **Timothy Bartl**, the center's senior VP and general counsel.

Links

1. http://www.execcomp.org/docs/c09-64%20Pay4Performance%20at%20a%20Glance%20Pay%20for%20Performance%20Comp%20Committee%20Explanation%2011-1%20rev2%20clean%20_2_.pdf