Compensia
THOUGHTFUL PAY

Via E-Mail: (rule-comments@sec.gov)

September 14, 2015

Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-9303
Attn: Brent J. Fields, Secretary

Re: File No. S7-12-15
Release Nos. 33-9861; 34-75342; IC-31702
Listing Standards for Recovery of Erroneously Awarded Compensation

Dear Mr. Fields:

This letter is submitted on behalf of Compensia, Inc. ("Compensia"), in response to the request for comments by the U.S. Securities and Exchange Commission (the "Commission") in the proposing release referenced above (published on July 14, 2015 and referred to herein as the "Proposing Release"). As set forth in the Proposing Release, the Commission has proposed a new rule and rule and form amendments (the "Proposals") to implement the requirements of Section 10D of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), as added by Section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). Section 954 requires the Commission, by rule, to direct the national securities exchanges and national securities associations to prohibit the listing of any security of an issuer that does not adopt and enforce a policy providing that, if the issuer is required to prepare an accounting restatement due to material noncompliance with any financial reporting requirement under the securities laws, the issuer will recover from any current or former executive officer who received incentive-based compensation (including stock options awarded as compensation) during the three-year period preceding the date the issuer is required to prepare the accounting restatement, based on the erroneous data, in excess of what would have been paid under the restatement.

Compensia, which is located in San Jose and San Francisco, California, is a management consulting firm providing executive compensation advisory services to compensation committees and senior management of knowledge-based companies. Formed in 2003 by a group of leading executive compensation experts, we advise the board compensation committees of numerous technology, life sciences, and other companies, and have extensive experience designing and implementing executive and director remuneration programs. We understand how board compensation committees function and we have assisted many of our clients, which range from recent IPOs to Fortune 500 companies, in preparing and improving their executive compensation disclosure.

We urge the Commission to take a pragmatic approach to its rulemaking obligations with respect to Section 954. As is apparent from a careful reading of the Proposals, they are, at times, both precise and vague, as well as broad and narrow. Consequently, we believe that the

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Commission should focus on achieving the conceptual objective of the statute, without giving undue deference to its express language, which, in some instances, may be inconsistent with its intended purpose. We further believe that this approach is necessary to ensure a proper balance between the interests of investors and the potential compliance burden of registrants.

To assist the Commission in this process, we offer the following comments and suggestions that we believe will enhance the implementing rules and further the stated objectives of the statute. We have previously submitted comments on the executive compensation disclosure provisions of the Dodd-Frank Act in response to the Commission's general request for preliminary comments on the executive compensation provisions contained in Subtitle E of Title IX of the Dodd-Frank Act (see our comment letter dated October 4, 2010).

Discussion

I. Issuers Subject to Proposed Exchange Act Rule 10D-1

Pursuant to proposed Exchange Act Rule 10D-1, the requirement to adopt and enforce a compensation recovery policy, as well as the other requirements of the Proposals, would apply to all listed issuers. While we recognize that the plain language of Section 10D of the Exchange Act would lead to such a conclusion, we recommend that the Commission exercise its general exemptive authority[1] to exempt emerging growth companies[2] and smaller reporting companies[3] from the Proposals.[4]

A. Emerging Growth Companies

In our experience, issuers that have just completed their initial public offering of equity securities, such as an emerging growth company,[5] have fairly simple executive compensation programs that often involve modest pay amounts. Typically, the incentive-based compensation of such companies will include an annual performance-based bonus plan and long-term incentive

[1] *See* Section 36(a)(1) of the Exchange Act (15 U.S.C. 78mm(a)(1)).

[2] An "emerging growth company" is an issuer that had total annual gross revenues of less than $1 billion during its most recently completed fiscal year, has not reached the fifth anniversary of the date of the first sale of its common equity securities pursuant to an effective registration statement under the Securities Act, had not issued $1billion in non-convertible debt during the previous three-year period, or is deemed to be a "large accelerated filer." *See* 15 U.S.C. 78c(a).

[3] A "smaller reporting company" is an issuer that had a public float of less than $75 million as of the last business day of its most recently completed second fiscal quarter or had annual revenues of less than $50 million during the most recently completed fiscal year for which audited financial statements are available. *See* 17 CFR 229.10(f)(1).

[4] We believe that the Commission may exercise its broad rulemaking authority and, if deemed necessary or appropriate in the public interest, and consistent with the protection of investors, its general exemptive authority (either conditionally or unconditionally), under the Securities Act and/or the Exchange Act to carry out the objectives of Section 954 of the Dodd-Frank Act.

[5] *See* The Jumpstart Our Business Startups ("JOBS") Act, Pub. L. No. 112-106, 126 Stat. 306 (2012).

compensation opportunities in the form of service (time)-based equity awards. Following their IPO, such companies gradually transition their executive compensation programs to a public company profile, including the gradual introduction of performance-based long-term incentive compensation. At the same time, such companies are also enhancing their corporate governance policies and practices in response to the expectations of the institutional investor community and their advisors.

In this environment, we do not believe that the immediate imposition of a compensation recovery policy serves a useful purpose. The bulk of the incentive compensation opportunities either previously provided or contemporaneously granted to the issuer's executive officers are likely to be beyond the reach of the compensation recovery policy. Further, the imposition of such a policy may serve as an incentive for such issuers to defer the introduction of performance-based long-term incentive compensation opportunities to minimize the exposure of the executive officers to such a policy. We also believe that the likelihood of a financial restatement in the period immediately following an IPO would be minimal given the degree of scrutiny the issuer must undergo during the offering process.

Consequently, we recommend that the Commission exempt emerging growth companies from the requirements of proposed Exchange Act Rule 10D-1 until such time as an issuer forgoes such status. Alternatively, if the Commission believes that such a blanket exemption is unwarranted, we recommend that the Commission provide an exemption for a minimum period of two years following the effective date of the issuer's initial public offering to give such issuers adequate time to develop and adopt a compliant compensation recovery policy.

B. Smaller Reporting Companies

In the case of smaller reporting companies, we believe that, in view of the costs and burdens of compliance with Section 10D of the Exchange Act, excluding such issuers from the requirements of proposed Exchange Act Rule 10D-1 is in the public interest and consistent with the protection of investors. For several years, the Commission has been sensitive to the costs and burdens faced by smaller reporting companies in complying with the federal securities laws. Most recently, to encourage capital formation and stimulate the U.S. economy, Congress has seen fit to exempt an entire category of companies – emerging growth companies – from many of the registration and reporting requirements of the federal securities laws pursuant to the JOBS Act. Further, the JOBS Act exempts emerging growth companies from several, although not all, of the provisions of Title IX of the Dodd-Frank Act, of which Section 954 is a part.

We believe that requiring smaller reporting companies to adopt and enforce a compensation recovery policy of the detail and scope contemplated by proposed Exchange Act Rule 10D-1 would impose unnecessary costs and burdens on such companies and, potentially, would be inconsistent with the Congressional objective of maintaining a reasonable balance between the benefits and burdens of enabling smaller companies to access the public markets.

Alternatively, if the Commission believes that such a blanket exemption is unwarranted, we recommend that the Commission postpone the compliance date for such issuers for a minimum period of two years following the effective date of the final rules to give such issuers adequate time to develop and adopt a compliant compensation recovery policy.

II. Restatements Triggering Application of Recovery Policy

A. "No Fault" Trigger

Section 10D(b)(2) of the Exchange Act stipulates that incentive-based compensation is recoverable only upon a financial restatement[6] resulting from material noncompliance with any financial reporting requirement under the securities laws.[7] Undoubtedly, the most notable – and controversial – aspect of this requirement is the implication that the required compensation recovery policy may be imposed without respect to fault.

We believe that the proposed "no fault" trigger will have dramatic adverse effects on issuers. At the outset, we can envision individuals negotiating to avoid "executive officer" status and its attendant consequences. In addition, the application of the mandated compensation recovery policy to incentive-based compensation is likely to cause savvy and/or risk-averse individuals to negotiate their compensation arrangements to include more "fixed," rather than "variable" compensation and to ensure that their performance-based incentives are linked to operational or strategic (rather than financial) performance measures.[8] While we believe that such developments run counter to the recent trend towards greater level of performance-based pay linked to financial performance measures, we expect many issuers and their senior managers to assess the uncertainty surrounding the new requirement, as well as its broad scope, and conclude that such actions are reasonable in an uncertain environment.

We also note that a "no fault" policy triggered solely by accounting errors will place increased pressure on an issuer's Board of Directors, as well as its managers who are responsible for reviewing the financial statements. This will be reflected in increased responsibility of the Audit Committee (as well as, in many cases, the Compensation Committee as it is responsible for administering the issuer's compensation recovery policy), making service less attractive and, possibly, resulting in increased compensation levels. We also anticipate that an issuer may become more dependent on its independent auditors to address accounting issues that may give rise to a financial restatement. In each of these situations, we expect that issuers will incur increased costs to administer their policies and to respond to the increased risks posed by a restatement.

[6] For purposes of proposed Exchange Act Rule 10D-1, an "accounting restatement" would be defined as the result of the process of revising previously issued financial statements to correct errors that are material to those financial statements. *See* proposed Exchange Act Rule 10D-1(c)(1).

[7] *See also* proposed Exchange Act Rule 10D-1(b)(1).

[8] Similarly, we anticipate that the adoption of the mandated compensation recovery policy will lead to an increase in incentive-based compensation awards that are earned based on subjective criteria or payable on a discretionary basis.

We question whether these results are necessary or inevitable. We believe that scaling back the scope of the Proposals could ameliorate these eventualities while, at the same time, continuing to serve Congress' overarching objectives. While the Proposals merely reflect the language of Section 10D, we note that they are considerably broader than the existing executive compensation recovery requirements of the Sarbanes-Oxley Act.[9] Specifically, Section 304 of the Sarbanes-Oxley Act provides a compensation recovery policy that has been in effect for more than a decade. In addition to limiting recovery to an issuer's Principal Executive Officer and Principal Financial Officer, this provision also triggers recovery only in the event of an accounting restatement due to the material noncompliance of the issuer as a result of misconduct.

We do not support a provision that assigns liability without culpability. We believe that Section 954 of the Dodd-Frank Act (and new Section 10D of the Exchange Act) should be read as Congress' decision to expand the scope of coverage of compensation recovery policies without necessarily broadening the circumstances in which such recovery would be triggered. We find this to be particularly reasonable when considered in the context of the situations where recovery would be in the best interest of the issuer and its shareholders.

Consequently, we recommend that the Commission exercise its general exemptive authority to limit the application of Section 10D to situations where an accounting restatement is required due to material non-compliance with any financial reporting requirements under the securities laws as the result of misconduct on the part of one or more individuals. In this context, "misconduct" would be construed as either negligence or intentional misconduct. Consistent with the application of Section 304 of the Sarbanes-Oxley Act, we recommend that the misconduct not be limited to that of an executive officer, but include that of any employee which resulted in the award or payment of compensation based on erroneous data.

Alternatively, if the Commission believes that such an interpretation is unwarranted, we recommend that the provision be limited to a smaller group of individuals, as discussed in Section III.A below.

B. Date an Issuer Is Required to Prepare an Accounting Restatement

We support the Commission's proposal to identify the date for calculating the three-year look-back period using the earlier to occur of:

- The date the issuer's board of directors, a committee of the board of directors, or the officer or officers of the issuer authorized to take such action if board action is not required, concludes, or reasonably should have concluded, that the issuer's previously issued financial statements contain a material error; or

[9] See Section 304 of the Sarbanes-Oxley Act of 2002.

- The date a court, regulator or other legally authorized body directs the issuer to restate its previously issued financial statements to correct a material error.[10]

We believe that the inclusion of an objective standard in the first prong of this test is appropriate to prevent manipulation and to provide certainty as to the look-back period. We are concerned, however, that such a provision may be used as a weapon against issuers to challenge the date upon which an issuer's Board of Directors actually concludes that the issuer's previously issued financial statements contain a material error. Consequently, we request that the Commission provide guidance as to the type of facts that would support the reasonableness of such a conclusion. The absence of a clear standard raises the specter of potential shareholder derivative litigation based on allegations that an issuer reasonably should have concluded that previous financial statements contained a material error at an earlier date.

Such guidance could include the issuance of a statement from the issuer's independent auditor notifying the issuer of its reasonable belief that the financial statements contain a material error.[11] In sum, this guidance should provide a basis for supporting the decision of the Board of Directors as to its determination as to whether a restatement is required so as to minimize a third party's subjective assertion that the identification of this date in incorrect.

III. Executive Officers Subject to Compensation Recovery Policy

A. Definition of "Executive Officer"

Pursuant to proposed Exchange Act Rule 10D-1, the required compensation recovery policy would apply to all current and former executive officers on a "no-fault" basis who served in such a capacity at any time during the applicable look-back period. Further, as proposed, the term "executive officer" would be defined[12] in a manner consistent with the definition of the term "officer" in Exchange Act Rule 16a-1(f).[13]

We believe that the combination of the "no-fault" basis for the recovery trigger and the expansive scope of the proposed definition of who should be subject to the compensation recovery policy would lead, in many instances, to unfair and inappropriate results. For example,

[10] See proposed Exchange Act Rule 10D-1(c)(2).

[11] If an issuer disagreed with its independent auditor, it would be incumbent on the Board of Directors to issue a statement setting forth its reasons for such a belief.

[12] As proposed, the term "executive officer" would mean the issuer's president, principal financial officer, principal accounting officer (or if there is no such accounting officer, the controller), any vice-president of the issuer in charge of a principal business unit, division or function (such as sales, administration or finance), any other officer who performs a policy-making function, or any other person who performs similar policy-making functions for the issuer. See proposed Exchange Act Rule 10D-1(c)(3). Further, executive officers of the issuer's parent(s) or subsidiaries would be deemed executive officers of the issuer if they perform such policy-making functions for the issuer. *Id*.

[13] 17 CFR 240.16a-1(f).

applying the compensation recovery policy to an individual whose functional responsibility or business unit has no influence or basis regarding the financial reporting error which has led to the need for a financial restatement would result in compensation forfeitures that could deprive these individuals of earned compensation merely because they have access to the type of information that makes them a "corporate insider." We do not believe that Congress intended for Section 10D to operate on such a sweeping basis. This is particularly true when you consider Section 304 of the Sarbanes-Oxley Act, its previous initiative addressing the matter of erroneously-awarded compensation.

As discussed below, the potential result contemplated by proposed Exchange Act Rule 10D-1 would be particularly harsh given the Proposals inflexibility with respect to the exercise of discretion by an issuer's Board of Directors in executing the compensation recovery policy in any specific situation.

Further, by using a definition that parallels an issuer's determination of its executive officers who are subject to the reporting requirements and trading consequences of Section 16 of the Exchange Act,[14] we fear that issuers would have an incentive to reevaluate their Section 16 "insiders" for purposes of reducing the number of individuals subject to those rules – particularly where the individual has little or no responsibility for accounting and finance matters. Out of an abundance of caution, we have observed that many issuers have been overly-inclusive in identifying the individuals within their organization who are subject to the reporting requirements of Section 16(a) and the "short-swing profits" recovery provisions of Section 16(b). In many of these instances, the transparency and monitoring benefits of over-inclusion have outweighed any concerns about a deliberate or inadvertent Section 16(b) violation. The stakes posed by the compensation recovery policy, however, provide issuers with the incentive to re-examine their prior determinations. In our view, given the importance of both the reporting requirements of Section 16(a) of the Exchange Act, as well as proposed Exchange Act 10D-1, the definition of who is subject to these provisions should not operate with conflicting purposes.

Accordingly, we recommend that the Commission consider a definition for the term "executive officer" that is limited to an issuer's principal executive officer, principal financial officer, and other executive officers who are responsible for or involved in the preparation and review of the issuer's financial statements (such as the principal accounting officer and any vice-president in charge of a principal business unit, division or function that involves a financial function).[15] Further, we believe that such a definition would be consistent with the intent of

[14] 15 U.S.C. 78p.

[15] For this reason, we do not support the limitation of the term "executive officer" to an issuer's named executive officers as set forth in Item 402(a)(3) and 402(m)(2) of Regulation S-K. 17 CFR 229.402(a)(3) and 402(m)(3). While such an approach would necessarily encompass an issuer's principal executive officer and principal financial officer, it would suffer from the same shortcoming as the proposed definition since there is no assurance that the issuer's three most highly-compensated executive officers (other than its PEO and PFO) who were serving as executive officers at the end of the last completed fiscal year would be individuals involved in the preparation and review of the issuer's financial statements.

Section 10D by reinforcing the responsibility for the preparation of complete and accurate financial statements (and the consequences of any failure to do so) on the individuals who have primary responsibility for this area.[16]

If the Commission determines that such a definition would be inconsistent with the intent of Section 10D, we recommend that it add a *scienter* requirement to the inclusion of any individual who is not otherwise responsible for or involved in the preparation and review of the issuer's financial statements within the ambit of the compensation recovery policy. We believe that such a requirement would address the problem of the overly-broad definition, while remaining faithful to Congress' objective of ensuring that the individuals from whom recovery is sought had some level of responsibility for or involvement in the actions that resulted in the need for a financial restatement.

B. Status as Executive Officer During Look-Back Period

As proposed, incentive-based compensation would be subject to recovery whether an individual was granted or earned such compensation in his or her capacity as an executive officer or as a non-executive employee. As we read proposed Exchange Act Rule 10D-1(b)(1)(i)(B), as long as the individual served as an executive officer at any point in time during an award's applicable performance period, all of the individual's incentive-based compensation would be subject to recovery for any excess received during the three-year look-back period. Thus, the "no-fault" aspect of the compensation recovery policy could capture the compensation of non-executive employees who later serve as an executive officer (even if only on an interim basis) during the look-back period.

We recommend that the Commission limit the application of proposed Exchange Act Rule 10D-1 to only incentive-based compensation earned during the portion of the three completed fiscal years immediately preceding the date that the issuer is required to prepare a restatement during which the individual was serving as an executive officer of the issuer. As proposed, recovery would apply to any incentive-based compensation earned during the three-year look-back period if the subject individual served as an executive officer <u>at any time</u> during the performance period.[17] While such a provision may appear plausible based on a literal reading of Section 10D, we believe that this result would unduly expand the reach of the compensation recovery policy to situations where the compensation subject to recovery was clearly not awarded in an "executive" context (and, in all likelihood, was not awarded by the Board of

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[16] We note that the Commission cites their responsibility for financial information as justifying the inclusion of an issuer's principal financial officer and principal accounting officer in the definition of "executive officer" for purposes of Section 10D of the Exchange Act (notwithstanding that such individuals are specifically included in the Exchange Act Rule 16a-1(f) definition of the term "officer"). *See* the Proposing Release, at Section II.C.1.

[17] Further, we do not support a provision that would subject an individual who is an executive officer at the time recovery is required to such recovery even if that individual did not serve as an executive officer of the issuer at any time during the performance period for the affected incentive-based compensation. In our view, such a provision suffers from the same deficiencies as the current proposal.

Directors or its Compensation Committee, but, instead, by management) and would compound the perceived (and actual) unfairness of the statute.

IV. Incentive-Based Compensation

The Commission is proposing that the required compensation recovery policy apply to any "incentive-based compensation," that is, any compensation that is granted, earned, or vested based wholly or in part upon the attainment of a financial reporting measure.[18] Further, for this purpose, a "financial reporting measure" would be:

- Any measure that is determined and presented in accordance with the accounting principles used in preparing an issuer's financial statements;
- Any measure that is derived wholly or in part from such measures;
- Stock price; and
- Total shareholder return ("TSR").[19]

While we support the Commission's decision to define "incentive-based compensation" by reference to the use of a financial reporting measure and the first two prongs of what would constitute a "financial reporting measure," we are concerned that the inclusion of stock price and TSR could create compliance challenges unless the Commission provides additional guidance on how such terms are intended to be applied.

We also request that the Commission expressly confirm that service (time)-based equity awards are not considered incentive-based compensation on the theory that the value of these awards is a function of two separate factors – satisfaction of the service requirement and appreciation in the market value of the shares during the service period. We note that, in the Proposing Release, the Commission acknowledges that service (time) –based stock options would be considered performance-based compensation for purposes of the exclusion from the deduction limits of Section 162(m) of the Internal Revenue Code.[20]

We believe that service (time) – based equity awards (whether stock options stock appreciation rights, or full-value awards) should not be included within the definition of incentive-based compensation. In fact, we understand that the proposed definition of "incentive-based compensation" has been drafted to exclude such awards from the scope of proposed Exchange Act Rule 10D-1. Accordingly, to minimize confusion and any potential litigation risk, we request that this result be expressly confirmed by the Commission.

[18] See proposed Exchange Act Rule 10D-1(c)(4).

[19] *Id*.

[20] 26 U.S.C. 162(m).

V. Recovery and Determination of Recoverable Amount

A. Board Discretion to Pursue Recovery

In drafting rules to implement Section 10D of the Exchange Act, the Commission has proposed that the required listing standard provide that issuers "must recover erroneously awarded compensation."[21] As proposed, this mandate has only one narrowly-drafted exception for situations where compliance would be "impracticable."[22] Under this exception, recovery would be deemed "impracticable" only if the direct expense paid to a third party to assist in enforcing the policy would exceed the amount to be recovered, or if recovery would violate home country law.[23] Further, such a conclusion could be reached only after as issuer has first made a reasonable attempt to recover that erroneously-awarded compensation.[24]

In other words, it appears that Section 10D is intended to operate automatically without regard to whether the recovery of the erroneously-awarded compensation is in the best interests of a listed issuer and its shareholders. Further, it appears that to show that the direct costs of recovery exceeded the recoverable amount, an issuer would still have to undertake the normal recovery process, make the calculations necessary to identify the recoverable amounts against which the enforcement costs would be measured, and, ultimately, attempt to enforce recovery. At the same time, the issuer would need to monitor and document its costs to be able to establish that, ultimately, recovery was futile. Given the absence of a *de minimis* threshold for pursuing recovery, in some situations issuers could need to retain costly experts to calculate the amounts subject to recovery even where those amounts ultimately prove smaller than the cost of recovery.[25]

We believe that, as proposed, this mandate imposes an unreasonable and impractical burden on issuers. We also believe that it inappropriately deprives Boards of Directors of their ability to exercise their fiduciary responsibilities to make an informed decision as to whether recovery of any erroneously-awarded compensation is in the best interests of the issuer and its shareholders.

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[21] *See* proposed Exchange Act Rule 10D-1(b)(1)(iv).

[22] *Id*.

[23] *Id*.

[24] *Id*.

[25] Although recovery would not be required in that circumstance, an issuer would be able to draw this conclusion only after investing significant amounts of time, effort, and money.

We note that Section 111 of the Emergency Economic Stabilization Act of 2008,[26] as amended by Section 7001 of the American Recovery and Reinvestment Act of 2009,[27] providing for a compensation recovery policy for institutions participating in the Troubled Assets Relief Program ("TARP") takes a more pragmatic approach; with the Department of the Treasury allowing a TARP recipient to forego the exercise of its "clawback" rights to the extent it demonstrates that it is unreasonable to do so, such as, for example, if the expense of enforcing the rights would exceed the amount recovered.[28] We believe that, at a minimum, a similar "reasonableness" exception should be provided for issuers that are faced with the operation of their compensation recovery policy.

In our view, the Board of Directors of the issuer should be permitted to exercise its business judgment to determine whether, based on all of the relevant facts and circumstances, recovery of any erroneously-awarded compensation is in the best interests of the issuer and its shareholders. This would include situations where the expense of enforcing recovery (based on the cost to the issuer, including, but not limited to, any amounts paid to a third party) would exceed the amount recovered. As proposed, the recovery standard excludes the Board of Directors from determining when and how to best execute its policy and reduces its involvement to a mere ministerial function.

We believe that, consistent with sound corporate governance, the rules implementing Section 10D should give the Board of Directors the discretion to determine:

- whether to pursue recovery of erroneously-awarded compensation;
- whether to settle a recovery obligation for less than the full amount;
- whether the amount of erroneously-awarded compensation represents such a *de minimis* amount that is not worth pursuing; or
- whether to recover through an alternative method.

In our experience, Boards of Directors are extremely diligent in fulfilling their fiduciary obligations. Consequently, a rigidly prescriptive set of rules is unnecessary. Ultimately, if shareholders believe that directors are not properly discharging their duties, including with respect to the issuer's compensation recovery policy, they may act by voting against those directors (or, in extreme cases, by bringing an action for breach of fiduciary duty).

We recommend that the Commission revise its proposed requirement with respect to recovery to allow, once again based on the exercise of the Board of Directors' discretion, the

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[26] Division A of Pub. L. 110–343, 122 Stat. 376 (2008).

[27] Pub. L. 111–5 (2009).

[28] See Section 30.8, Q.-8 of the TARP Standards for Compensation and Corporate Governance (31 CFR Part 30).

recovery of a lesser amount that the full amount of the erroneously-awarded compensation if its determines that such an outcome is in the best interests of the issuer and its shareholders.

We believe that such a provision would promote the efficient administration of the compensation recovery policy (and, thus, the overarching objectives of the statute), simplify the determination of when the costs and burdens of compliance outweigh the benefits of recovery to the issuer and its shareholders, and continue to hold the issuer's executive officers accountable in situations where a meaningful amount of incentive-based compensation has been granted, earned, or vested in excess of what should have been granted, earned, or vested, without depriving the Board of Directors of its oversight responsibilities. It would also enable issuers to avoid the potentially awkward dynamic that may otherwise arise where a Board of Directors (through its Compensation Committee) is responsible for providing adequately designed and funded incentives for the issuer's executive officers while, at the same time, it is being compelled to recover potentially significant amounts of compensation from these very same individuals in what may quickly dissolve into an adversarial relationship.

We also note that the "impracticability" exception for violations of home country law appears to be limited to situations involving a foreign jurisdiction.[29] We believe that this exception should be expanded to include circumstances where a listed issuer is unable to recover erroneously awarded compensation because it would violate an existing statutory or contractual provision. This is likely to be an issue in states where wage and hour laws create genuine issues as to whether an issuer would be permitted to recover incentive-based compensation that is considered "wages" under the relevant statutory provision.

Depending on the jurisdiction, "wages" may be defined broadly to include numerous types of compensation for work performed, including commissions and bonuses.[30] Where an incentive-based compensation arrangement involves a bonus that is to be earned, either in whole or in part, on the achievement of one or more financial reporting measures as defined in proposed Rule 10D-1(c)(4), we are concerned that an issuer in a jurisdiction with such a definition may be faced with the prospect of delisting or undertaking costly and protracted litigation to seek recovery in a situation where its ability to recover is problematic, at best.[31]

Consequently, we recommend that the Commission expand the "impracticability" exception to include situations where recovery would also violate any provision of state law.

[29] See the Proposing Release, at Section II.C.3.b.

[30] For example, under the labor laws of the State of New York, "wages" are defined broadly as "the earnings of an employee for labor or services rendered, regardless of whether the amount of earnings is determined on a time, piece, commission or other basis." *See* N.Y. Lab. Law 190(1). It is our understanding that, pursuant to this definition, commissions are expressly considered "wages." Further, we understand that, in certain situations, courts in New York State have held that bonuses may be "wages," as well.

[31] The potential issues that may arise under such laws range from whether the payment involves "wages," whether the payment was discretionary or mandatory, and whether the wages have been earned.

Similar to the current proposal, the Commission may limit the availability of such exception to instances where the conditions of proposed Rule 10D-1(b)(iv) have been satisfied.[32]

Consistent with our belief regarding the decision to pursue recovery, we support the Commission's proposal to permit an issuer's Board of Directors to exercise discretion regarding the means of recovery. In our view, once an appropriate triggering event has occurred, a listed issuer and its Board of Directors should be afforded the maximum level of discretion to determine whether recovery is occurring "reasonable promptly" and how the mechanics of recovery will be handled, without second-guessing and the risk of inadvertently failing to comply with any technical detail.

This could include, for example, allowing deferred payment arrangements when an executive officer otherwise is unable to repay the erroneously-awarded compensation immediately (over a reasonable time period as determined by the Board of Directors in its discretion) or netting incentive-based compensation overpayments with incentive-based compensation underpayments that result from restating financial statements for multiple periods during the three-year recovery period. At the same time, given the potential enforcement costs (both direct and indirect) to recover erroneously-awarded compensation, we believe that some issuers may gravitate towards subjecting their incentive-based compensation arrangements to "holdback" policies that defer payment of earned or vested amounts until the expiration of the look-back period.[33]

Given the potentially broad scope of situations where recovery may be triggered, as well as the potentially large number of individuals from whom recovery may be required, we believe that issuers should not be obligated to devote unlimited resources and time to pursue recovery simply to satisfy a hypothetical standard of "promptness."

B. Calculation of Recoverable Amount

Section 10D(b)(2) provides for the recovery of the amount received on the basis of erroneous data in excess of what an executive officer otherwise would have received, based on the restated financial statements. While we expect that, in some cases, this amount will be readily apparent, we believe that, given the ever-evolving complexity of performance-based incentive compensation plans and arrangements, it will be less clear in many situations.

[32] Such conditions could include (i) the receipt of an opinion of counsel, not unacceptable to the applicable national securities exchange or association, that recovery would result in such a violation, (ii) provision of such opinion to the exchange or association, (iii) the applicable law having been adopted prior to the date of publication in the Federal Register of proposed Rule 10D-1, and (iv) the issuer's committee of independent directors responsible for executive compensation decisions, or in the absence of such a committee, a majority of the independent directors serving on the issuer's Board of Directors, making a determination that recovery would be impracticable.

[33] Further, the lost compensation associated with the time value of money of those deferred payments may ultimately be addressed in other forms of compensation, such as base salaries.

Given the potential complexity of many incentive-based compensation arrangements, we recommend that the Commission establish a clear set of guidelines as to how listed companies are to calculate the amount that is recoverable under a variety of common arrangements, including different equity-based arrangements or, alternatively, a clear set of principles that can be used to make such calculations. Specifically, we recommend that the Commission provide additional guidance regarding how reasonable estimates should be calculated where the financial performance measure for an incentive-based compensation award involves stock price or TSR.

We also note that, where the incentive-based compensation is to be earned or vest using stock price or TSR as the relevant performance measure and the amount of erroneously-awarded compensation is not subject to mathematical recalculation directly from the information in an accounting restatement, the amount of erroneously-awarded compensation is to be based on a reasonable estimate of the effect of the accounting restatement on the stock price or TSR upon which the incentive-based compensation was received.[34] We believe that in many instances making these estimates will be very challenging and will require considerable attention.

We also note that virtually no guidance has been provided on how to estimate the impact of an accounting restatement on a performance award based on stock price performance or relative TSR, which are, in our experience, fairly common performance measures. Calculating the difference between the compensation that was awarded and the compensation that should have been awarded based on the restated financials may require some exceedingly difficult calculations.

While the Proposing Release refers readers to the Commission's economic analysis for a discussion of different methodologies for determining a reasonable estimate of the effect of the accounting restatement on the stock price or TSR,[35] that discussion largely indicates that:

> The significant complications of establishing a reasonable estimate of the "but for" price,[36] in conjunction with the likely monetary costs incurred to calculate it, make it difficult to assess the relative costs and benefits accruing to an issuer from enforcing a recovery policy that covers compensation based on stock price and/or TSR. These uncertainties also could undermine issuers' incentives to enforce their recovery policies and make it more difficult for exchanges to monitor compliance. This effect may be partially or entirely mitigated by the requirement for issuers to provide documentation to the relevant exchange of any reasonable estimates used or attempts to recover compensation, which will assist exchanges in monitoring compliance and incentivize

[34] *See* proposed Exchange Act Rule 10D-1(b)(iii)(A). In addition, as proposed, an issuer making such an estimate would be required to maintain documentation of the determination of that reasonable estimate and provide such documentation to the exchange or association. *See* proposed Exchange Act Rule 10D-1(b)(iii)(B).

[35] *See* the Proposing Release, at footnote 164.

[36] That is, the stock price that would have been if the financial statements originally had been presented as later restated.

> issuers to carefully document the considerations that went into the determination to enforce (or not enforce) their recovery policy. On balance, we think other aspects of the proposed rule and rule amendments, such as the ability to use reasonable estimates and the board's discretion not to pursue recovery when the direct enforcement costs would exceed the amount to be recovered, may serve to mitigate these costs; however, below we request comment on this aspect of the proposed rule and rule amendments to help us better understand its economic effects.[37]

As a result, we believe that significant ambiguities exist that will make it very difficult for issuers that use either (or both) stock price or TSR as a performance measure to calculate any erroneously-awarded compensation in the event that their compensation recovery policy is triggered. For example, it is unclear as to the form or forms of "reasonable estimates" that will be deemed adequate without the need to engage a valuation expert and/or other third-party advisor. Further, this current ambiguity increases the risk of potential shareholder derivative litigation alleging that the analyses and calculations used to determine the impact of a restatement on stock price and TSR were inadequate.

In view of the potential challenges in calculating the erroneously-awarded compensation in the event of incentive-based compensation that is either granted, earned, or vests based on stock price or TSR, we request that the Commission provide guidance as to how issuers should approach this task in light of the requirements of Section 10D. Such guidance could take the form of examples of how to adjust share price and/or TSR in the event of a financial restatement. Absent such guidance, we are concerned that many issuers will be inclined to move away from using stock price or TSR as a performance measure in their equity awards.

We believe that such guidance may take the form of additional examples of some common arrangements involving performance-based long-term incentive awards designed to measure absolute and relative stock price and/or TSR performance. While we would not expect such examples to be an exhaustive treatment of how calculations may be made, they could be an effective means of illustrating the basic principles by which issuers should be guided in enforcing their compensation recovery policies.

While we do not object, on a theoretical basis, with the inclusion of compensation that is based upon stock price performance or TSR as incentive-based compensation subject to the mandated compensation recovery policy, we are opposed to their inclusion in the definition if issuers are simply going to be left to their own devices to calculate the amounts that are subject to recovery.

Finally, we support the Commission's proposal to require issuers to maintain documentation of the determination of the reasonable estimate used to calculate the amount of erroneously-awarded compensation and to provide such documentation to the relevant exchange. As to this latter requirement, we would recommend that such documentation be maintained by the issuer and provided upon request to eliminate a procedural detail that may be overlooked. We

[37] *See* the Proposing Release, at Section III.B.2.

do not believe that such a change would have an adverse impact on compliance monitoring, and would simply restrict delivery of this documentation to situations where an exchange was evaluating the compliance efforts of a specific issuer.

VI. Disclosure of Issuer Policy on Incentive-Based Compensation

Proposed Exchange Act Rule 10D-1 would require that any new listing standards include among its requirements that listed issuers disclose their compensation recovery policies.[38] Further, to provide consistent disclosure among the national securities exchanges, proposed Exchange Act Rule 10D-1 would also provide that the required disclosure about the issuer's compensation recovery policy must be filed in accordance with the disclosure requirements of the federal securities laws.[39]

Generally, we support the Commission's proposed approach of having the listing standard require an issuer to disclose its compensation recovery policy as an appropriate means to implement Section 10D(a) of the Exchange Act. Consistent with the Commission's proposed interpretation of Section 10D(b)(1), we believe that this provision should be read in conjunction with the description contained in Section 10D(b)(2) of the Exchange Act concerning the recovery of erroneously-awarded compensation and not as an independent disclosure requirement. In our view, the current executive compensation disclosure rules provide an adequate basis for the disclosure of incentive-based compensation.[40] Thus, we recommend that the Commission not interpret Section 10D(b)(1) as creating a new disclosure requirement about incentive-based compensation.

Finally, we believe that proposed Item 402(w) of Regulation S-K (as well as the proposed amendment to Item 404 of Regulation S-K) are sufficient to ensure that an appropriate level of information about how issuers have applied their compensation recovery policies to investors. We believe that it is not necessary, nor does is serve as compelling objective, to require listed issuers to disclose the name of any executive officer from whom recovery has been forgone, the amounts forgone, and the reason the listed issuer decided not to pursue recovery. In our view, the disclosure of such details is simply an invitation to plaintiffs' attorneys to second-guess the decision of the Board of Directors and the creation of a litigation risk in an area that should be wholly within the province of the business judgment of the members of the Board of Directors.

VII. Indemnification

Under proposed Exchange Act Rule 10D-1, listed issuers would be prohibited from indemnifying any current or former executive officer against the loss of erroneously-awarded

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[38] *See* proposed Exchange Act Rule 10D-1(b)(1).

[39] *Id.*

[40] *See* Item 402(b)(1)(v) of Regulation S-K (17 CFR 229.402(b)(1)(v), as well as Items 402(b)(2)(vi) and (vii) of Regulation S-K (17 CFR 229.402(b)(2)(vi) and (vii).

compensation.[41] Among other things, the Commission has cited Section 29(a) of the Exchange Act[42] as rendering any indemnification agreement unenforceable to the extent that the agreement purported to relieve the issuer of its obligations under Section 10D, the Proposals, and a resulting listing standard to recover erroneously-paid incentive compensation.

We are concerned that, absent guidance, compensation payments and awards in the ordinary course of business could be mistaken for "indemnification" payments or payments otherwise being made to mitigate the consequences of the operation of a listed issuer's compensation recovery policy. Thus, we recommend that the Commission provide one or more guiding principles that can be used to safeguard ordinary-course payments. Given the potential negative publicity that may accompany the triggering and operation of a compensation recovery policy, we believe that such guidance would be critical to ensuring that an issuer's actions are not unfairly and inaccurately characterized as an attempt to circumvent the objectives of proposed Exchange Act Rule 10D-1.

VIII. Transition

The Commission is proposing that each listed issuer be required to recover all erroneously awarded incentive-based compensation received by executive officers and former executive officers as a result of attainment of a financial reporting measure based on or derived from financial information for any fiscal period ending on or after the effective date of proposed Exchange Act Rule 10D-1 and that is granted, earned or vested on or after the effective date of Rule 10D-1 pursuant to the issuer's recovery policy.[43] We note that, assuming the proposed rule is adopted and becomes effective prior to December 31, 2015, this requirement would subject incentive-based compensation with a performance-period ending on or after the effective date to the requirements of proposed Exchange Act Rule 10D-1 even though such compensation was granted or awarded prior to the publication of the Proposals.

While we can understand why the Commission believes that such application may be appropriate for annual incentive awards granted at the beginning of 2015 with a one-year performance period ending at or near December 31st, we are concerned that, as proposed, compensation recovery would also potentially be required for incentive-based awards granted as early as the beginning of 2013 (and assuming a three-year performance period ending at or near December 31, 2015). Further, this appears to have the effect of making any financial information that an issuer reports on or after this date (which may be an entire year before the relevant listing

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[41] *See* proposed Exchange Act Rule 10D-1(b)(1)(v). In addition, the indemnification prohibition would prohibit an issuer from paying or reimbursing the executive officer for premiums for such an insurance policy. *See* the Proposing Release, at Section II.E.

[42] 15 U.S.C. 78cc(a).

[43] *See* proposed Exchange Act Rule 10D-1(a)(2)(ii).

standards are effective and more than a year before the issuer is required to adopt its own compensation recovery policy) the basis for a potential "clawback."[44]

We believe that it is unfair to apply any statutorily-mandated compensation recovery policy to awards that may have been granted several years prior to the adoption of rules implementing Section 954. Such unfairness is exacerbated when the other expansive aspects of the Proposals are considered – for example, an individual who served as an interim executive officer of a listed issuer for three months from June through August 2013 and then subsequently terminated his or her employment with the issuer could potentially be subject to the "clawback" of a portion of his or her incentive-based compensation awarded in 2013.[45]

Instead, we recommend that the Commission apply proposed Exchange Act Rule 10D-1 to compensation plans and arrangements entered into after the effective date of the national securities exchanges' and national securities associations' listing standards. Consequently, Section 10D of the Exchange Act would not be applicable to a listed issuer's incentive-based compensation arrangements that were granted or awarded prior to such effective date, irrespective of when such arrangements are earned or otherwise vest. In our view, such application would also help alleviate the potential effect that proposed Exchange Act Rule 10D-1 will have on existing compensation plans and employment agreements that are either subject to an issuer-developed compensation recovery policy or simply do not contemplate recovery under any compensation recovery policy. Prospective application would give issuers much-needed additional time to evaluate and amend their existing compensation plans and employment agreements to provide for the application of the mandated compensation recovery policy, as well as to harmonize any existing compensation recovery policy with the mandated policy.

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We appreciate the opportunity to comment on the Proposals, and respectfully request that the Commission consider the recommendations set forth in this letter. We are prepared to meet and discuss these matters with the Commission and its staff at its convenience. Any questions about this letter may be directed to the undersigned at [redacted].

Respectfully submitted,

Mark A. Borges

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[44] Further, it appears that all relevant incentive-based compensation where performance is based on such information would be subject to recovery regardless of whether the compensation is awarded pursuant to a pre-existing employment or award agreement.

[45] Of course, this result would only arise in situations where the post-employment compensation arrangements of the issuer permitted the former executive officer to received incentive-based compensation that is earned following his or her termination of employment.