



Christina Crooks

Director, Tax Policy

September 14, 2015

Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090
VIA Internet Comment Form (<http://www.sec.gov/rules/proposed.shtml>)
Attention: Mr. Brent J. Fields, Secretary

RE: File Number S7-12-15

Dear Mr. Fields:

The National Association of Manufacturers (NAM) – the largest manufacturing association in the United States, representing small and large manufacturers in every industrial sector and in all 50 states – appreciates the opportunity to provide comments to the Securities and Exchange Commission (SEC) on the proposed rule implementing the provisions of Section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act). The proposed rule directs the national securities exchanges and national securities associations to establish listing standards to require issuers to develop, implement and disclose policies for recovering erroneously awarded compensation in excess of what would have been received under an accounting restatement. Thousands of manufacturers are public companies that would be subject to this new “clawback” requirement.

Overview

During Congressional consideration of the Dodd-Frank Act, the NAM urged lawmakers to focus their efforts on strengthening the U.S. financial system and avoiding new regulations that could be costly and hinder job creation for manufacturers and other non-financial companies that had nothing to do with the financial crisis. The NAM continues to have strong concerns about costly rules and regulations implementing Dodd-Frank, including the SEC’s final rule on the “pay ratio” requirement and the proposed “pay versus performance” requirement, both of which create significant costs for manufacturers. Similarly, the newly proposed clawback regulation would add an additional burden to manufacturers without providing any significant benefit to shareholders or companies.

Overly Broad Application of the Clawback

Under the SEC proposed rule to implement provisions of Section 954 of the Dodd-Frank Act, issuers will be required to develop, disclose and implement policies to recover the incentive-based compensation of current and former executive officers in excess of what would have been received under an accounting restatement. The NAM understands that Section 954 of the Dodd-Frank Act is intended to ensure that executive officers do not retain incentive-based pay received

in error, but manufacturers are concerned that the application of the clawback requirement under the proposed rule is overly broad, sweeping in executives who may have little to do with the issuer's financial reporting and thus not at fault for a financial misstatement.

The statute did not specify how executive officers should be defined for the clawback provision. As the SEC states in the release, "Section 10D does not define 'executive officer' for the purpose of the recovery policy."¹ Yet, the SEC's proposed rule sets forth an overly broad approach to defining executive officers who would be subject to the clawback requirement, including top executives such as the principal financial and accounting officer and also "any other officer who performs a policy-making function" for the company.² According to the proposal, the SEC believes the "policy was intended to apply, at a minimum, to all executive officers of the issuer..."³ despite the fact that companies may have many executives whose role is not tied to the financial reporting process. This application exceeds current recovery policies, including the Sarbanes Oxley Act of 2002, which requires only the chief executive officer and chief financial officer of the issuer to reimburse the company for incentive-based pay if there is an accounting restatement as a result of misconduct.

The NAM disagrees with the SEC's broad interpretation of the clawback requirement since many of the executives swept into the new definition do not have direct insight into the financials that are subject to restatement. Therefore, the proposed requirement would subject employees to a clawback of their incentive-based pay despite having no association with the financial reporting error that resulted in a restatement. While the statutory recovery requirement does not stipulate that a clawback should apply regardless of fault, the proposed rule applies the clawback regardless of whether an executive was liable for the error.

Such a far-reaching application will have negative consequences on manufacturers. As more executives are faced with the risk of having to return incentive-based pay, executives will begin demanding higher total compensation or increased amounts of salary-based pay. In addition, an issuer's internal financial reporting process, which can already be very complex, may become bogged down as more executives, who currently have a very limited role in the process, will want more oversight of the financials since they will face the consequences of clawback resulting from a material accounting error. These officers will be diverting their time and efforts to understand and verify financials when their resources may best be used elsewhere, including engaging in efforts to help the company grow.

Ambiguity in Clawback Trigger

Under the clawback requirement, issuers must have policies in place to recover executive's incentive-based pay in the event of an accounting restatement resulting from "material noncompliance of the issuer with any financial reporting requirement under the securities laws."⁴ The SEC proposal does not define material noncompliance or describe the type of error that would be material and subject to a clawback since materiality is based on facts and circumstances. Instead, the proposal takes the approach of listing some cases where an error does not occur. Manufacturers are concerned that this ambiguity in what constitutes a material error will result in

¹ Listing Standards for Recovery of Erroneously Awarded Compensation, Securities and Exchange Commission, RIN 3235-AK99, Federal Register/Vol. 80, No. 134, July 14, 2015, p. 41152

² Vol. 80, No. 134, p. 41153

³ Vol. 80, No. 134, p. 41153

⁴ The Dodd-Frank Act, Public Law No. 111-203, Section 954

great variation among companies in which restatements should trigger a clawback. The NAM is concerned the ambiguity may cause manufacturers to adopt a more conservative recovery policy and engage in more clawbacks than necessary, creating a greater compliance burden.

Difficulty in Calculating the Recoverable Amount

As defined by the SEC proposal, incentive-based compensation subject to recovery includes compensation that is based “wholly or in part upon the attainment of any financial reporting measure,” and these measures would include “stock price and total shareholder return” in addition to accounting measures.⁵ The SEC’s inclusion of stock price and total shareholder return (TSR) in measuring the compensation that must be recovered adds to the burden of the clawback requirement since it is difficult to ascertain how much these elements were actually influenced by the financial error that caused the restatement.

The SEC acknowledges that “...issuers may need to engage in complex analyses that require significant technical expertise and specialized knowledge, and may involve substantial exercise of judgment in order to determine the stock price impact of a material restatement.”⁶ Since stock price and TSR can be impacted by many factors beyond financial statements, such as announced mergers and acquisitions activities or economic factors, it is next to impossible to accurately account for what the stock price and return would have been had it not been for the restatement. Still, manufacturers will be required to come up with a reasonable calculation for the price the stock would have been if the financial statement originally reflected the what was shown in the restatement, also known as the “but for” price. Manufacturers will need to know the “but for” price before they can calculate the compensation amount that must be recovered from current and former executives after a material accounting error. Public companies may need to divert internal accounting resources to conducting these complex calculations, or may hire new staff or even retain experts to do so, adding to the cost and burden of the requirement. Thus, the NAM agrees with the SEC that “the cost of recovering incentive-based compensation may be higher” in cases where stock price and TSR are included in the type of compensation that is recoverable.⁷

Tax Implications

The NAM would appreciate clarification on the tax implications of carrying out a recovery of an executive’s incentive-based compensation. Since current and former executives are subject to the clawback on a pre-tax basis -- meaning the amount to be recovered is calculated without regard to the taxes paid by the executive -- it seems likely that executives would have faced a tax penalty at the time the original incentive-based pay was awarded, without a corresponding reimbursement or refund when the taxable amount is actually less as a result of the claw back.

Unintended Impacts

The proposal also may have an unintended impact on the strategic decisions of manufacturing companies and the composition of executive compensation packages. The clawback risk may deter executives from undertaking or approving business strategies with more complex accounting methods, since the complexity may add to the likelihood of a reporting error and corresponding clawback of their compensation. As noted by the SEC, having a policy in place

⁵ Vol. 80, No. 134, p. 41155

⁶ Vol. 80, No. 134, p. 41155

⁷ Vol. 80, No. 134, p. 41177

to recover executive compensation received as a result of a financial reporting error may “...encourage executives to forgo value-enhancing projects if doing so would decrease the likelihood of a financial restatement.”⁸ In other words, public companies may hold back on the types of endeavors that would help grow the business and add long-term value for shareholders as a result of the clawback requirement.

Another unintended consequence of the proposal is the impact on the design of executive compensation packages. In order to grow a strong and competitive manufacturing economy, manufacturers need to find and attract world-class talent at all levels. The NAM has long supported flexibility in the design of executive compensation benefit packages to ensure manufacturers can recruit and retain leaders that will grow the business, create more jobs and contribute to our overall economic growth. That flexibility enables manufacturers to stay competitive. Unfortunately, the proposed rule may limit the ability of public companies to find and retain top talent since an executive’s incentive-based pay would always be at risk of loss through a clawback.

To avoid this uncertainty, executives may begin to demand higher total compensation, or higher salary-based pay and less performance-based compensation. For employers, this new demand would add significantly to the cost of the implementing the clawback proposal. For shareholders, the shift in executive compensation packages would also have a negative impact because of a lower correlation between executive pay and company performance. As the SEC acknowledges, “the incentive to shift compensation away from forms that are subject to a recovery policy may affect the level of incentive alignment between executive interests and shareholder interests in terms of the enhancement of firm value...”⁹ Less emphasis on performance and value may hinder the company’s growth, hurting the company, its shareholders, employees and the broader economy.

Conclusion

The NAM opposes the clawback requirement and appreciates the opportunity to raise concerns with the proposed rule, which would impose compliance and cost burdens on manufacturers.

Manufacturing supports an estimated 17.6 million jobs in the United States – about one in six private-sector jobs – and more than 12 million Americans (or 9 percent of the workforce) are employed directly in manufacturing.¹⁰ Manufacturers strive to compete in a global world and are committed to ensuring that their workforces are highly trained and well compensated. In fact, in 2013, the average manufacturing worker in the United States earned \$77,506 annually, including pay and benefits. Whereas the average worker in all industries earned \$62,546.¹¹ Manufacturers are proud of their commitment to their workforces and want to dedicate resources to competing, growing and investing in their companies, their products and their employees and are concerned about regulatory burdens that will distract them from this mission.

⁸ Vol. 80, No. 134, p. 41175

⁹ Vol. 80, No. 134, p. 41179

¹⁰ Bureau of Labor Statistics (2014), with estimate of total employment supported by manufacturing calculated by NAM using data from the Bureau of Economic Analysis (2013, 2014).

¹¹ Bureau of Economic Analysis, National Economic Accounts by Industry (2013).

In contrast, the cost of complying with this rule would divert company resources from needed investment and job creation without providing any significant benefit to shareholders, companies or the broader economy. On behalf of the NAM and the 12 million men and women that work in manufacturing, thank you for your attention to these concerns.

Sincerely,

A handwritten signature in black ink that reads "Christina Crooks". The signature is written in a cursive, flowing style.

Christina Crooks
Director, Tax Policy