Council of Institutional Investors®
The voice of corporate governance

Via Email

June 24, 2022

Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

Re: File Number S7-12-15: Reopening of Comment Period for Listing Standards for Recovery of Erroneously Awarded Compensation (June Release).[1]

Dear Madam Secretary:

I am writing on behalf of the Council of Institutional Investors (CII), a nonprofit, nonpartisan association of U.S. public, corporate and union employee benefit funds, other employee benefit plans, state and local entities charged with investing public assets, and foundations and endowments with combined assets under management of approximately $4 trillion. Our member funds include major long-term shareowners with a duty to protect the retirement savings of millions of workers and their families, including public pension funds with more than 15 million participants – true "Main Street" investors through their pension funds. Our associate members include non-U.S. asset owners with about $4 trillion in assets, and a range of asset managers with more than $40 trillion in assets under management.[2]

The purpose of this letter is to respond to the Securities and Exchange Commission's (SEC or Commission) *June Release*[3] for the proposal to implement the provisions of Section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank)[4] (Proposed Rule).[5] As the leading voice for effective corporate governance and strong shareholder rights, and as a primary advocate for Section 954 of Dodd-Frank,[6] we continue to strongly support the

[1] Reopening of Comment Period for Listing Standards for Recovery of Erroneously Awarded Compensation, Securities Act Release No. 11,071, Exchange Act Release No. 95,057, Investment Company Act Release No. 34,610, 87 Fed. Reg. 35,938 (June 8, 2022), https://www.federalregister.gov/documents/2022/06/14/2022-12792/reopening-of-comment-period-for-listing-standards-for-recovery-of-erroneously-awarded-compensation.
[2] For more information about the Council of Institutional Investors ("CII"), including its board and members, please visit CII's website at https://www.cii.org/about.
[3] *See* 87 Fed. Reg. at 35,938.
[4] Public Law 111-203, 124 Stat. 1900, § 954 (July 21, 2010), *available at* https://www.govinfo.gov/content/pkg/PLAW-111publ203/pdf/PLAW-111publ203.pdf.
[5] Listing Standards for Recovery of Erroneously Awarded Compensation, Securities Act Release No. 9,861, Exchange Act Release No. 75,342, Investment Company Act Release No. 31,702, 80 Fed. Reg. 41,144 (proposed July 14, 2015), https://www.govinfo.gov/content/pkg/FR-2015-07-14/pdf/2015-16613.pdf.
[6] *See* Protecting Shareholders and Enhancing Public Confidence by Improving Corporate Governance: Hearing Before S. Subcomm. on Sec., Ins., & Invest. of the Comm. on Banking, Hous., & Urb. Aff., 111th Cong. 13 (July

Commission promptly issuing the long overdue rule to "strengthen the transparency and quality of corporate financial statements as well as the accountability of corporate executives to their investors."[7]

We note that the *June Release* identified three issues[8] relating to a June 2022 memorandum of the SEC's Division of Economic and Risk Analysis "Supplemental data and analysis on the voluntary adoption of compensation recovery provisions by issuers and the impact of including 'little r' restatements as triggers for a compensation recovery analysis" (DERA Memo).[9] The following are CII's views with respect to each of those issues.

1. Increase in voluntary adoption of compensation recovery policies by issuers

CII generally agrees with the DERA Memo data and analysis finding that "many companies have voluntarily adopted compensation recovery provisions since the Proposing Release in 2015 . . . [and] the increase in voluntary adoption of compensation recovery provisions relative to the baseline in the Proposing Release may reduce the anticipated benefits and mitigate the anticipated costs of the proposed rules."[10] This finding is not surprising to us and does not diminish in any way our strong support for the issuance of a final rule.

29, 2009) (Testimony of Ann Yerger, Exec. Dir. of CII), https://www.govinfo.gov/content/pkg/CHRG-111shrg55479/html/CHRG-111shrg55479.htm ("The Council believes a tough clawback policy is an essential element of a meaningful 'pay for performance' philosophy [and] [i]f executives are rewarded for 'hitting their numbers'--and it turns out that they failed to so--they should not profit."); Letter from Jeff Mahoney, General Counsel, Council of Institutional Investors et al., to The Honorable Nancy Pelosi, Speaker of the House, United States House of Representatives at al. 2 (Dec. 2, 2008) (on file with CII) ("any financial markets regulatory reform legislation [should include] . . . **Stronger Clawback Provisions:** At a minimum, senior executives should be required to return unearned bonus and incentive payments that were awarded due to fraudulent activity or incorrectly stated financial results").

[7] Chair Gary Gensler, Public Statement: Statement on Rules Regarding Clawbacks of Erroneously Awarded Compensation (Oct. 14, 2021), https://www.sec.gov/news/public-statement/gensler-clawbacks-2021-10-14; *see, e.g.,* Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to Vanessa A. Countryman, Secretary, Securities and Exchange Commission 1-2 (Nov. 18, 2021), https://www.cii.org/files/issues_and_advocacy/correspondence/2021/November%2018%202021%20SEC%20clawback%20letter%20(final).pdf ("As the leading voice for effective corporate governance and strong shareholder rights, and as a primary advocate for Section 954 of Dodd-Frank, we strongly support the Commission promptly issuing the long overdue rule to 'strengthen the transparency and quality of corporate financial statements as well as the accountability of corporate executives to their investors.'").

[8] *See* 87 Fed. Reg. at 35,938-39 ("the staff memorandum (i) discusses the increase in voluntary adoption of compensation recovery policies by issuers; (ii) provides estimates of the number of additional restatements that would trigger a compensation recovery analysis if, as the Commission described in the Reopening Release, the rules were extended to include all required restatements made to correct an error in previously issued financial statements; and (iii) briefly discusses some potential implications for the costs and benefits of the proposed rules").

[9] *See* Memorandum from Division of Economic and Risk Analysis, Supplemental data and analysis on the voluntary adoption of compensation recovery provisions by issuers and the impact of including "little r" restatements as triggers for a compensation recovery analysis (June 8, 2022), https://www.sec.gov/comments/s7-12-15/s71215-20130560-298718.pdf.

[10] *Id.* at 1, 3.

As explained in CII's November 2021 letter to the SEC (November Letter)[11] in response to the Commission's October 2021 "Reopening of Comment Period for Listing Standards for Recovery of Erroneously Awarded Compensation" (October Release):[12]

> CII acknowledges that there have been a number of developments since the Proposed Rule relating to clawbacks, most notably the voluntary adoption by some companies of clawback policies that go beyond the requirements of Section 954 of Dodd-Frank.[13] We, however, continue to believe that it is in the best interests of investors for the Commission to finally bring this long overdue, Congressionally mandated rulemaking to a close by issuing a final rule. As we explained in our most recent response to the SEC's semiannual regulatory agenda:
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> > We acknowledge the observation of former SEC Chair Jay Clayton that "several companies . . . [have clawback] policies [that] go beyond what would be required under Dodd-Frank." We also acknowledge that there are some legal and practical reasons that can limit the effectiveness of existing clawbacks. . . . *However, in our view, the better course of action is for the Commission is to proceed directly to a final rule.*
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> > We believe a final rule . . . would improve corporate governance by finally implementing the requirements of section 954 of Dodd-Frank and thereby establishing a common floor for clawback policies at listed companies. After experience with a new listing standard based on section 954, investors, listed companies, and other market participants could then determine whether the listing standard should be revised to require a different . . . floor for clawback policies at listed companies.
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> . . . CII strongly agrees with SEC Chair Gary Gensler that a final rule as described in the Proposed Rule, as supplemented by the Reopening Release and this letter, would "strengthen the transparency and quality of corporate financial statements as well as the accountability of corporate executives to their investors."[14]

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[11] Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to Vanessa A. Countryman, Secretary, Securities and Exchange Commission at 9.

[12] Reopening of Comment Period for Listing Standards for Recovery of Erroneously Awarded Compensation, Securities Act Release No. 10,998, Exchange Act Release No. 93,331, Investment Company Act Release No. 34,399, 86 Fed. Reg. 58,232 (Oct. 21, 2021), https://www.govinfo.gov/content/pkg/FR-2021-10-21/pdf/2021-22754.pdf.

[13] We also acknowledge that changes to CII's own membership approved policies on executive compensation adopted in September 2019 may have "mitigated the effects of the proposed rules" by deemphasizing performance-based pay. Memorandum from Division of Economic and Risk Analysis at 2, 8 n.16; *see* Council of Institutional Investors, Corporate Governance Policies, § 5.5c Performance-Based Compensation (updated Mar. 7, 2022), https://www.cii.org/files/03_07_22_corp_gov_policies.pdf ("Performance-based compensation plans are a major source of today's complexity and confusion in executive pay . . . [and] susceptible to manipulation.").

[14] Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to Vanessa A. Countryman, Secretary, Securities and Exchange Commission at 9 (footnotes omitted).

2. Number of additional restatements that would trigger a compensation recovery analysis

CII generally agrees with the DERA Memo finding that "if the final rules were to encompass both ["little r" and "Big R"] types of restatements, it would increase the total number of restatements that could potentially trigger a compensation recovery analysis that may result in recovery."[15] Again, this finding is not surprising to us and we continue to believe that encompassing both types of restatements in the final rule is not only consistent with the intent of Section 954 of Dodd-Frank but increases the benefits to investors that would result from the issuance of a final rule.

As we explained in the November Letter:

> CII was actively involved in the development of Section 954. Given our level of involvement, we are confident that the language of Section 954 was not intended to narrowly limit the required clawback policy to exclude little r restatements.
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> . . . .
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> In addition to being inconsistent with the intent of Section 954, CII believes it would be harmful to investors and the capital markets for the SEC to narrowly limit the required clawback policy to exclude little r restatements. As indicated, under existing requirements little r restatements correct material erroneous financial results in a manner that is less transparent to investors and the markets than Big R restatements. And in recent years there has been a disappointing trend by companies that appear to be "opportunistically" using their discretion to categorize more and more corrections of material financial reporting errors as little r restatements.
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> As the *Wall Street Journal* recently reported:
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> > So-called "little r" [restatements] . . . last year represented 75.7% of all restatements by U.S.-based public companies, up from 34.8% in 2005, according to data provider Audit Analytics. [Big R] restatements, meanwhile, have become less common, comprising 24.3% of all restatements in 2020, down from 65.2% 15 years earlier, data show.
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> CII believes excluding little r restatements from the required clawback policy would likely not only further exacerbate this opportunistic behavior to reduce the transparency of restatements to investors, but more importantly limit the ability of the required clawback policy to recover for shareowners the executive pay that was unearned and erroneously awarded.[16]

[15] Memorandum from Division of Economic and Risk Analysis at 3.
[16] Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to Vanessa A. Countryman, Secretary, Securities and Exchange Commission at 4-6 (footnotes omitted).

Similarly, the Ohio Public Employees Retirement System, a CII member, and the largest public retirement system in Ohio, with more than 1.1 million active, inactive, and retired members commented:

> It is disappointing to think that the Commission's Clawback Proposal was limited only to instances involving formal restatements of material errors because (1) the trend among issuers to revise, rather than formally restate, prior period financial statements was already well established in 2015 and continues to accelerate, and (2) this trend, if left unaddressed, could erode the effectiveness of the Commission's efforts on this issue and blunt the impact of Section 954 before it has even been implemented.
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> . . . .
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> As such, OPERS believes the SEC should clarify that its definition of "accounting restatement" includes all required restatements made to correct an error in previously issued financial statements, regardless of whether they are formal restatements or revisions. This definition comports with what shareholders have believed throughout this rulemaking process, namely that issuers would not be able to avoid the application of a Section 954 clawback provision simply by using their discretion to determine that an error is immaterial.[17]

[17] Letter from Patti Gazda, Corporate Governance Officer, Ohio Public Employees Retirement System to Vanessa Countryman, Secretary, Securities and Exchange Commission 2 (Nov. 22, 2021), https://www.opers.org/pdf/government/FederalResponses/2021/OPERS-Comment-Letter-SEC-Reopening-of-Comment-Period-%20Listing-Standards-for-Recovery-of-Erroneously-Awarded-Compensation.pdf; *see* Letter from Marcie Frost, Chief Executive Officer, California Public Employees' Retirement System to Ms. Vanessa Countryman, Secretary, Securities and Exchange Commission 3 (Nov. 22, 2021), https://www.calpers.ca.gov/docs/legislative-regulatory-letters/sec-countryman-11-22-2021.pdf ("there has been concern that the use of formal restatements relative to revision statements should be carefully monitored"); Letter from Kerrie Waring, Chief Executive Officer, ICGN to Vanessa A. Countryman, Secretary, Securities and Exchange Commission 4 (Nov. 22, 2021), https://www.icgn.org/sites/default/files/2022-03/27.%20USA%20SEC%20-%20Listing%20Standards%20for%20Erroneously%20Awarded%20Compensation%20Clawbacks%20-%20Nov%2021.pdf ("ICGN believes the revised clawback trigger would be useful, which would specifically refer to 'all required restatements to previously issued financial statements, including those restatements that were not material to those previously issued financial statements, but would result in a material misstatement if (a) the errors were left uncorrected in the current report or (b) the error correction was recognized in the current period.'"); Letter from Sandra J. Peters, CPA, CFA, Senior Head, Global Financial Reporting Policy Advocacy, CFA Institute to The Honorable Gary Gensler, Chair, U.S. Securities and Exchange Commission 6 (Nov. 22, 2021), https://www.cfainstitute.org/-/media/documents/comment-letter/2020-2024/20211123.pdf ("we believe that a Commission rule or an interpretation that only certain restatements will trigger clawbacks, while other restatements will enjoy a safe harbor for executives, would undermine the purpose and intent of Section 954 of Dodd-Frank").

3. Potential implications for the costs and benefits of the Proposed Rule

CII generally agrees with the following DERA Memo findings regarding potential implications for the cost and benefits of the Proposed Rule as a result of the increase in the number of companies with voluntarily adopted compensation recovery provisions since 2015:

- "[B]enefits of the proposed rules, including increased incentives to improve financial reporting and business practices, as well as reduced costs of incentive-based compensation, may be reduced if companies have already adopted strong compensation recovery provisions."[18]
- "[C]osts of the proposed rules, such as those associated with implementation and compliance, potential changes in reporting incentives, and potential shifts in executive compensation would likewise be mitigated under such circumstances."[19]
- "To the extent that companies are already disclosing information about voluntarily adopted recovery policies, the benefits and costs from the proposed disclosure requirements may be mitigated."[20]

CII also generally agrees with the following DERA Memo findings regarding potential implications for the cost and benefits of the Proposed Rule as a result of the inclusion of "little r" restatements as described in the October Release and supported in the November Letter:

- "[T]o the extent that companies may recover additional erroneously awarded compensation with the inclusion of 'little r' restatements, the company may benefit from the availability of those additional funds for other productive uses, and the implementation costs associated with those recoveries may also increase."[21]
- "[I]nclusion of 'little r' restatements might increase the benefits associated with incentives for high quality financial reporting, as well as incentives for value-enhancing business practices because more restatements would potentially be affected by the compensation recovery provisions."[22]
- "[I]nclusion of 'little r' restatements may also increase the benefits and costs associated with potential shifts in managerial compensation."[23]

On balance, CII believes the potential implications for the costs and benefits of the Proposed Rule as a result of the (1) increase in the number of companies with voluntarily adopted compensation recovery provisions since 2015, and (2) inclusion of "little r" restatements as

[18] Memorandum from Division of Economic and Risk Analysis at 2 (footnotes omitted).
[19] *Id.* (footnotes omitted).
[20] *Id.*
[21] *Id.* at 3 (footnotes omitted).
[22] *Id.* (footnotes omitted).
[23] *Id.* (footnotes omitted).

described in the October Release and supported in the November Letter provides a net benefit to investors and the capital markets and further supports our view that the Commission should promptly issue this long overdue rule.

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Thank you for consideration of CII's views. If we can answer any questions or provide additional information regarding this letter, please do not hesitate to contact me.

Sincerely,

Jeff Mahoney

Jeffrey P. Mahoney
General Counsel