

# TheCityUK

## SEC Proposed Listing Standards: Proposed Rule 10D-1 under the Securities Exchange Act for Clawing Back Erroneously Awarded Executive Compensation (File Number S7-12-15)

### Views submitted to the SEC by TheCityUK

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#### **Context**

1. TheCityUK is an independent membership body representing the UK-based financial and related professional services industry in the United Kingdom. This ranges from banking, insurance, asset management, securities and private equity through to legal, accountancy and management advisory services. These sectors as a whole account for 12.8% of the UK's GDP and financial services account for 12% of UK tax receipts. They employ over two million people, more than two-thirds of whom work outside of London. TheCityUK's membership includes UK-headquartered and inward investor firms. Our work on trade and investment policy is undertaken through the Liberalisation of Trade in Services (LOTIS) Committee and the International Trade and Investment Group (ITIG).
2. TheCityUK welcomes the opportunity to submit views on the SEC's Proposed Listing Standards for Clawing Back Erroneously Awarded Executive Compensation, as invited in the SEC Press Notice issued in connection with the proposal (<http://www.sec.gov/news/pressrelease/2015-136.html>).

#### **Detail**

3. TheCityUK notes that the proposed rule would direct US securities exchanges to adopt listing standards requiring listed companies to implement policies that would mandate bonus clawbacks in the event of a material accounting restatement. Unlike many compensation-related disclosure rules adopted by the SEC in the past, foreign private issuers (such as a UK company) would not be exempt from this requirement. A company would be subject to delisting if it did not adopt a policy that complies with the applicable listing standard, disclose the policy as prescribed by the SEC rules or enforce the policy's recovery provisions.
4. This SEC proposal differs significantly from current analogous UK requirements in that the proposed clawback would appear to affect all executive officers whose bonuses are based on:
  - the attainment of any financial reporting measure
  - share price; and/or
  - total shareholder return.
5. As TheCityUK understands the proposal, this would be the case regardless of whether the executive concerned bore any responsibility for the erroneous financial statements. Furthermore, the proposed rule would make clawback mandatory, removing the decision to seek recovery from the discretion of the foreign company's board. The only exceptions would be:
  - if pursuing recovery would place undue costs on the company or its shareholders; or
  - if, in the case of foreign private issuers, recovery would violate home-country law.

6. The language of proposal does not appear to contemplate allowing substituted compliance with home-country standards to which a foreign company may be subject. However, one of the SEC's specific requests for comment (page 16 of the SEC's full consultation document (<http://www.sec.gov/rules/proposed/2015/33-9861.pdf>) concerns cases in which a foreign private issuer's home country has a law like Section 10D, with a specific question as follows:

"4. In the event that a foreign private issuer's home country has a law that like Section 10D requires the issuer to disclose its policies on incentive-based compensation and recover erroneously awarded incentive-based compensation from current or former executive officers [footnote referencing the UK Corporate Governance Code and Capital Requirements Directive IV], should the foreign private issuer be permitted to comply with its home country law instead of complying with the listing standard of the U.S. exchange that lists the foreign private issuer's securities? Please explain why or why not."

### **Recommendation**

7. The SEC's Question 4 above suggests a willingness on the part of the SEC to be flexible in its approach to applying the proposed requirements to foreign private issuers. In TheCityUK's view, the SEC ought to provide for substituted compliance of the kind referenced in the footnote to Question 4. While neither the UK Corporate Governance Code nor CRD IV corresponds exactly to the SEC proposal, both provide for similarly rigorous disciplines which we believe meet the SEC goals in introducing this rule. A substituted compliance provision would therefore remove the problems for foreign issuers that have been explained above.
8. TheCityUK accordingly hopes that the SEC will be ready to introduce such a provision to address these issues in the way we have suggested. For example, under the Prudential Regulation Authority's Remuneration Rules, UK firms are required to ensure that variable remuneration is "considerably contracted when subdued or negative financial performance of the firm occurs ... including through malus or clawback arrangements." Clawback applies for a period of at least seven years from the date of award and must be considered, for example, where the employee participated in or was responsible for conduct which resulted in significant losses for the firm, where there is reasonable evidence of employee misbehaviour or material error, or there is a material failure of risk management. In addition, an adjustment to unvested variable remuneration must specifically be considered where the firm or a material business unit suffers a "material downturn in its financial performance".
9. We consider that the discretionary application of clawback and malus under the UK rules provides for a wider potential application of recovery of variable remuneration than proposed by the SEC and so provides full scope for meeting the requirements under the SEC provisions using substituted compliance.
10. TheCityUK notes that the SEC consultation ends on 14 September 2015 (sixty days from the publication of the SEC's proposal in the Federal Register) and asks for this submission to be taken into consideration. It stands ready to provide further comment if the SEC would find that helpful.

### **TheCityUK**

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