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Management

September 14, 2015

Via Email

Brent J. Fields
Secretary
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. Secretary,

The undersigned institutional investors submit this comment in support of the Securities and Exchange Commission’s Proposed Rule, “Listing Standards for Recovery of Erroneously Awarded Compensation,” implementing Section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (“Dodd-Frank”).

As long-term investors, we view compensation clawbacks (sometimes referred to as recoupments) as an important mechanism to promote the alignment of pay with performance and help deter executives from taking actions that are not in the long-term best interests of the company and its shareholders. We recognize the Commission’s limited discretion due to Section 954’s specificity and view the Proposed Rule as striking generally the right balance on matters on which the Commission has latitude.

That said, we have two recommendations. These recommendations are informed by extensive engagement with companies and fellow investors around the use of clawback policies to communicate and enforce behavioral norms as well as promote pay for performance.

First, we ask that the Commission expand the disclosure requirement to include any compensation clawed back from executives under company policies or required by law, including but not limited to restatement-based clawbacks. For example, some companies have policies that authorize the board to claw back compensation for costly misconduct or excessive risk-taking.

Second, we urge the Commission to broaden the reach of the Proposed Rule, or consider initiating new rulemaking, to encompass misconduct that does not trigger a financial restatement.

Misconduct, beyond the financial restatement context, is a critical element of clawback policies already adopted by companies. A 2013 Equilar Study of Fortune 100 companies that have a clawback policy found that only 10.7% of companies surveyed had triggers based solely on a financial restatement.

Background

Spurred by record company legal settlements and the absence of robust individual accountability mechanisms, in early 2012 the UAW Retiree Medical Benefits Trust convened a working group of 13 institutional investors and six pharmaceutical companies (“Working Group”) to develop a model incentive compensation recoupment policy that would apply to non-financial-statement misconduct. Specifically, the Working Group was focused on legal violations stemming from the manufacturing, marketing and sale of pharmaceuticals, including violations of the federal False Claims Act and Foreign Corrupt Practices Act. The goal of the Working Group in formulating the policy was to communicate behavioral expectations—the oft-referenced “tone at the top”—and avoid the financial losses, reputational damage and erosion of investor confidence associated with legal violations.

In August 2012, the Working Group issued “Principal Elements of a Leading Practices Recoupment Policy” to provide principles-based guidance to companies. The Principles recommended that boards adopt a clawback policy that would:

- Be triggered by misconduct resulting in a material violation of a company policy related to the manufacturing, sales or marketing of products,¹ causing significant harm to the company;
- Apply both to individuals who engaged in misconduct and individuals who failed in their supervisory responsibility to appropriately manage or monitor conduct or risks;
- Allow recovery of incentive compensation still under the company’s control (e.g., unvested options or equity) and compensation already paid;
- Give the compensation committee full discretion to make clawback decisions; and
- Provide for public disclosure of clawback decisions where appropriate and in the interest of the company and its investors.

Following the issuance of the Principles, 11 companies adopted clawback policies substantially conforming to the Principles including Johnson & Johnson, Eli Lilly, Merck, Amgen and Pfizer. Another 11 companies that already had adopted clawback policies with misconduct triggers

¹ The working group found that company policies and codes of conduct typically include provisions requiring adherence to the law, so a violation of applicable law or regulation would also be a violation of company policy.

strengthened those policies to cover supervisors and to provide for disclosure. Examples of companies in this group include Allergan, McKesson, PNC Bank and Bank of America.

In a separate but related initiative, the New York City Comptroller's Office, on behalf of the City's five pension systems, achieved strengthened recoupment policies at Goldman Sachs and JP Morgan and disclosure at another eight companies including Northrup Grumman, United Technologies, Haliburton and Lockheed Martin.

Below, we address several specific aspects of the Proposed Rule.

Disclosure

The Proposed Rule would require companies to disclose certain information regarding their clawback policies, including the policies themselves and how they have been implemented following any restatement. Specifically, companies would need to disclose for each restatement, the aggregate dollar amount of excess incentive compensation attributable to the restatement; the aggregate dollar amount of excess incentive compensation that remains outstanding at the end of the last fiscal year; and the name of each person subject to recovery from whom the company decided not to pursue recovery and the reasons recovery was not pursued.

As shown by the Working Group's members' initiatives seeking disclosure regarding the implementation of recoupment policies, we believe that such disclosure is key for shareholders in both a restatement and non-restatement related clawback. First, greater disclosure emphasizes compliance and ethics by leading by example, while providing investors with information on whether or not the clawback is operational and at least has been considered by the board.

Clawback disclosure also increases accountability to investors, allowing shareholders to better evaluate the risks their companies face. Because much of a board's work is done in private, visible decisions such as these provide a valuable window into the board's overall functioning. Shareholders might weigh the quality of the disclosure—for example, how completely and persuasively the reasons for not pursuing a particular recovery are detailed—in assessing the board's stewardship of compensation. Finally, enforcement of a clawback policy would likely be considered part of a company's executive compensation policies and practices for purposes of the shareholder advisory vote on pay.

Triggering Event

The listing standards to be adopted pursuant to the Proposed Rule would require listed companies to adopt a clawback policy whose application is triggered by a financial restatement prepared to correct an error that was material to previously issued financial statements. The policy must provide for the recovery of excess incentive compensation above what would have

been payable had the error not been made, regardless of whether the recipient was responsible for the error.

Despite the fact that this language closely tracks Section 954, some have attacked it for its “no fault” approach. (See Comment by Pay Governance, LLC dated Aug. 19, 2015) But that criticism is based on an overly limited view of the purpose of clawbacks. Although they do operate to deter misconduct, they also strengthen the pay-performance connection and align the interests of executives and shareholders.

In the context of a non-restatement misconduct clawback like the one outlined in the Principles, recoupment is allowed when one aspect of the company’s performance—specifically, its adherence to the law—does not meet expectations. The violations triggering the clawback may themselves have contributed to financial results that boosted incentive compensation. Likewise, recovering compensation paid based on erroneous metrics following a financial restatement ensures that real, not illusory, performance is used to determine compensation. A material restatement to correct an error constitutes an admission that an earlier report of financial performance was erroneous; thus, fault, or lack thereof, is irrelevant to the question of whether incentive pay was in fact justified by financial performance.

We urge the Commission to require that listed companies should also be required to adopt policies authorizing the recovery of incentive compensation outside the context of a financial restatement to include misconduct that does not trigger a financial restatement. None of the major company players in the financial crisis—the catalyst for Dodd-Frank—restated their financial results, though the excessive risk-taking, inadequate controls and misaligned incentives caused massive losses for shareholders. By including this type of policy in a listing standard, all companies would be required to adopt a formal recoupment policy and notice to executives. Investors would benefit from a uniform standard across sectors.

Finally, the board would need to have significant discretion to administer a clawback policy triggered by less clear-cut and quantitative events than a material restatement, given the many factors to be considered in deciding whether to recover incentive pay. A precise cost/recovery analysis that is required in the Proposed Rule for the financial restatement consideration by the Compensation Committee might not be feasible, though a company could be required to disclose the factors the board analyzed in determining how to proceed.

Covered Employees

Section 954 did not define the term “executive officer.” The Proposed Rule would incorporate the Commission’s existing definition of executive officer contained in Rule 16a-1(f), which applies to, among other things, limits on and disclosure of executive transactions in company stock. Question 23 of the Proposing Release asks whether this definition is appropriate, or whether some other group, like “named executive officers” (“NEOs”) should be used.

In the our view, using the Rule 16a-1(f) definition is consistent with Section 954’s legislative history and is the most appropriate option from a policy standpoint. As discussed in the Council of Institutional Investors’ comment letter, the SEC’s Investor Working Group recommended, in a report referenced in Section 954’s legislative history, stronger federal clawback requirements for the broad category of “senior executives.” Rule 16a-1(f) defines executive officers to include the president; principal financial officer; principal accounting officer; vice presidents in charge of a principal business unit, division or function; and other persons who perform a policymaking function for a company. As well, given that executive officers were a well-defined and familiar group for SEC compliance and reporting purposes when Dodd-Frank was enacted, it is logical to conclude that Congress meant to incorporate that concept into the clawback provision.

As a policy matter, covering just NEOs would undermine the ability of clawback provisions to shape executive behavior. Except for the CEO, who is always an NEO, an executive’s status as an NEO is determined in hindsight because it is based on how the executive’s total compensation for the most recent fiscal year stacks up to the compensation of other executives. At any given time, an executive other than the CEO does not know whether he or she will be an NEO for that year. In contrast, an executive knows that he or she is classified as an executive officer because that status entails additional ongoing compliance obligations. Thus, for deterrence purposes, covering the executive officer group is much more effective than covering only NEOs.

Board Discretion Not to Pursue Recovery

The language of Section 954 states that the clawback policy must provide that “the issuer will recover” excess incentive compensation, and does not contain any exceptions or reference to board discretion regarding recovery. The Proposed Rule nonetheless allows a policy to give the board discretion not to pursue recovery where the cost would outweigh the recoverable amount, and in the case of foreign private issuers, if recovery would violate home country law.

In our view, board discretion is appropriate to prevent inefficient use of company resources. We have had the opportunity in our engagements with companies to discuss the challenges boards face in making complex and sensitive recoupment decisions. Therefore, we do not object to the discretion included in the Proposed Rule, so long as the procedural and disclosure safeguards included in the Proposed Rule are adopted.

We are pleased to have this opportunity to make our views known to the Commission. The UAW Retiree Medical Benefits Trust (RMBT) has led several of the investor coalition corporate engagement efforts over the past years. Please feel free to contact Meredith Miller, Chief Corporate Governance Officer of the UAW RMBT with any questions you may have at 734-887-4964 or mamiller@rhac.com.

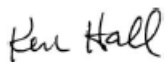
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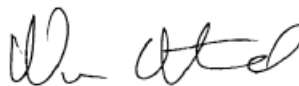
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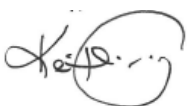
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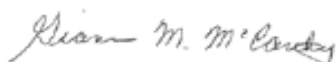
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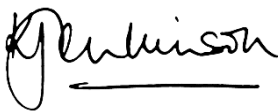
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