HR POLICY ASSOCIATION
The Association of Senior Human Resource Executives

January 29, 2007

VIA E-MAIL

Ms. Nancy Morris
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-9303

RE: **File Number S7-03-06**
Proposed Amendments to Requirements for Executive Compensation and Related Party Disclosure

Dear Ms. Morris:

HR Policy Association ("HR Policy") is pleased to submit comments on the U.S. Securities and Exchange Commission's ("SEC" or "Commission") interim final rules ("Amended Rules") published on December 22, 2006, amending its final rules on executive compensation and director disclosure.[1] We believe the Commission's goal of creating consistency between financial reporting and executive compensation disclosure of stock and stock option awards is laudable. However, because the accounting rules for equity compensation create additional complexities, we believe that the Amended Rules will make it more difficult for companies to prepare the disclosures as well as for investors to understand equity compensation.

HR Policy Association is a public policy advocacy organization representing the chief human resource officers of over 250 leading employers doing business in the United States. Representing nearly every major industry sector, HR Policy members have a combined U.S. market capitalization of more than $7.5 trillion and employ more than 18 million employees world wide. Our members are particularly interested in executive compensation disclosure because they are responsible for assisting boards of directors and board compensation committees in developing compensation programs for executives in an effort to recruit and retain the best talent. We believe that executive compensation should be clearly and fully disclosed in a comprehensive and understandable manner to give investors an accurate basis for evaluating the effectiveness of a company's executive compensation program.

I. HR Policy Supports Greater Clarity in Equity Disclosure, But Not Financial Statement Treatment

Throughout the Commission's recent executive compensation rulemaking process, HR Policy has urged it to adopt disclosure rules that allow for true comparability among compensation elements on the Summary Compensation Table. However, the

[1] Securities and Exchange Commission, Executive Compensation Disclosure, Release Nos. 33-8675, 34-55009, 71 Fed. Reg. 78,338 (Dec. 29, 2006) (interim final rule).

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Commission appears to have mistaken this goal as expressed in our April 10, 2006 comments[2] for an endorsement of using financial reporting rules for executive compensation. The Commission cites HR Policy's April comments as requiring "disclosure of the proportionate amount of an award's total fair value that is recognized in the company's financial statements for the fiscal year."[3] However, HR Policy did not endorse using a financial statement approach.

In our April comments, HR Policy stated that by providing an estimate of the full grant date fair value of stock and stock option compensation along with actual amounts for salary and bonus, the Commission's proposed rules "would combine compensation elements that are essentially not equivalent."[4] In response, we suggested that stock and stock option compensation be included in the Summary Compensation Table when earned or vested, depending on the type of compensation.[5] Our comments did not endorse the FAS 123(R) approach due to concerns among our members regarding the practical efforts of importing accounting rules. By recommending the disclosure of equity compensation when it is earned or vested, the Association sought to balance the interests in accurate disclosure with the realities of estimating equity compensation, while limiting confusion and unintended consequences. As discussed below, we believe that the Commission's Amended Rules follow accounting rules too closely, and thus create additional misunderstanding and unintended consequences.

II. The Amended Rules Will Not Provide Investors a Clearer View of Executive Compensation

In promulgating its Amended Rules, the Commission reasoned that disclosure "should provide investors with a clearer view of annual compensation earned by executives."[6] However, in operation, the Rules will add a number of inconsistencies to those already present in the final rules promulgated in July 2006, and will serve to further confuse investors. There are three principle areas that deserve mention: (a) differing amounts

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[2] Letter from Jeffrey C. McGuiness, President, HR Policy Association to Nancy Morris, Secretary, U.S. Securities & Exchange Commission, April 10, 2006 [hereinafter "HR Policy April 2006 Comment Letter"].
[3] 71 Fed. Reg. at 78,340.
[4] HR Policy April 2006 Comment Letter, *supra* note 2, at 10.
[5] "We believe that the Summary Compensation Table should report compensation only as it is actually earned or vested, depending on the nature of the compensation. Thus, while annual compensation (such as salary and bonus) would continue to be reported as proposed, long-term incentive compensation would only be reported as awards are earned during the year (for example, as restricted stock awards, stock options, and stock appreciation rights vest, and nonstock incentive plan awards are paid out). This would provide a more accurate picture of the compensation earned by each named executive officer during a covered fiscal year, as it would require disclosure of compensation that is actually received by the NEOs as well as compensation that is earned as of the vesting date. This approach answers one of the criticisms regarding disclosure of options and related equity as of the exercise date, because executives decide when to exercise stock options and SARs and receive the unrealized gain at their discretion." Letter from Jeffrey C. McGuiness, President, HR Policy Association to Nancy Morris, Secretary, U.S. Securities & Exchange Commission, April 10, 2006, at 11-12.
[6] 71 Fed. Reg. at 78,340.

disclosed for named executive officers (NEOs) that reach retirement age versus similarly situated younger NEOs; (b) the annual valuation of equity arrangements settled in cash ("liability instruments") and performance-based equity, and (c) deductions for forfeitures of stock and stock option awards.

A. The Amended Rules Would Create Disparity in the Reporting of Equity Compensation for Retirement-Eligible Executives Versus Younger Executives

The Amended Rules will make it appear that retirement-eligible NEOs receive larger stock and/or stock option awards than younger NEOs. As under FAS 123(R), the Rules require companies to report the full grant date fair value of these awards on the Summary Compensation Table in the year of grant for NEOs who are eligible for retirement and who are allowed to keep it after retirement.[7] By contrast, NEOs who are not eligible for retirement would have the fair value of the grant reported over the vesting period. Thus, if two NEOs receive identical grants that cliff vest over three years, and one is retirement-eligible, his or her equity and total compensation would appear to be substantially greater because the entire grant value would be included, versus one-third of that amount for the younger executive.

In the Preamble to the Amended Rules, the Commission argued that disclosing compensation as it is measured under FAS 123(R) "should eliminate the potential for distortion in identifying named executive officers"[8] that results from grant date fair value disclosure. Unfortunately, the Commission has swapped one distortion for another.

The Amended Rules are likely to have a significant impact on the composition of the executives whose compensation is reported each year in the Summary Compensation Table and affect comparability both between and within companies. Retirement-eligible executives will be more likely to be NEOs due to the accelerated reporting of stock and equity grants, even if they are likely to work for the company throughout the vesting period of the grants in question. By comparison, this would not be a significant issue for comparisons among executives within companies that rely more on nonstock incentive compensation, which would continue to be reported when it is earned (generally at the end of the incentive period), regardless of retirement eligibility.[9]

In addition, the Amended Rules would create comparability issues between companies with younger versus retirement-age senior executives. For example, a company with many retirement-age senior executives is likely to include them as NEOs and thus may appear to have greater total compensation, than a different company with similar grant practices but with younger senior executives, who will appear to have lower

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[7] *Id*. at 78,342.
[8] *Id.* at 78,340.
[9] Regardless of the changes, nonstock incentive compensation has been and will continue to be reported on a different basis than stock or option compensation. One form of inconsistency has been replaced with multiple inconsistencies.

compensation. While it is true that the total grant date fair value amounts would be included on the Grants of Plan-Based Awards Table, most investors will look to the Summary Compensation Table first when comparing companies.

The Amended Rules also will increase the annual variability of the composition of the NEOs based on accounting rules rather than compensation programs. This result is similar to the Commission's proposal to include the annual increase in the actuarial value of defined benefit plan amounts in total compensation for the purpose of determining the three most highly compensated NEOs other than CEO and CFO. HR Policy joined the chorus of other interested parties who successfully urged the SEC to exclude the incremental retirement amounts from total compensation used to determine the NEOs because of the concern that investors would not understand the amounts. Consistency with financial accounting does not justify re-introducing such variability into the table, especially with respect to a core element of compensation such as equity compensation that cannot be excluded in determining total compensation.

B. Fluctuating Values of Cash-Settled Awards and Performance-Vested Awards Will Create Additional Shareholder Confusion

The Amended Rules would further create confusion by applying the FAS 123(R) requirements for equity vehicles settled in cash or that provide for optional settlement in cash (collectively known as "liability awards"), as well as those that contain performance-based vesting conditions. In addition to recognizing compensation over the vesting periods, liability awards must be revalued each year until they are settled or expired.[10] Thus, after the vesting period, these values can increase or decrease based upon several factors, such as the company's performance or the performance of the underlying equity vehicle. Although this approach may make sense in the financial statement context, under executive compensation disclosure, it will serve to confuse shareholders, who will have to sort through explanatory information to understand the total compensation number. It will also make it more difficult for companies to provide "plain English" explanations in the supplemental explanations to the tables.

In addition, equity vehicles with performance-based vesting that at one time appeared likely to vest and thus were included in compensation are subtracted from the stock or stock option column if it is later determined that the performance criteria are not likely to be met. Again, fluctuations that ensure accuracy in the accounting treatment do not translate well for compensation disclosure purposes.

C. Forfeitures of Stock and Stock Option Awards May Potentially Be Shown As Negative Numbers on the Summary Compensation Table

The Amended Rules require that in the year a stock or option award is forfeited, any vested amounts pertaining to that award that were disclosed as compensation in prior

[10] 71 Fed. Reg. at 78,341.

years must be subtracted from the correct column in the Summary Compensation Table.[11] In some cases, this will result in disclosure of a negative number in the stock or stock option awards column that will need to be carefully explained in a footnote as well as in the Compensation Discussion and Analysis.[12] The change would also reduce the total compensation for any individual that forfeits equity awards, requiring additional explanation.

As HR Policy previously argued with respect to including the additional actuarial value of accrued defined benefit pension amounts in the Summary Compensation Table's total compensation number, the Commission's approach to forfeited options will generate substantial confusion among investors. In addition, we reiterate our concern that investors "would lack the understanding necessary to place these values into their proper context and that the supplemental disclosure that would be necessary to explain these values and properly contextualize them would be lengthy, highly technical, and of questionable value."

III. The Amended Rules Were Adopted Unduly Close to the Beginning of Proxy Season

The Commission promulgated this significant set of changes and released them on December 22, 2006, just before a long holiday weekend. The changes left many companies scrambling to adapt as they worked to complete drafts of their proxy disclosures in time for committee and board meetings that occurred just after the first of the year. Clearly, the effects of the changes have left several of our members extremely concerned because of the confusion the disclosures are likely to create. Despite these reactions, the Commission has asserted that public notice and comment before adoption was "impracticable, unnecessary and contrary to the public interest," because it could create substantial uncertainty over which rules would apply for the 2007 proxy season. However, with the complexities discussed above in mind, it seems clear that the changes should have been proposed earlier in the year and subject to notice and comment.

As we have explained in detail above, the changes are a considerable departure from the final rules promulgated in July. Although they will enable consistent treatment with financial statement disclosures, that consistency will require considerable additional explanation just to begin cultivating investor understanding. The Commission has argued that it is better to have such changes implemented before the proxy season. However, that presupposes that the changes would improve disclosure. HR Policy believes that assertion is questionable given the distinctions it creates among different individuals and different types of compensation. In addition, those treatments are inconsistent with similar decisions the Commission made with respect to determining the NEOs in the final rules it promulgated in July.

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[11] In other words, if a stock option grant to an NEO provides for four-year cliff vesting, and the NEO decides to leave after year 3, the pro-rata amounts displayed in the stock option awards for years one through three would be subtracted from the stock option awards column for that year.
[12] 71 Fed. Reg. at 78,340 n. 25.

IV. Conclusion

The variability that will result from incorporating FAS 123(R) into executive compensation disclosure will create more questions than immediate clarity. Companies will be required to provide significant supplemental explanations to reduce shareholder confusion and promote understanding of a company's compensation program.

Thank you for the opportunity to comment on this letter. Any questions regarding the letter should be directed to Timothy J. Bartl, Assistant General Counsel and Vice President, Corporate Relations.

Sincerely,

/s/

Jeffrey C. McGuiness
President