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September 14, 2015

VIA ELECTRONIC DELIVERY

Brent Fields, Secretary
U.S. Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

Re: Listing Standards for Recovery of Erroneously Awarded Compensation (File No. S7-12-15)

Dear Mr. Fields:

We write in response to the request of the Securities and Exchange Commission (the "Commission") for comments on its proposal implementing Section 954 of the Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd–Frank Act") pursuant to File No. S7-12-15.[1] The Commission's proposed rule (the "Proposed Rule") would require national securities exchanges and associations to set standards requiring public companies to establish and disclose policies providing for the recovery of certain incentive-based compensation received by their current and former executives if the companies must correct their financial statements due to noncompliance with financial reporting requirements. Our comments focus on the Proposed Rule's potential application to tax-qualified retirement plans and certain supplemental executive retirement plans. These comments respond to Question 35 in the preamble to the Proposed Rule, in which the Commission asks about the scope of the definition of "incentive-based compensation." We are submitting these comments on our own behalf, and not on behalf of any specific client.

<u>Summary</u>.

As discussed below in detail, we make the following comments:

- The Proposed Rule should not apply to any amounts under tax-qualified retirement plans.

[1] Listing Standards for Recovery of Erroneously Awarded Compensation, 80 Fed. Reg. 41,144 (Jul. 14, 2015).

- The Proposed Rule should not apply to amounts deferred under non-qualified supplemental executive retirement plans that utilize a tax-qualified plan's benefit formula and are designed solely to provide benefits in excess of the tax limits imposed on tax-qualified plans.

The Proposed Rule Should Not Apply to Tax-Qualified Retirement Plans.

Section 954 of the Dodd–Frank Act applies to "incentive-based compensation (including stock options awarded as compensation)." The Proposed Rule interprets "incentive-based compensation" broadly. It covers "any compensation that is granted, earned or vested based wholly or in part upon the attainment of any financial reporting measure."[2] In the preamble to the Proposed Rule, the Commission indicates that it intends the rule to apply to "pension plans."[3] Although the Commission appears to be focused on non-qualified pension plans, the Proposed Rule could be interpreted to apply to tax-qualified retirement plans that take into account incentive compensation in their benefit formula or that condition contributions on the attainment of financial reporting measures.[4] For example, a defined benefit pension plan or defined contribution profit-sharing plan could include annual incentives as an element of the compensation that is taken into account in the plan's benefit formula. Or, a defined contribution profit-sharing plan could base the annual company contribution on satisfaction of certain company performance goals.[5]

The Proposed Rule should not apply to amounts held in tax-qualified retirement plans because requiring forfeiture or repayment of amounts held in a qualified plan would likely violate the anti-forfeiture, anti-alienation, and anti-reversion rules of the Employee Retirement Income Security Act of 1974 ("ERISA") and the Internal Revenue Code (the "Code").

ERISA and the Code provide that any vested amounts held in a retirement plan may not be forfeited, with very limited exceptions not applicable here (e.g., death, lost participants).[6] For example, the Treasury Regulations interpreting Code § 411(a) (which is essentially identical to the parallel provision in ERISA § 203) provide that a plan provision requiring forfeiture of

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2 See Proposed Rule 10D-1(c)(4); 80 Fed. Reg. 41,155.

3 See 80 Fed. Reg. 41,155.

4 See, e.g., 80 Fed. Reg. 41,160 n.167 ("In addition, *for retirement benefits under pension plans*, the excess incentive-based compensation would be deducted from the benefit formula, and any related distributions would be recoverable." (emphasis added)).

5 We note that in many cases, the inclusion or exclusion of incentive compensation in a benefit formula will not be relevant for the higher paid officers, because qualified retirement plans may not take into account compensation in excess of a dollar limit ($265,000 for 2015) that these executives will reach with base salary alone. However, this will not be true for officers with lower salary amounts or for plan designs that condition contributions on the attainment of financial reporting measures.

6 ERISA § 203; Code § 411(a).

vested benefits if a former employee competes with the employer would violate the anti-forfeiture rules of Code § 411(a).[7] Courts have repeatedly reached similar conclusions.[8]

Furthermore, subjecting a tax-qualified retirement plan benefit to a repayment obligation would violate the provisions of ERISA and the Code that prohibit the alienation of a retirement plan benefit.[9] In Guidry v. Sheet Metal Workers, for example, the Supreme Court considered whether a constructive trust could be imposed under labor law on the retirement plan benefit of a union official guilty of embezzling funds.[10] The Court found that this would violate ERISA's anti-alienation rule and refused to let the remedial provisions of a labor statute take precedence over ERISA, saying that that "[w]here there is no clear intention otherwise, a specific statute will not be controlled or nullified by a general one . . . ."[11] Thus, courts are likely to find that ERISA's anti-alienation rule would trump an SEC regulation under Dodd–Frank Act alienating tax-qualified retirement plan benefits.

ERISA and the Code also prohibit amounts held in a tax-qualified retirement plan from reverting to the employer, with limited exceptions not applicable here.[12] Repayment of benefits from a plan to the employer would likely be viewed as an impermissible reversion. Moreover, each of the following methods of avoiding the foregoing rules could be viewed as an indirect violation of the rules: (i) requiring the repayment to occur after plan funds have been distributed from the plan, (ii) requiring repayment outside the plan from the executive's other assets, or (iii) requiring the participant to waive his benefits under the plan. For example, in United States v. Smith,[13] the Fourth Circuit held that pension benefits received as retirement income are not subject to attachment by creditors, stating that "[t]he government should not be allowed to do indirectly what it cannot do directly."[14] Although other courts have reached different

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7 Treas. Reg. § 1.411(a)-4(c), Example 1.

8 Many cases have held that a vested qualified plan benefit cannot be forfeited even in the event of employee misconduct or fraud. See United Metal Products Corp. v. National Bank, 811 F.2d 297 (6th Cir. 1987); Ellis National Bank v. Irving Trust Co., 786 F.2d 466 (2nd Cir. 1986); Winer v. Edison Brothers Stores Pension Plan, 593 F.2d 307 (8th Cir. 1979); Fremont v. McGraw–Edison Co., 606 F.2d 752 (7th Cir. 1979), cert. denied, 445 U.S. 951 (1980); Vink v. SHV North American Holding Corp., 549 F. Supp. 268 (S.D.N.Y. 1982).

9 ERISA § 206(d); Code § 401(a)(13).

10 493 U.S. 365, 369–71 (1990).

11 Id. at 375–76, 376 (quoting Morton v. Mancari, 417 U.S. 535, 550–51 (1974) (alteration in original)). Cf. New Orleans Elec. Pens. Fund v. Newman, 784 F. Supp. 1233 (E.D. La. 1992) and IRS Gen. Couns. Mem. 39,000 (June 16, 1983) (each finding an implied public policy exception to the anti-alienation rule for purposes of applying state "slayer statutes" which prevent murderer from receiving his or her victim's retirement plan benefit). The Proposed Rule has far more in common with the financial fraud circumstances addressed in Guidry than the "slayer statute" circumstances.

12 ERISA § 403(c); Code § 401(a)(2); IRS Rev. Rul. 1991-4, 1991-1 C.B. 57 (Jan. 22, 1991) (permitting repayment of plan assets to the employer in only very limited circumstances (e.g., a contribution made due to a mistake of fact or law)).

13 47 F.3d 681 (4th Cir. 1995).

14 Id. at 684.

conclusions on this specific issue, the Smith decision demonstrates that courts will question indirect methods of depriving participants of their benefits under ERISA-governed plans.[15]

Thus, applying the Proposed Rule to tax-qualified retirement plan benefits would likely constitute a violation of ERISA and the Code and could subject the plan, plan sponsor, and participants to significant adverse consequences. Violating ERISA could subject the plan and the employer to lawsuits by participants and, potentially, the Department of Labor. Violating the Code could result in the retirement plan losing its tax-qualified status. In that case, *all* plan participants, not just the executive officers, would suffer the adverse consequences of immediate income inclusion and lost tax deferral of plan contributions.

The Commission need not take such a broad view of the scope of Section 954 of the Dodd–Frank Act. The statute merely refers to "incentive-based compensation." Tax-qualified retirement plans are not considered incentive-based compensation in the normal sense of that term, as is evident when similar terms are used in other corporate and securities law contexts. For example, retirement plans are not included in the "incentive plan" columns of the summary compensation table, even if incentive compensation factors into the benefit formula of a retirement plan.[16] Also, the Troubled Asset Relief Program ("TARP") compensation recovery rules explicitly carve out tax-qualified retirement plans from the definitions of "bonus" and "retention award"—types of compensation that are subject to clawback under those rules—and from the definition of a prohibited "golden parachute payment."[17] A narrower interpretation that did not cover qualified retirement plans would be consistent with the statutory language of Section 954 of the Dodd–Frank Act, as well as a common-sense view that the Act's rules are aimed at executive-level plans, not broad-based arrangements like qualified retirement plans.

Finally, we note that contributions to and benefits under qualified retirement plans are strictly limited by the Code. For example, the maximum annual contribution to a defined contribution plan for an employee is $53,000 for 2015.[18] The dollar value of any potential repayment is, therefore, relatively small. Given the amounts involved, it is inappropriate to subject plan participants and sponsors to the risk of highly adverse ERISA and Code consequences that could arise if the Commission requires repayments from tax-qualified retirement plans.

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15 See also Gallade v. Commissioner, 106 T.C. 355 (1996) (the sole shareholder of a corporation attempted to waive his benefits under a terminated defined benefit plan so the corporation could receive a reversion of the plan assets attributable to his benefit; the court ruled that the waiver was, in effect, an assignment of his benefit in violation of Code § 401(a)(13)).

16 See 17 C.F.R. § 229.402(a)(6)(iii).

17 See 31 C.F.R. § 30.1 Q&A-1.

18 See Code § 415(c). Employees over age 50 can also make a catch-up contribution of an additional $6,000 for 2015. See Code § 414(v).

The Proposed Rule Should Not Apply to Certain Supplemental Executive Retirement Plans.

As discussed above, the Proposed Rule appears to apply to benefits under non-qualified retirement plans. We note at the outset that there are many different designs for non-qualified retirement plans. In some cases, these plans allow an executive to elect to defer portion of his or her compensation. In others, the plans use special benefit formulae for executives. In still others, the plans merely provide benefits in excess of those that can be provided under a tax-qualified retirement plan due to the Code limits (i.e., an "Excess Plan"). In other words, an Excess Plan uses the same benefit formula as an employer's tax-qualified retirement plan, but without the contribution caps imposed on qualified plans by the Code, and offset by any benefit accrued under the qualified plan.

The Proposed Rule should not apply to benefits under an Excess Plan. (There are reasons why the Proposed Rule should not apply to benefits under other types of non-qualified plan designs as well, and we do not intend to suggest that the Proposed Rule should apply to those other plan designs. This comment focuses on Excess Plans because we believe that the issues are most clear cut in that instance.)

For reasons similar to those discussed above with respect to tax-qualified retirement plans, the Commission need not interpret the term "incentive-based compensation" so broadly as to include Excess Plans. The plain language of the term "incentive-based compensation" indicates that the clawback rules are intended to apply to arrangements that are designed to incentivize executive performance. Excess Plans, however, are closely tied to qualified retirement plans and, as a result, are clearly designed to provide retirement benefits, rather than for the primary purpose of incentivizing performance. In the typical defined benefit Excess Plan, incentive compensation is merely a part of a benefit formula intended to capture all compensation. Even in a defined contribution plan design in which company performance is a direct factor in determining the amount of the company's contribution to the participant's account, the purpose of the plan is to provide retirement benefits, and the same contribution formula applies to all employees of the employer eligible for the qualified defined contribution plan to which the Excess Plan is related. Thus, applying the clawback requirement to Excess Plans does not serve the purpose behind the Proposed Rule.

We also note that there is precedent for a carve-out for Excess Plans due to their comparability and close relationship to tax-qualified retirement plans. The short-swing trading rules of Section 16(b) include an exception for tax-qualified retirement plans, Excess Plans, and tax-qualified stock purchase plans, presumably on the theory that Excess Plans are a natural extension of qualified plans and are not in danger of being used for avoidance of the short-swing trading rules.[19] Also, the equity-based compensation shareholder approval rules of the New York Stock Exchange ("NYSE") and the National Association of Securities Dealers Automated Quotations ("NASDAQ") each include an exception for tax-qualified retirement plans, Excess Plans, and tax-qualified stock purchase plans.[20] Finally, the Pension Source Tax Act of 1996 provides that qualified retirement plan benefits are "sourced" for tax purposes to the state of residence, rather than the state in which the benefits were earned. The statute extends this treatment to annuity-type benefits under Excess Plans.[21] The Commission should follow this precedent and exclude Excess Plans from the clawback rule.

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Thank you for the opportunity to comment on the Commission's proposed rule. Please contact Adam Cohen at [redacted] if you have questions or would like to discuss our comments.

Respectfully yours,

Sutherland Asbill & Brennan LLP

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19 See 17 C.F.R. § 240.16b-3(b)(2) and (c).

20 See NYSE Listed Company Manual § 303A.08; NASDAQ Rule 5635(c)(2) and IM-5635-1.

21 See Pension Source Tax Act § 114(b)(1)(I).