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By Email

Mr Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street
Washington, DC 20549-1090

14 September 2015

Dear Mr Fields

Subject: File Number S7-12-15 - Recovery of Erroneously Awarded Compensation

This letter provides comments to the SEC on the proposed rule on Listing Standards for Recovery of Erroneously Awarded Compensation (the ***Proposals***). We are grateful for this opportunity to provide comments on the SEC's Proposing Release (the ***Release***).

Our letter focuses primarily on the impact of the Proposals on foreign private issuers (***FPIs***). This area has been singled out for comment as it has not to date been addressed in detail in other comment letters.

In summary, our recommendations are that:

(a) the clawback rules set out in the Proposals should not apply to FPIs because many FPIs would thereby become subject to two separate clawback regimes (that in the US, and that in their home country) and because of enforceability concerns; or

(b) if the clawback rules are to apply to FPIs, there should be an exemption from the US clawback regime in circumstances where the FPI's home country has an appropriate governance regime or law governing clawback (including appropriate disclosure standards), with which the FPI complies. For reasons explained in the letter, we do not consider that the approach of having an opinion letter from home country counsel would operate satisfactorily in view of the legal complexities surrounding the implementation of clawback policies.

The comments in this letter reflect our experience in giving legal advice to UK listed companies (including FPIs) on executive compensation and pay governance matters, including advice on their clawback policies and the legal enforceability of such policies. The letter also draws on the experience of lawyers in our Continental European offices in

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advising on these issues, and on the experience of our US securities and executive compensation lawyers.

As there are many different home countries for FPIs, we appreciate that the Proposals may have been designed to reflect the range of home country governance standards that apply.

A. INTRODUCTION / OVERVIEW

1. Like the US, the UK and other European countries are currently developing their laws and governance standards on the clawback of incentive compensation, in the context of wider developments on pay governance (such as "say on pay" regimes).

2. For UK listed companies, this has involved:

   (a) as a statutory requirement, the need for a binding vote of shareholders (at least every three years) on the company's remuneration policy for directors. This would include the company's policy, in relation to directors, on clawback and "malus"[1];

   (b) specific statutory disclosure requirements in the company's annual Directors' Remuneration Report, including in relation to pay that is subject to clawback; and

   (c) as indicated on page 16 (footnote 40) of the Release, a "comply or explain" obligation under the UK Corporate Governance Code to the effect that performance-related remuneration schemes (that is, both annual bonuses and long-term incentives) for executive directors should "include provisions that would enable the company to recover sums paid or withhold the payment of a sum, and specify the circumstances in which it would be appropriate to do so".

3. Similar developments are taking place in Europe, including at European Union level – the current draft Directive is also referred to on page 16 of the Release. This draft Directive is largely based on the UK statutory regime described in 2(a) and (b) above. The Netherlands has amended its Civil Code to assist in the implementation of the clawback of incentive compensation by enabling companies to include clawback provisions in incentive schemes. Some other European countries – including France, Italy and Spain - have amended their governance codes to encourage or require companies to include clawback and malus provisions in their incentive schemes.[2] Germany's corporate governance code for listed companies

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[1] In European terminology, "malus" involves the adjustment of incentive awards that have not yet vested to take account of adverse events, whereas clawback involves the recovery of the value of awards that have already vested.

[2] For completeness, it should be noted that, in relation to the financial sector, EU countries are taking steps – sometimes by enacting specific local legislation – to comply with the clawback and malus provisions in the EU Capital Requirements Directive IV. EU-based FPIs in the financial sector are subject to these provisions, which are generally more onerous than (and apply to a wider employee population than) the equivalent local corporate governance regime.

recognises the possibility of clawback but does not require or recommend such arrangements.

4. For listed companies, these European regimes are usually non-prescriptive as to their operation, and confer on the compensation committee a degree of flexibility in relation to the clawback of incentive compensation. In part, this approach – together with the focus on malus – is driven by legal uncertainty surrounding the enforceability of clawback provisions. This is discussed below.

5. In contrast, the Proposals envisage a detailed and prescriptive framework for the operation and disclosure of clawback policies – for example, the group of covered executives, the definition of incentive-based pay, the look-back period and the limited discretion available to the company over whether to seek recovery.

6. We do not comment in detail here on whether the approach in 5 is appropriate for companies affected by the Proposals that are not FPIs (***Non-FPIs***).[3] However, in relation to FPIs, we consider that compliance with the Proposals would be excessively onerous – and more onerous than the compliance burden for Non-FPIs – because:

   (a) in cases where the FPI is subject to a clawback regime in its home country, this would involve compliance with two regimes – that imposed by the home country, and that imposed by the US exchange under the Proposals; and

   (b) compliance with the Proposals by FPIs would necessitate (for the first time) the adoption of other US categorisations that currently have no relevance to an FPI (for example, in identifying and keeping track of "executive officers" for the purposes of the Proposals; this is effectively an identification of Section 16 officers – whilst this is something which a Non-FPI would be required to do in any event, it currently has no relevance to an FPI).

   Overall, we are concerned that the compliance burden involved in applying the Proposals would be a material factor in a company's decision to become or remain an FPI. To this extent, we believe that the Economic Analysis in the Release understates the compliance burden for FPIs especially if the FPI becomes subject to two clawback regimes.

7. We also note that the SEC's general approach on remuneration is to treat this as a matter for the FPI's home country rather than imposing US requirements – key examples are that FPIs are exempt from the US proxy rules (so do not need to provide a Compensation Discussion & Analysis) and from the US rules on "say on pay" and pay ratio disclosure. This general approach recognises that the FPI's home country (and its exchanges) will be motivated to adopt good corporate governance standards that are suited to their local market. In headline terms, our view is that application of home country rules would also be a preferable approach on clawback.

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[3] We note that Non-FPIs include companies that are incorporated outside the US, or have non-US based executive officers. Many of the points raised in this letter are relevant to such companies and individuals, and we submit that appropriate steps should be taken to address their circumstances.

B. RESPONSES

Against the above background, we have responded to the following numbered Requests for Comment in the Release. Please note that we have not repeated the relevant questions in full, and have grouped or sub-divided certain questions for convenience.

1. **Should the listing standards and other requirements of the Proposals apply generally to all listed issuers, as proposed?**

   We do not consider that the Proposals should apply to FPIs in the same way as to Non-FPIs. We note from the commentary on pages 10-12 of the Release that the SEC would have the power to use its general exemptive authority under the Exchange Act to exempt specific categories of issuer from the Proposals, to the extent that "doing so would be necessary or appropriate in the public interest and consistent with the protection of investors". Whilst we note the extract from the Senate Committee report quoted on page 11 of the Release, we believe that the SEC is attaching too much weight to this extract (the terms of which are not reflected in legislation), and we submit that exempting FPIs would be an appropriate exercise of the SEC's exemptive authority.

3A. **Would the proposed listing standards conflict with any home country laws, stock exchange requirements, or corporate governance arrangements that apply to FPIs?**

It is likely that the Proposals would frequently conflict with an FPI's home country laws, stock exchange requirements or corporate governance arrangements. This is for a number of reasons, including:

(a) many home countries of FPIs have, or are in the process of developing, their own requirements or pay governance standards in relation to the clawback of incentive compensation. Where that is the case in relation to an FPI's home country, application of the Proposals would inevitably lead to a two-tier regime because the home country requirements/standards would differ from those in the Proposals.[4]

(b) another area of potential conflict relates to legal enforceability of clawback provisions. This is addressed below.

3B. **Should the Proposals allow exchanges to permit FPIs to forego recovery of erroneously awarded compensation if recovery would violate the home country's laws and certain conditions were met, as proposed?**

[4] In terms of the likelihood of such conflict arising, we have noted the estimated data in the table on page 108 of the Release – which suggests that 3.3% of the 511 FPIs disclose a recovery policy, compared to 23% of all filers (4,845 in total). Without querying the accuracy of this data, we believe that it gives a lop-sided picture in relation to home states that have a significant number of FPIs and have a clawback regime (for example, the UK and the Netherlands). Looking at the UK only, and taking account of the "comply or explain" provision on the clawback of compensation in the UK Corporate Governance Code (referred to above), we would expect all UK companies that are FPIs either already have a clawback policy in place, or will implement one when their directors' remuneration policy is next submitted for shareholder approval.

If the clawback of incentive compensation would involve a violation of an FPI's home country laws, then our view is that it would be essential to have an appropriate exemption – otherwise, the Proposals would involve a violation of such laws. Relevant issues – relating to the framing of the exemption and legal enforceability issues – are discussed further below.

4. **In the event that an FPI's home country has a law that like Section 10D requires the issuer to disclose its policies on incentive-based compensation and the clawback thereof from current/former executive officers, should the FPI be permitted to comply with its home country law instead of complying with the listing standard of the relevant US exchange?**

If the SEC considers that it is insufficient to rely solely on an FPI's home country regime, we agree that the above would form the basis of a suitable exemption for FPIs. This is on the basis that it would ensure FPIs were subject to a clawback regime, whilst generally avoiding the need for compliance with two separate regimes.

However, in framing an exemption, we believe that there would need to be some important modifications, including the following:

(a) the wording above refers to home country law, but it should be noted that the relevant disclosure would in many cases arise under corporate governance standards and listing rules of particular exchanges – rather than law. A wider test should be sufficient in framing an exemption – subject to the FPI complying with the relevant provision;

(b) the wording above refers to current or former "executive officers" of the FPI. In framing an exemption, our view is that there should be greater flexibility in relation to the executives covered rather than incorporating US terminology that (in the Proposals) has a particular meaning. For example, the UK regime relates primarily to employed directors (i.e. executive directors) of the issuer which may comprise only the CEO and CFO - though in many cases the clawback provisions are applicable to a wider group of senior executives. Moreover, if the FPI is in the financial sector and therefore subject to the EU regime described in footnote 2 above, the coverage would extend to all "material risk takers" – which may comprise a much wider population than that covered by the Proposals' definition of "executive officer";

(c) on a similar point, the test of what constitutes "incentive-based compensation" should confer more flexibility than that under the Proposals; and

(d) the exemption would need to recognise that a home country regime might operate on a more discretionary basis than the Proposals envisage – in part because of legal difficulties associated with enforcement of clawback policies (as discussed below).

59 & 60. **Board discretions relating to the amount to be recovered, and material tax considerations**

Irrespective of the approach that the SEC adopts for FPIs, our view is that it would be appropriate for the Proposals to contain greater discretion in relation to the amount to be recovered. This is primarily because of the difficulty of predicting in advance the range of fairness issues that are likely to arise where clawback is triggered. For example, the compensation committee may have good reason to wish to treat differently a junior executive officer who was head of an division that had no involvement in the circumstances leading to a restatement, compared to a CEO or CFO.

Tax considerations are one aspect of the need for flexibility.[5] In many countries, there are likely to be enforceability concerns associated with applying clawback on a pre-tax basis as the effect would be penal/unfair where the tax cannot be recovered. In Europe, there is a divergence as to whether, following the clawback of compensation, the tax previously paid on the amount clawed back is repayable. As a result, the effect of the Proposals in relation to a group of executives based in different countries could involve radically different financial outcomes by reference to (a) whether or not the executive is able to recover, or obtain relief for, tax paid in his country of residence, and (b) if the tax is not recoverable, the relevant tax rate suffered in his country of residence (bearing in mind that certain European countries have tax rates that are materially higher than the US). Overlaid on the above is the possibility of an executive establishing that the clawback was unenforceable by reason of (amongst other potential factors) the penal/unfair tax impact.

98, 99 & 101. **Ability of issuers to enforce clawback provisions, including amendments to compensation plans, employment agreements. Sufficiency of enforcement mechanisms.**

Based on our experience in advising UK and European companies on clawback, our view is that it would be appropriate for the design of the Proposals (both for FPIs and Non-FPIs) to reflect the risk that the relevant clawback provisions may not be legally enforceable against the executive. As proposed, there need be no fault on the part of the executive, and recovery is required unless impracticable either in economic terms or (for non-US companies) because it would violate home country law. The exceptions in proposed Rule 10D-1(b)(1)(iv) are narrow. The company must make reasonable efforts to seek recovery, document those efforts and only conclude recovery is economically impracticable where the costs would exceed the amount to be recovered. Non-US companies would be required to submit an opinion of home country counsel acceptable to its US exchange that recovery would violate home country law.[6]

In our experience, enforceability of clawback provisions in many European jurisdictions is a complex and uncertain area of law, even where the trigger is an accounting restatement. The main relevant factors are summarised below:

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[5] In this paragraph, references to tax include social security and similar charges.

[6] Here, home country means that of the company (rather than that of the executive), so that difficulties arising where executives are based in a different home country (where such recovery may be unlawful) are not addressed in the Proposals.

(a) in general, clawback provisions will not be enforceable at all unless the employer has a clear contractual right (to which the executive has explicitly agreed) to apply them – with that right either being comprised in the incentive award terms, or there being a more general authority (for example, via an employment agreement) that a clawback of compensation may be applied. Thus, a company's publication of a clawback policy is unlikely by itself to permit a clawback of compensation to be enforced without the executive's specific agreement.[7] The need for the executive's written agreement is generally required by employment protection laws in the UK;

(b) our expectation is that executives would be unwilling to agree to employment agreement changes that would have the effect of imposing clawback where the clawback could have retrospective effect – i.e. in relation to historic awards – and we would expect companies to be reluctant to ask executives to do so. This has been our experience in the UK. As a result, we would expect clawback to be imposed via the contractual terms of the incentive award. In consequence, clawback would not apply on a retrospective basis;[8]

(c) even where the clawback language is incorporated into the relevant contract, an executive may succeed in establishing that the clawback provision should not be enforceable against him because the clawback is unfair or unreasonable on the facts as they relate to him.[9] The likelihood of such an argument succeeding in the relevant jurisdiction would be fact-specific, and may involve such issues as the executive's seniority (for example, comparing a CEO to the most junior "executive officer"), and the degree of involvement in or culpability for the events leading to application of the clawback provisions;[10]

(d) in some countries, the amount subject to clawback would be determined by reference to damages suffered by the company as a result of the accounting

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7 The Netherlands is understood to be an exception to the principle stated here, in that the power to impose the clawback of incentive compensation is set out in the Civil Code (with effect from January 2014), thus enabling the company to impose the clawback so long as the clawback policy operates fairly and reasonably.

8 More generally, we suggest that clawback should not apply retrospectively to any category of issuer – but rather should only apply to awards granted after any final rule takes effect.

9 How such an argument was presented would depend on the relevant country's laws – but in most European countries a high degree of protection is conferred on employees (including senior executives) against an employer's decision which is unfair or unreasonable. An employee may also be able to challenge the validity of a clawback policy on the basis of the inequality of bargaining power between the parties. For example, in Germany, there is a concept of unenforceability as a result of the employee facing "unreasonable disadvantages" where an employer attempts (by way of favourable contractual wording) to enforce his interests in an improper way without taking account of the employee's interests and without trying to find a fair balance of interest.

10 We would expect all categories of issuer to be concerned about the very broad coverage of the definition of "executive officer", and the Proposals' adoption of a no-fault standard in applying clawback to such a wide population. The population includes persons who would have had no responsibility for or involvement in preparing the financial statements, or in establishing appropriate internal controls for their preparation.

misstatement. Such an approach would give rise to a complex assessment, particularly because (as indicated in the Release), there is not necessarily a predictable relationship between the financial terms of an accounting restatement and the impact on share price (and, separately, the impact on share price is not necessarily a measure of damage suffered by the company);

(e) in addition, in some countries, there may be specific rules for limiting recovery from executives – for example, in Italy, we understand that recovery could be taken only from future remuneration payments, and could not exceed one-fifth of such payments; and

(f) in many European countries, enforcement difficulties arise from employment law, and there is a variety of practice in relation to whether a company's directors are also employees.[11] Thus, in a country where a director is not an employee, it is possible that enforcement may be more likely to succeed than in a country where that is not the case.

The above gives a flavour of likely legal issues. However, we hope it is sufficient to illustrate the difficulties associated with the element of the Proposals relating to the use of a legal opinion of home country counsel. In practice, the production of such an opinion would be an onerous and expensive matter in view of the need to analyse a wide range of relevant factors (and there may need to be a separate part of the opinion relating to each affected individual).

We appreciate the opportunity to participate in this process, and would be pleased to discuss our comments or any questions the SEC may have with respect to this letter. Any questions about this letter may be directed to Simon Evans in London [redacted]) or Howard Klein in New York [redacted]).

Yours truly

Freshfields Bruckhaus Deringer LLP

[11] We would also expect this to be a concern in the US, and note that the Proposals are unclear on whether the final rules would be intended to override applicable state and federal employment laws.