

Sept. 14, 2015

Via email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov)

Securities and Exchange Commission  
Brent J. Fields, Secretary  
100 F St., NE  
Washington, D.C. 20549-1090

**Re: Listing Standards for Recovery of Erroneously Awarded Compensation (File Number S7-12-15)**

Dear Secretary Fields,

WorldatWork respectfully submits these comments regarding the Securities and Exchange Commission's (the SEC or Commission) proposed rulemaking (the proposal) as required by Section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank), which added Section 10D to the Securities Exchange Act of 1934. Section 10D requires the Commission to adopt rules directing the national securities exchanges and national securities associations to prohibit the listing of any security of an issuer that is not in compliance with Section 10D's requirements for disclosure of the issuer's policy on incentive-based compensation and recovery of incentive-based compensation (clawback) that is received in excess of what would have been received under an accounting restatement.

**WorldatWork Background Information**

[WorldatWork](#) is a nonprofit human resources association for professionals and organizations focused on compensation, benefits, work-life effectiveness and total rewards — strategies to attract, motivate, retain and engage a productive workforce. WorldatWork and its affiliates provide comprehensive [education](#), [certification](#), [research](#), [advocacy](#) and [community](#), enhancing careers of professionals and, ultimately, achieving better results for the organizations they serve. WorldatWork has more than 70,000 members and subscribers worldwide. Founded in 1955, WorldatWork is affiliated with more than [70 local human resources associations](#) and has offices in Scottsdale, Ariz., and Washington, D.C.

WorldatWork members believe there is a powerful exchange relationship between employer and employee, as demonstrated through the [WorldatWork Total Rewards Model](#). Total rewards involves the integration of six key elements that effectively attract, motivate, retain and engage the talent required to achieve desired organizational results. The six key elements are: compensation, benefits, work-life effectiveness, recognition, performance management and talent development.

The model recognizes that total rewards operates in the context of overall business and human resources strategies, as well as organizational culture and a complex external environment. Within this context, an employer leverages the six total rewards elements to offer and align a value proposition that

Washington, D.C. Office  
1100 13<sup>th</sup> Street NW, Suite 800  
Washington, D.C. 20005 USA  
Phone: 202-315-5500  
Toll-free: 877-951-9191  
Fax: 202-315-5550  
Toll-free fax: 866-816-2962

[www.worldatwork.org](http://www.worldatwork.org)

benefits the organization and the employee. An effective total rewards strategy results in satisfied, engaged and productive employees, who in turn create desired business performance and results.

**Comments on Listing Standards for Recovery of Erroneously Awarded Compensation Notice of Proposed Rulemaking (File Number S7-12-15)**

WorldatWork appreciates the Commission's attempt and intent to align executive incentive compensation practices with financial reporting accuracy as directed by Dodd-Frank. We agree accountability is critical to effective executive compensation programs and good governance, but we want to remind the Commission that many protections are already in place. Companies are acting on their own and clawback policies are on the rise. According to Institutional Shareholder Services Inc. (ISS), more than 85% of S&P 500 companies have clawback policies that are more stringent than the current SEC standards.<sup>1</sup> We are concerned that the proposed rules would require significant changes to current clawback policy design and have serious negative unintended consequences.

The Sarbanes-Oxley Act of 2002 already requires one-year clawbacks for CEOs and CFOs in case of financial restatement due to misconduct; the Troubled Asset Relief Program (TARP) required financial organizations to have a clawback policy for senior executive officers in order to receive capital infusion; and proxy advisory firms encourage clawback policies (and it's beneficial for companies to have them to obtain favorable recommendations). WorldatWork believes that these requirements, in addition to the widespread self-governance of executive compensation, are sufficient enough that flexible design of clawback policies should be retained in any new requirements so that they aren't overly burdensome and don't require major policy redesign. New and more prescriptive requirements to current executive compensation practices and clawback policies border on over-regulation, not smart regulation, and could have far-reaching unintended consequences that executive compensation experts have worked tirelessly to avoid through effective program design.

As submitted in previous comments, WorldatWork supports a principles-based approach to pay practices and believes that business strategies and executive compensation program design are unique and should be tailored to the specific needs of individual organizations.<sup>2</sup> The proposal is new territory for executive compensation experts, and it is very difficult to anticipate all the issues that companies will run into as they eventually exercise revised clawback policies that are compliant with new requirements. A principles-based approach would allow companies to adapt and address these issues as they arise. We commend the principles-based approach the Commission took in writing parts of the rule and recommend that the Commission retain this flexibility as it finalizes the proposal. We also advise the Commission to consider expanding this approach throughout the rule.

Furthermore, while the SEC's mission is to "protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation," the proposal conflicts with that mission as it is neither in the best interest of shareholders nor does it facilitate capital formation. Additional administrative costs associated with compliance and auditing are counter to the SEC's purpose, and the additive nature of regulation such as this creates overhead costs for U.S. companies that other countries' companies do

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<sup>1</sup> Michaels, David. "Sec Proposes Executive-Pay Clawbacks When Companies Restate." BloombergBusiness. July 1, 2015. <http://www.bloomberg.com/news/articles/2015-07-01/sec-to-propose-executive-bonus-clawbacks-when-companies-restore>. Viewed: Sept. 9, 2015.

<sup>2</sup> [WorldatWork. July 6, 2015. Comment Letter: RE: Pay for Performance \(File Number S7-07-15\).](#)

not have. This puts U.S. companies at a competitive disadvantage and over time will negatively affect investors and harm capital formation.

While WorldatWork strongly supports clawback initiatives voluntarily created within an organizational executive pay program, our association does have several concerns with the proposal as it is written.

#### *No-Fault Standard Without Internal Discretion Is Too Rigid*

WorldatWork is concerned that the proposal goes too far by autonomously requiring a clawback be applied regardless of whether the executive had any influence on a restatement or whether there was intentional misconduct. Invoking an inflexible approach negates a board's ability to use situation-appropriate judgment. The proposal will virtually eliminate discretionary authority to consider special facts or circumstances about the restatement, unlike current policies that are triggered only if there is evidence of executive misconduct associated with the restatement. Additionally, unintended consequences may occur as boards use other compensation tools to address what they feel is punitive treatment. With little discretion in executing the policy, boards of directors may see their authority in governance matters further diminished and could be undeservedly characterized as enemies of the shareholders. Smart regulation would retain the current practice of allowing internal discretion to determine the facts and circumstances of a restatement to decide who is at fault and the amount to recover.

#### *Definition of Executive Officers Could Create Complications*

WorldatWork is concerned with the proposal's new definition of covered executives, which includes all Section 16 officers under the Securities and Exchange Act who were executive officers during the performance period covered by the incentive-based compensation. We believe that the application of this broader definition to the no-fault provision without any board discretion, as noted earlier, could trigger a clawback regardless of whether the executive had any influence on the restatement or whether there was intentional misconduct. This could lead to unintended consequences, such as moving away from incentive-based compensation, which goes against the purpose of clawback policies and Dodd-Frank. Again, if the definition is expanded beyond current practice, WorldatWork recommends a principles-based approach where discretion is allowed and that the Commission not expand the definition beyond Section 16 officers as the proposal is finalized.

#### *Alternative Means of Recovery Should Be Allowed*

WorldatWork appreciates the Commission's philosophy that the appropriate means of recovery will vary by company and compensation design. We also agree that if a clawback is triggered, compensation should be recovered promptly and effectively. Following that philosophical vein, we recommend that companies be allowed to recoup clawback amounts through any legally owing obligation a company may have to the executive officer. This could include cancellation of unvested equity and nonequity awards or offsetting against amounts otherwise payable by the company to the executive officer such as nonqualified deferred compensation, unpaid incentive compensation and/or any future compensation obligations. It is much easier and more cost-effective for a company to cancel or retain compensation that remains within its control versus recovering compensation already paid to an executive.

It is worth noting there is the very real possibility of litigation as executives fight recovery of compensation already paid. Litigation inevitably adds costs and time to the recovery process. The proposal explicitly states that one of two exceptions in which a company can decide not to proceed with a clawback is if the direct costs of enforcing recovery would exceed the recoverable amount. In some cases, an alternative means of recovery might allow for companies to proceed with a clawback where previously it would have been too costly and therefore exceeded the amount to be recovered. WorldatWork again urges the Commission to extend flexibility and allow a principles-based approach toward recovering compensation. A principles-based approach in clawback design that allows alternative means of recovery would align the goals of companies, shareholders and the Commission to recover incentive-based compensation effectively and efficiently. WorldatWork also understands that allowing alternative means of recovery might conflict with other legal guidelines (i.e., Internal Revenue Code Section 409A and loan prohibitions under the Sarbanes-Oxley Act of 2002) and recommends the Commission coordinate with other agencies when needed and investigate granting leniency on the rare occasion an alternative might be used in a clawback.

#### *The Commission Should Consider the Following Unintended Consequences*

WorldatWork believes that smart regulation is the Commission's responsibility, and such regulation is achieved by realizing and weighing all the intended and unintended consequences of any new requirements. Again, as previously stated, the proposal as written would require substantial changes to current clawback policies in place. With that in mind, we hope the Commission will consider the following possible consequences:

1. **Change in program design:** Organizations and investors favor pay-for-performance rewards programs that align executives with shareholders' interests. The proposal may move away from performance-based pay, with companies placing a greater emphasis on restricted stock and stock options (which vest based solely on the passage of time) to mitigate risk of recoupment. As written it could drive up base salaries, making executives less aligned with shareholders, and it may result in executive compensation increasing to account for the risk of a clawback. The proposal could also push companies away from using objective formulas or financial performance metrics to determine pay in favor of subjective or operational metrics. This will be at odds with proxy advisers and investors, who prefer objective formulas.
2. **Valuation difficulties and legal challenges:** The proposal gives little guidance on how to determine "reasonable estimates" for the impact of accounting restatement on performance rewards tied to relative total shareholder return (TSR) or stock price. It will be a very difficult process to estimate which stock-value increases were attributable to the misstated financials, and the process will require economic expertise, possibly beyond that possessed by many companies, leading to costs associated with securing that expertise. Executive officers will likely challenge these estimates if a clawback is levied on them, and we fear companies may consider moving away from TSR-based incentive plans to avoid the potential costs and uncertainty that may result should a clawback be triggered.
3. **Administrative burden and costs:** As mentioned previously, there are a number of requirements, regulations and guidelines in place governing clawback policies. Additionally, a majority of companies have a policy in place. The further layered requirements in this proposal

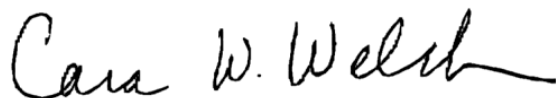
would force companies to substantially change their policies and invest in additional resources, as well as add yet another required disclosure to the list. While the Commission may think that changing current policy is simple enough and only affects a few compensation policies for most companies, with those changes comes a litany of additional work such as updating associated materials and additional communications at the bare minimum. With any change also come costs, and companies are already feeling the weight of the numerous executive compensation regulatory burdens of Dodd-Frank, which will only get heavier as the remaining regulations are finalized and following the massive pay-ratio requirements. Again, we recommend a minimally invasive approach that allows flexible design of clawback policies and good governance.

## **Conclusion**

WorldatWork appreciates the opportunity to provide comments on the Securities and Exchange Commission's Listing Standards for Recovery of Erroneously Awarded Compensation notice of proposed rulemaking (File Number S7-12-15). Again, we commend the Commission's attempt and intent to align executive incentive compensation with financial reporting accuracy as directed by Dodd-Frank. We also commend the Commission for following the principles-based approach in writing parts of the rule, and recommend that the Commission retain this flexibility as it finalizes the proposal. We advise the Commission to consider expanding this approach throughout the rule. WorldatWork inherently believes that business strategies and executive compensation program design are unique and should be tailored to the specific needs of individual organizations.

On behalf of WorldatWork's more than 70,000 members and subscribers, the association looks forward to working with the Commission on this issue and on future endeavors. Please do not hesitate to contact me at [REDACTED] or [REDACTED] for further information.

Sincerely,



Cara Woodson Welch, Esq.  
Vice President of External Affairs & Practice Leadership