Hay Group, Inc.
111 E. Wacker Drive
Suite 1250
Chicago, IL 60601-4402
USA

tel +1.312.228.1800
www.haygroup.com

September 14, 2015

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

Re: File Number S7-12-15 – Comment Letter on
<u>Claw-back (Compensation Recovery) Proposals</u>

Dear Mr. Fields:

The Securities and Exchange Commission ("Commission") has proposed rulemaking to implement section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Act"), which added Section 10D to the Securities Exchange Act of 1934 ("Exchange Act"). Under these provisions, the Commission is required to adopt rules that direct the exchanges to establish listing standards to require each issuer to develop and implement a compensation recovery ("claw-back") policy.

Pursuant to the Commission's request for comments on its proposed rules, Hay Group offers its suggestions regarding certain aspects of the proposed rules. We focus our comments, in particular, on areas where we believe (a) the statutory language does not directly address the situation so the Commission is not so limited in its rulemaking and (b) there is an opportunity to lessen the burdens imposed on issuers and shareholders. Since our comments relate to the requirements of section 954, we thought it helpful to summarize its provisions in the next paragraph.

The statute addresses the recovery of compensation in the event that an issuer is required to prepare an accounting restatement due to its material noncompliance with any financial reporting requirement under the securities laws. In relevant part, the Act provides that, in such event, an issuer will recover from any of its current or former executive officers who received incentive-based compensation during the three-year period preceding the date the issuer is required to prepare the restatement based on the erroneous data, the amount that exceeds what would have been paid to the executive officer under the restatement. In addition, the proposed rules require certain disclosures relating to the issuer's claw-back policy.

Hay Group is a global, full-service human resource consulting firm with 86 offices in 49 countries. Our comments are based on a review and analysis of the proposed rules and reflect our views (after considering feedback received from clients).

1. <u>General comments</u>

In general, the Commission's proposed rulemaking is overly proscriptive and does not include the discretion that boards of directors typically have had in developing and applying their existing claw-back policies. As a starting point, the proposals require claw-backs from covered executives regardless of fault or responsibility for the financial error(s) triggering the restatement; the

Commission's proposals would compel mandatory, "no-fault" recoveries. Further, as discussed in item 4 below, under the proposed rules, a board of directors has almost no discretion in determining whether and the extent to which it must pursue recovery. Overall, the Commission should limit its rulemaking by recognizing the potential impact of overly broad rules while allowing reasonable discretion in their application.

Further, and where reasonably practicable, we suggest that the Commission provide guidelines and examples regarding the manner in which registrants may comply with the proposed rules. In addition, at a time when many companies are struggling with the costs and time expended in regulatory compliance, we believe that the Commission should re-examine any proposed requirement which imposes burdens on issuers beyond what is called for by the statute.

2. Overly inclusive coverage extending to almost all issuers

The Commission in Question 1 of its request for comments asked whether the proposed rule should apply generally to all listed issuers. As noted by the Commission, its proposed rulemaking would require that exchanges apply the disclosure and recovery ("claw-back") policy requirements to "all listed issuers, with only limited exceptions." However, this result is not mandated by the Act but rather was a policy decision by the Commission; in its discussion of this topic (in section II.A.1. of the proposed rules), the Commission recognized that it had authority under the Exchange Act to exempt specific categories of issuers.

We suggest that the Commission revisit the question of which issuers are appropriate to cover under its claw-back rules. The substantive provisions of the proposed rule will require covered employers to keep track of a potentially large group of executives who fall within the proposed definition of "executive employee" for the three-year period preceding the date on which an accounting restatement is required (see our comments in item 3 below of this letter). Further, employers will have to determine "excess" amounts paid to such executives and then attempt recovery. These can require substantial time and expense which need to be considered in any determination of the issuers subject to the proposals.

We suggest that "smaller reporting companies" and "emerging growth companies" be exempted from all or at least some of the claw-back requirements in order to avoid imposing additional burdens on companies that often are the least able to bear such costs. Smaller companies generally must devote a larger percentage of their revenues to such compliance efforts than larger or more established publicly-traded companies. We note that Congress sought in the "Jumpstart Our Business Startups Act" to lessen certain compliance and disclosure burdens on emerging growth companies to better enable such newly public companies to prosper (and create jobs) with lessened governmental and regulatory interference and costs. The potential impact on these employers justifies exempting these issuers from the claw-back proposed rules.

3. Definition of "executive officer"

Under section 954 of the Act, recoveries are to be made from "any current or former executive officer." While the term "executive officer" is not defined in the statute, the Commission proposed a definition (based on Rule 16a-1(f) under the Exchange Act) that includes the issuer's president, principal financial officer, principal accounting officer, any vice president in charge of a principal business unit, division or function, any other officer who performs a policy-making function, and any other person who performs similar policy-making functions for the issuer. However, recognizing that a less inclusive definition was common in many existing claw-back policies, the Commission in Question 23 asked whether its definition of executive officer was too broad. In a second part of Question 23 the Commission requested comments on whether it should limit recovery policies to "named executive officers" (as defined for proxy disclosure and related purposes) or an otherwise narrower set of officers.

In an area where Congress has not clearly required an expansive definition, we suggest that the Commission instead should set only a minimum definition (e.g., "named executive officers" clearly are "executive officers" and would be an appropriate minimum group for inclusion) and then permit companies to continue (or develop) their own policies that consider their particular facts and circumstances (such as the executive group covered by an issuer's existing claw-back policy). Considering the "no-fault" nature of required compensation recoveries (discussed in item 1 above of this letter), we do not believe that the Commission should subject any more executives to claw-back policies than either are clearly required by the statute or such larger group determined by the particular issuer. The Commission in large part justifies its proposed definition based on an assumed "responsibility for financial information" of members of this group. However, not only is no such requirement found in the statute, but at many issuers only a few members of this group could reasonably be considered to have such responsibility. Thus, we suggest that the Commission revise its proposal to only require the inclusion of named executive officers and leave any larger extension to an issuer's particular compensation recovery policy.

4. <u>Board discretion on whether to seek recovery</u>

As we mentioned in item 1 above of this letter, the Commission's proposals are largely inflexible and leave little discretion to the board of directors. With respect to what and when erroneously awarded incentive based compensation is to be recovered, the Commission makes reference to the language in section 954 that "the issuer will recover", but then notes that the statute "does not address whether there are circumstances in which the board of directors may exercise discretion not to recover." With respect to its proposed rules, the Commission explained that it is providing an exception where "pursuit of recovery would be impracticable because it would impose undue costs on the issuer or its shareholders…." The Commission then requested comments on this standard in a series of questions (most with multiple parts) spanning Questions 51 through 58; we address our comments to the overall issue of board discretion in seeking a recovery rather than to particular questions.

Under the Commission's proposals, a board of directors has almost no discretion in determining whether and the extent to which it must pursue recovery. Even the limited exception that can apply where the direct costs of pursuing recovery would exceed the recoverable amounts is largely illusory: a company would first have to make a reasonable attempt at recovery and provide documentation of its efforts to the stock exchange where it is listed. The Commission's proposed standard could require an issuer to devote significant time, effort and expense before a board could be assured it was met with respect to an executive; the proposed rule attempts to impose a precision that will be difficult for many companies to apply in practice. Unless more guidance is provided to boards of directors regarding what actions would be sufficient in seeking a recovery, we expect that many boards would determine that it would be advisable to undertake all conceivable actions to enforce a claw-back, regardless of likelihood of recovery or costs involved, rather than face the prospect of litigation questioning the efforts made for recovery. Such a result would not be in the interests of the issuer and its shareholders.

Accordingly, we suggest that the Commission modify its proposal to furnish examples of actions that would satisfy this exception from further efforts to obtain recovery. Further, the Commission should consider permitting reliance on the board's discretion in deciding whether, when and how to recover any "excess compensation" based on the board's determination that any potential recovery would be overly costly in comparison to the anticipated recovery. Ideally, examples would contain one or more "safe harbors" to satisfy the requirement of making reasonable attempts at recovery.

5. Determination of excess compensation for incentive compensation based on stock price or total shareholder return

Before seeking recovery under a claw-back policy, a company must determine the "recoverable amount" with respect to a covered executive. When a claw-back policy is triggered, the proposed rules look to the type of compensation involved in determining the recoverable amounts. This determination can be particularly speculative for incentive-based compensation tied to stock price or on total shareholder return ("TSR"), where the amount of erroneous awarded compensation cannot be calculated directly from the information in the restated financials. In this situation the proposed rules permit the recoverable amount to be determined based on "a reasonable estimate of the effect of the accounting restatement on the applicable measure."

In Question 45 of its request for comments, the Commission asked whether the use of reasonable estimates facilitates administration of the proposed rule. In addition, the Commission inquired whether it should provide "additional guidance regarding how such estimates should be calculated?" This is an especially important issue since the use of performance-based incentives tied to stock price or TSR can comprise the largest portion of the compensation of top executives. In view of the potentially complicated issues in making such determinations, we suggest that the Commission provide examples on how an issuer may make adjustments of share price and TSR in connection with an accounting restatement.

6. Requirement of tagging new required disclosure in XBRLformat

In Question 85, the Commission asked whether it should require that the proposed disclosure be tagged in XBRL format. The stated rationale of the Commission for this proposal is that "requiring the data to be tagged "would lower the cost to investors of collecting this information, and would permit data to be analyzed more quickly by shareholders, exchanges and other end-users than if the data was provided in a non-machine readable format."

Some of our clients have informed us that XBRL (or other similar format) tagging would impose additional costs on covered issuers. Another concern is that the XBRL tagging requirement could be a precedent for a further expansion of tagging without due consideration of companies' compliance costs, leading to a tagging of more and more of proxy statement information as new rules are promulgated. We note that the Commission started down this road in its pay-versus-performance proposed rules released in late April, indicating that the Commission may seek to include an XBRL tagging requirement in each case in which it addresses rulemaking on executive pay topics. Since no such tagging mandate is appears in the Act, the Commission especially needs to consider the costs so imposed on employers in comparison to the value of any such benefits that the Commission believes that tagging would provide.

In response to the last portion of Question 15, we support making tagging the disclosure optional with the registrant. Further, if the Commission nevertheless determines to proceed with the proposed XBRL tagging requirement in its final rulemaking, we suggest that smaller reporting companies and emerging growth companies be exempt (consistent with our comments in item 1 of this letter) from the requirement in order to avoid imposing additional burdens on companies that often are the least able to bear such costs.

Hay Group appreciates this opportunity to provide comments regarding the proposed rulemaking on “claw-backs” of erroneously awarded compensation.

Very truly yours,

Hay Group

By:

William M. Gerek
Senior Principal and Regulatory Expertise Leader,
Board Solutions