Via http://www.sec.gov/rules/proposed.shtml

September 14, 2015

Mr. Brent J. Fields
Secretary
United States Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Listing Standards for Recovery of Erroneously Awarded Compensation, Securities Exchange Act Release No. 75342 [File No. S7-12-15]

Dear Mr. Fields:

The Financial Services Roundtable ("FSR")[1] appreciates the opportunity to respond to the proposed "Listing Standards for Recovery of Erroneously Awarded Compensation"[2] rules (the "Proposal"), which would implement section 954(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act").[3]

Section 954 of the Dodd-Frank Act directs the Securities and Exchange Commission (the "Commission") to adopt rules that require national securities exchanges and national securities associations (each, a "national securities market") to prohibit a company from listing any security on the national securities market if the company fails to develop and implement (1) a policy providing for disclosure of "incentive-based compensation that is based on financial

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[1] As *advocates for a strong financial future*,™ FSR represents the largest integrated financial services companies providing banking, insurance, payment, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. FSR member companies provide fuel for America's economic engine, accounting directly for $92.7 trillion in managed assets, $1.2 trillion in revenue, and 2.3 million jobs.

[2] SEC. & EXCH. COMM'N, Listing Standards for Recovery of Erroneously Awarded Compensation [File No. S7-12-15], 80 FEDERAL REGISTER 41144 (July 14, 2015) (the "Proposing Release"), *available at* http://www.gpo.gov/fdsys/pkg/FR-2015-07-14/pdf/2015-16613.pdf.

[3] Section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Public Law No. 111-203, 124 Stat. 1376, 1904 (July 21, 2010) (the "Dodd-Frank Act").

information that is required to be reported under the securities laws;" and (2) a policy to recover incentive-based compensation in excess of what the company's current or former executive officers had received during the three-year period prior to any restatement of the company's financial statements resulting from the company's "material noncompliance . . . with any financial reporting requirement under the securities laws."[4] The Proposal follows the Commission's prior actions to implement other mandates governing executive compensation disclosure under the Dodd-Frank Act, including the recently-adopted "Pay Ratio Disclosure" rule[5] and the so-called "say-on-pay" rule[6] adopted in 2011.

I. Executive Summary

FSR's principal comments on the Proposal may be summarized as follows:

- The final clawback rule should avoid duplicating existing recovery requirements under the competing clawback policies or requirements, including those mandated under the Sarbanes-Oxley Act of 2002.
- As a matter of public policy, the Commission should prohibit the indemnification and insurability of any clawed-back incentive-based compensation.
- FSR urges the Commission to clarify in the final clawback rule the type of "accounting restatement" that will trigger application of the clawback.
- FSR urges the Commission to use its authority under section 36(a) of the Exchange Act to exempt certain issuers and securities (*e.g.*, registered management investment companies, debt-only issuers, and foreign private issuers) from the proposed listing standards.
- Incentive-based compensation that is awarded, earned, or vested based on non-financial measures should not be subject to recovery under the clawback rule.

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[4] *See* Proposing Release at 41145.

[5] SEC. & EXCH. COMM'N, Pay Ratio Disclosure, Securities Act Release No. 9877 [File No. S7-07-13], 80 FEDERAL REGISTER 50104 (Aug. 18, 2015), *available at* http://www.gpo.gov/fdsys/pkg/FR-2015-08-18/pdf/2015-19600.pdf (implementing section 953(b) of the Dodd-Frank Act).

[6] SEC. & EXCH. COMM'N, Shareholder Approval of Executive Compensation and Golden Parachute Compensation, Securities Act Release No. 9178 [File No. S7-31-10], 76 FEDERAL REGISTER 6010 (Feb. 2, 2011), *available at* http://www.sec.gov/rules/final/2011/33-9178fr.pdf (implementing section 951(a) of the Dodd-Frank Act). We note that the say-on-pay vote results of 235 U.S. banks showed that an overwhelming number of shareholders approved the banks' executive compensation programs. *See* EQUILAR, U.S. Banks Passing Percentage of Say on Pay Vote, *available at* http://sayonpay.equilar.com/sayonpay/home;jsessionid=F4167C640C785D93E9C174C325210DE9.sayonpay_jvm2 (noting that the median vote result was 94.2% of shareholders favored the banks' executive compensation, and only 2% of that group received a shareholder approval of less than 50% of the vote, while 95% of that group received a shareholder approval of at least 70% of the votes placed).

II. Introduction

By a majority vote[7] on July 1, 2015, the Commission proposed the Listing Standards for Recovery of Erroneously Awarded Compensation (or "clawback") rule to implement section 10(D) of the Securities Exchange Act of 1934 (the "Exchange Act"),[8] as added by section 954 of the Dodd-Frank Act ("section 954").

As proposed, the rules would require national securities markets to amend their listing standards for reporting companies to include clawback provisions for erroneously-paid incentive based compensation. Under the proposed listing standards, each reporting company would be required to adopt and enforce policies to recover from its executive officers any incentive-based compensation tied to financial reporting metrics, stock price, or total shareholder return that was paid in error because the compensation was measured based on materially inaccurate financial statements. The company also would be required to file its clawback policy with the Commission and disclose its actions to recover erroneously-paid incentive-based compensation.

III. The final clawback rule should avoid duplicating existing recovery requirements under the competing clawback policies or requirements, including those mandated under the Sarbanes-Oxley Act of 2002.

In the Proposing Release, the Commission explains the interplay of the clawback required by section 954 of the Dodd-Frank Act with that required by section 304 of the Sarbanes-Oxley Act of 2002 ("section 304"), noting that any compensation repaid by an issuer's chief executive officer or chief financial officer pursuant to the section 304 clawback should be credited to the extent the clawback under section 954 of the Dodd-Frank Act requires repayment of the same compensation.[9]

We note that incentive-based compensation paid to executive officers also may be subject to recovery under a variety of other company-specific clawback or recoupment policies or under the laws of other jurisdictions (particularly for individuals working within the financial services sector). Accordingly, FSR urges the Commission to extend this "anti-duplication" provision in the final clawback rule so that compensation repaid by any officer under any other company recoupment policy or pursuant to applicable law may be credited to the extent that the clawback policy under section 954 would require repayment of the same incentive-based compensation.

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[7] Commissioners Daniel M. Gallagher and Michael S. Piwowar dissented from the Commission's decision to propose the Listing Standards for Recovery of Erroneously Awarded Compensation rule. *See* COMM'R DANIEL M. GALLAGHER, Dissenting Statement at an Open Meeting on Dodd-Frank Act "Clawback" Provision (July 1, 2015), *available at* http://www.sec.gov/news/statement/dissenting-statement-compensation-clawback-listing-standards.html; COMM'R MICHAEL S. PIWOWAR, Dissenting Statement at Open Meeting on Dodd-Frank Act "Clawback" Provision (July 1, 2015), *available at* http://www.sec.gov/news/statement/statement-at-open-meeting-on-clawbacks-of-erroneously-awarded-co.html.

[8] 15 U.S.C. § 78j-4 (2012).

[9] *See* Proposing Release at 41160 ("If, however, an executive officer reimburses an issuer pursuant to Section 304, such amounts should be credited to the extent that an issuer's Rule 10D-1 recovery policy requires repayment of the same compensation by that executive officer").

IV. As a matter of public policy, the Commission should prohibit the indemnification and insurability of any clawed-back incentive-based compensation.

a. The company's recovery of erroneously paid incentive-based compensation is not a "loss" to the executive, but a return of the company's property.

The Commission enumerated several benefits that could be achieved by the Proposal, which it believes provide further disincentives beyond the existing civil and criminal penalties[10] for executives to engage in "deliberate misreporting" of financial performance. Examples of the proposed clawback rule's benefits include the following:

(a) Reduce incentives for executives "to pursue impermissible accounting methods under [generally accepted accounting principles ("GAAP")] that result in a material misstatement of financial performance."[11]

(b) Increase incentives for executives "to take steps to reduce the likelihood of *inadvertent* misreporting," including by "devoting more resources to the production of high-quality financial reporting, thereby reducing the likelihood of a material accounting error."[12]

(c) An incentive to adopt business practices that "use accounting standards that are more straightforward to apply and perhaps require fewer accounting judgments, which may reduce the likelihood of material accounting errors."[13]

However, the Commission noted that a company's ability to indemnify or insure against the risk that a covered executive's incentive-based compensation could be clawed-back could eliminate anticipated benefits of the clawback rule on the behavior of executives.[14]

FSR notes that incentive-based compensation paid based on erroneously stated earnings is not compensation to which the covered executive was entitled to receive. For purposes of section 302, we note that the Second Circuit Court of Appeals has held that "indemnification cannot be permitted where it would effectively nullify a statute."[15] We believe a similar impact would result for purposes of section 954. Thus, the company's recovery of the erroneously paid incentive-based compensation is not a "loss" to the executive, but rather a return of the company's property.

Even though section 954 does not have a requirement that an executive must be culpable for the material misstatement of financial performance, the important public policy underlying

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[10] *See,* section 304 of the Sarbanes-Oxley Act of 2002 [codified at 15 U.S.C. § 7243].

[11] *See,* Proposing Release at 41174.

[12] *See*, Proposing Release at 41174.

[13] *See*, Proposing Release at 41174-75.

[14] *See,* Proposing Release at 41182.

[15] *See*, *Cohen v. Viray*, 622 F.3d 188, 195 (2d. Cir. 2010). *See also*, Proposing Release at note 232.

the clawback requirement remains: those who receive incentive-based compensation calculated on a material misstatement of financial performance are in possession of unearned compensation, and any requirement to return these unearned amounts to the company should not be an insurable event. Accordingly, FSR urges the Commission in the final clawback rule to prohibit a company's (1) indemnification of executives and (2) use of company assets to purchase insurance covering the return of incentive-based compensation.

b. The final rule also should prohibit the use of company assets to purchase insurance to reimburse executives for amounts subject to the clawback rule.

The Proposal consideration of the impacts of indemnification and insurance is too narrow, because it does not adequately reflect the findings in the Preamble and would not, on its own, achieve the outcome desired by the Commission. We note that the Commission observed that the essential purposes of the statute would be frustrated if the executive officer were allowed to retain compensation he would not otherwise have received absent the company's material noncompliance with financial reporting requirements.[16]

FSR urges the Commission to prohibit in the final clawback rule the use of the company's assets to purchase insurance intended to reimburse executives for incentive-based compensation amounts that would be subject to the clawback rule. We, therefore, recommend that the Commission revise proposed rule 10D-1(b)(1)(v) as follows (new text is *italicized*):

> "The issuer is prohibited from *(A)* indemnifying any executive officer or former executive officer against the *return of* erroneously awarded *incentive-based* compensation*; and from (B) paying or reimbursing any executive officer or former executive officer for any premiums on any insurance policy to fund potential recovery obligations for the return of erroneously awarded incentive-based compensation*."

V. FSR urges the Commission to clarify in the final clawback rule the type of "accounting restatement" that will trigger application of the clawback.

Section 10D(b)(2) of the Exchange Act requires, in part, the recovery of erroneously awarded incentive-based compensation "in the event that the issuer is required to prepare an accounting restatement due to material noncompliance of the issuer with any financial reporting requirement under the securities laws."[17] As proposed, the term "accounting restatement" means "the result of the process of revising previously issued financial statements to reflect the correction of one or more errors that are material to those financial statements."[18] As proposed, a restatement due to "material noncompliance" means a "restatement to correct an error that is material to previously issued financial statements."[19]

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16 *See*, Proposing Release at 41169.

17 15 U.S.C. § 78j-4(b)(2).

18 Proposed rule 10D-1(c)(1), 80 FEDERAL REGISTER at 41193.

19 Proposed rule 10D-1(c)(5), 80 FEDERAL REGISTER at 41193.

In a note to the proposed definition of the "date on which an issuer is required to prepare an accounting restatement," the Commission stated that the date the issuer concludes or reasonably should have concluded that its previously issued financial statements contain a material error is "generally expected to coincide with the occurrence of the event described under Item 4.02(a) of Exchange Act Form 8-K" (while noting that such date is not predicated on if or when a Form 8-K is filed).[20] Finally, in establishing the incentive-based compensation subject to recovery, proposed rule 10D-1(ii) refers to compensation received in the "three completed fiscal years immediately preceding the date the issuer is required to prepare a restatement . . . to correct a material error,"[21] although it noted that "an issuer's obligation to recover excess incentive-based compensation is not dependent on if or when the restated financial statements are filed."[22]

Based on our analysis of the above proposed provisions, it appears that the clawback obligation would be triggered by a "requirement to prepare" a restatement to correct a material error, which means a restatement of the type that would trigger an obligation to file a Form 8-K under the Exchange Act.[23] Once the *requirement* to restate financial statements occurs, the clawback obligation applies and the three-year recovery period is measured from this moment, regardless of whether a Form 8-K is filed and regardless of if or when restated financial statements are filed.

The Commission states that "issuers should consider whether a series of immaterial error corrections, whether or not they resulted in filing amendments to previously filed financial statements, could be considered a material error when viewed in the aggregate."[24] Although this statement could be read to suggest that the clawback obligation may be triggered even where the issuer is not required to prepare an amendment to previously filed financial statements (*e.g.*, where a revision is made on a going-forward basis), in view of the terms of the Proposal as described above, FSR's members interpret this to mean that the clawback obligation applies only if—following the aggregation of a series of immaterial errors—the issuer is required under accounting standards to prepare an accounting restatement to correct a material error of the type that triggers an obligation to file a Form 8-K under Item 4.02(a) of the Exchange Act.

FSR asks the Commission to confirm our interpretation in the final clawback rule, which would avoid ambiguity concerning the timing of the clawback trigger or the type of accounting restatement that would trigger clawback of incentive-based compensation.

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[20] *See* Note to proposed rule 10D-1(c)(2), 80 FEDERAL REGISTER at 41193.

[21] *See* Proposed rule 10D-1(b)(1)(ii), 80 FEDERAL REGISTER at 41192.

[22] *Id*.

[23] *See* Item 4.02(a) of Form 8-K [17 C.F.R. § 249.308].

[24] *See* Proposing Release at 41150.

VI. FSR urges the Commission to use its authority under section 36(a) of the Exchange Act to exempt certain issuers and securities from the proposed listing standards.

a. We urge the Commission to exempt registered management investment companies from the final rule.

Under section 36(a) of the Exchange Act, the Commission generally may exempt "any person, security or transaction" as necessary or appropriate in the public interest and as consistent with the protection of investors.[25] The Commission proposes to exempt from the clawback rule securities futures products, standardized options, unit investment trusts, and the securities of certain registered investment management companies because it believes the compensation structures for these issuers and financial instruments do not implicate the policy goals Congress sought to attain in section 954.[26] With respect to registered management investment companies, the Commission's proposed relief would be available "if the company has not awarded incentive-based compensation to any [of its executive officers] in any of the prior three fiscal years, or in the case of a company that has been listed for less than three fiscal years, since the initial listing."[27]

FSR agrees with the Commission's determination and urges the Commission to exempt unconditionally these issuers and securities from the final rule.

b. FSR urges the Commission to exempt debt-only issuers from the final rule because the compliance burdens of the rule exceed its benefits.

Any company with listed debt securities, whose equity securities are not listed on a national securities market (a "Debt-only Issuer"), should be exempt from the Proposal because the compliance burdens on the company outweighs any potential benefit to the investors in the company's publicly-issued debt securities.

Implementing a clawback policy in accordance with the Proposal will be much more burdensome for Debt-only Issuers than equity issuers because Debt-only Issuers are not subject to section 16 of the Exchange Act,[28] from which the definition of "executive officer" under the Proposal is taken. As a result, Debt-only Issuers that do not currently provide executive compensation disclosure in their annual reports will be starting *de novo* in identifying which individuals would be appropriately classified as "executive officers" and therefore subject to the rule, as well as in determining how to communicate and implement the clawback policy.

Many Debt-only Issuers do not have board members experienced in navigating the nuances of executive compensation programs applicable to publicly-held companies, and some

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[25] 15 U.S.C. § 78mm(a)(1) (2012).

[26] *See* Proposing Release at 41147.

[27] *See* Proposing Release at 41149.

[28] 15 U.S.C. § 78p (2012).

do not have dedicated compensation committees. The Proposal will be unduly burdensome to implement because Debt-only Issuers must design and execute an entirely new executive compensation governance structure—including appointing compensation committees and implementing compensation policies—for the sole purpose of complying with the Proposal, even though this disclosure is immaterial to investors in debt securities.

The costs and burdens associated with the Proposal may provide a significant disincentive for companies to list (and an incentive for listed companies to delist) debt securities on a national securities market—a concern that the Commission has previously acknowledged, and which supports the Commission's prior determinations to exempt Debt-only Issuers from many other listing and disclosure rules as described below.[29]

Additionally, unlike the impact on the company's shareholders, the harm that the Proposal is designed to address is immaterial to investors in the company's debt securities. Debtholders are concerned with matters that affect an issuer's balance sheet and credit risk, and are generally less concerned than shareholders with the distribution of an issuer's funds to other stakeholders unless these distributions are inconsistent with the covenants in the trust indenture under which the debt securities were issued. In many cases debtholders already have contracted for the provisions in the trust indenture that they deem necessary to protect them from the harm that the Proposal is seeking to stem.

In prior rulemakings, the Commission has raised similar concerns in distinguishing Debt-only Issuers from equity issuers. For example, Debt-only Issuers that are wholly-owned subsidiaries of Exchange Act reporting companies may omit executive compensation disclosure and certain other information in their Annual Reports in accord with General Instruction I(1) of Form 10-K under the Exchange Act, because the Commission found this disclosure inapplicable or immaterial to debtholders.[30] The Commission specifically added executive compensation disclosure as a permitted omission in its adoption of the final rule, citing comments that debtholders who do not vote in director elections can evaluate their investment without information on executive compensation information beyond what is in the issuer's financial statements.[31]

Debt-only Issuers are not required to file proxy statements, which effectively means that they are not subject to several of the key executive compensation regulations enacted under the Dodd-Frank Act (*e.g.*, "say-on-pay" voting requirements, the "say-on-golden-parachute"

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[29] See SEC. & EXCH. COMM'N, Exemptive Relief and Simplification of Filing Requirements for Debt Securities To Be Listed on a National Securities Exchange, Exchange Act Release No. 34922, 59 FEDERAL REGISTER 55342 (Nov. 1, 1994) (noting that the requirement to file proxy disclosure "is cited by some as a significant disincentive for corporate issuers to list their debt securities on a national securities exchange").

[30] The rule permitting these omissions was proposed "in an effort to more precisely tailor the reporting requirements to these particular companies and to the needs of their investors," and the Commission noted that it had "attempted to isolate that information about a wholly-owned subsidiary of a reporting company which is either inapplicable to a company with only debt securities outstanding or immaterial to debtholders generally." *See* SEC. & EXCH. COMM'N, Relief for Certain Wholly-Owned Subsidiaries from Portions of Annual & Quarterly Reports, 44 FEDERAL REGISTER 57374, 57374 (Oct. 4, 1979) [to be codified at 17 C.F.R. pt. 249].

[31] *Id.* at 57376.

disclosure and voting requirements and the recently-proposed "pay-for-performance" disclosure). Similarly, they are exempt from listing standards relating to compensation committee independence and compensation advisers. The Commission based its exemptions on the fact that debtholders are adequately protected by the indenture covenants, the provisions of the Trust Indenture Act of 1939,[32] and the proxy rules' antifraud proscriptions.[33] For example, the Commission noted that debtholders often negotiate provisions of the indenture, and therefore, unlike shareholders, debtholders do not need the protection of the proxy rules.[34] Executive compensation payments and structure are simply not material to investors in the company's debt securities.

Executives of Debt-only Issuers also are not subject to the short-term market pressures and scrutiny of quarterly earnings results to the same extent as executives of companies with publicly-held equity securities, because the performance metrics on which they are judged are not based on the movement of the company's publicly-traded common stock.

Further, where Debt-Only Issuers are wholly-owned subsidiaries of a reporting company that has oversight over the executive compensation programs and policies and the financial statements of the Debt-Only Issuer, the requirement for the Debt-Only Issuer to implement its own set of executive incentive-based compensation practices and procedures would be irrelevant and unnecessarily duplicative. In this instance, it makes more sense to rely on the Proposal as it relates to the publicly-reporting parent company, because it is the parent company and its executives that have ultimate oversight responsibility over the preparation of the subsidiary company's financial statements and its executive incentive-based compensation programs and personnel. If a material defect in the subsidiary company's financial statements resulted in a financial restatement that flowed through to the parent, the parent's executive officers would be subject to recovery under the parent company's clawback policy.

Given the burdens the Proposal will impose on Debt-only Issuers and the lack of any potential benefit it could provide for debtholders, we urge the Commission to exempt unconditionally Debt-only Issuers from the final rule.

c. The Commission should defer to "home-country" law and custom and exempt foreign private issuers from the final rule.

FSR believes the Commission should exempt foreign private issuers from the final rule out of deference to home country law and local custom. We note that foreign private issuers are subject to the rules and regulations relating to executive compensation in their home countries and in the countries where their executives reside. These local laws may conflict with the compensation régimes used in the United States. As such, foreign private issuers are generally

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[32] Trust Indenture Act of 1939, 15 U.S.C. § 77aaa *et seq*.

[33] Exemptive Relief and Simplification of Filing Requirements for Debt Securities To Be Listed on a National Securities Exchange, Exchange Act Release No. 34922, 59 FEDERAL REGISTER 55342 (Nov. 1, 1994). *See also* Listing Standards for Compensation Committees, 76 FEDERAL REGISTER 18966, 18975 (Apr. 6, 2012) [to be codified at 17 C.F.R. pts. 229 and 240].

[34] *Id*.

exempted from many of the executive compensation regulations enacted under the Dodd-Frank Act, as well as from the detailed executive compensation disclosure requirements under Item 402 of Regulation S-K.[35]

When the Commission adopted Form 20-F[36] to streamline disclosure for foreign private issuers, the Commission noted that commenters supported the approach because it showed "appropriate deference to a foreign private issuer's home country requirements."[37] The Commission also noted that foreign private issuers also could face privacy issues under home country law with the requirement to file individual employment agreements.[38]

In addition, like Debt-only Issuers, foreign private issuers are not subject to section 16 of the Exchange Act, and any requirement that they determine their list of executive officers and design and implement an entirely new executive compensation governance structure solely to comply with the Proposal would be unduly burdensome for the same reasons previously discussed in **Section VI.b.,** above. Accordingly, FSR urges the Commission to exempt foreign private issuers that are subject to home country and local laws governing executive compensation from the final rule.

FSR notes that the Proposal may subject foreign private issuers to further adverse impacts, including material conflicts that may arise between the enforcement of the Proposal and applicable home country and local laws. The Commission proposes to allow an issuer the discretion to decline enforcement of recovery of a clawback when recovery would violate a pre-existing home country law. The proposed exception would be too limited to provide appropriate relief for foreign private issuers. For example, a foreign private issuer cannot control future enactment of laws. We further note that most global issuers have executives that may reside in a country outside of the foreign private issuer's home country, and therefore, would be subject to laws of the locality.

As drafted, the Proposal merely provides an exception from compliance due to a conflict with laws enacted *prior* to the date of publication of the Proposal. However, due to the global scale on which many reporting companies operate, we urge the Commission to expand this exception and provide the company with the discretion not to enforce recovery if recovery would also violate the local law of the executive's place of residence (which governs the executive's employment arrangement), which may be different from the company's home country.

Moreover, FSR believes this exception from compliance should not apply solely to conflicts of non-U.S. laws that existed prior to publication of the final rule. Accordingly, FSR urges the Commission to expand the exception to cover compliance with *all* home country and local laws *irrespective* of their dates of enactment.

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35 Item 402 of Regulation S-K, 17 C.F.R. § 402 (2013).

36 Form 20-F, 17 C.F.R. § 249.220f (2013).

37 Executive Compensation and Related Person Disclosure, 71 Fed. Reg. 53158, 53193 (Sept. 8, 2006) [to be codified at 17 C.F.R. pts. 228, 229, 232, 239, 240, 245, 249 and 274].

38 *Id*. at 53196.

d. The Commission should extend the "home-country" law exception to U.S. reporting companies, and establish a de minimis amount below which recovery of incentive-based compensation would not be required.

In the event of a covered accounting restatement, the Proposal requires recovery of erroneously awarded incentive-based compensation unless pursuit of recovery would be impracticable (*e.g.*, the direct expense paid to a third party to assist in enforcing the policy would exceed the amount to be recovered) or recovery would violate a pre-existing "home-country" law, as verified by an opinion of home country counsel.

The Commission notes that the home-country law exception is intended to be available only to foreign private issuers. In order to rely on either exception to enforcement, the company must make a "reasonable attempt" to recover the incentive-based compensation. However, companies do not have discretion to make a preliminary determination that the recoverable amount is *de minimis* and not worth pursuing in view of the costs of recovery.

The practical effect is that companies must attempt to enforce the clawback, regardless of the recoverable amount and, in the case of U.S. companies, regardless of whether the clawback of earned and vested incentive-based compensation is prohibited by state wage protection laws or by the laws of a country in which an executive officer of a U.S. company resides.

The requirement to pursue recovery even in instances where the recoverable amount is *de minimis* or, for U.S. issuers, the legality of the recovery is questionable under applicable state or foreign law will result in situations where companies are forced to expend significant corporate resources solely for the purpose of being able to satisfy the rule's standard of impracticability to the detriment of the shareholders that the rule was in part intended to protect.

FSR urges the Commission to include in the final clawback rule: (1) an extension of the "home-country" law exception to enforcement that also would be available to U.S. companies whose executive officers reside in states or non-U.S. jurisdictions that prohibit clawback of compensation; and (2) a *de minimis* amount or formula for determining an amount below which pursuit of recovery would not be required.

VII. Incentive-based compensation that is awarded, earned, or vested based on non-financial measures should not be subject to recovery under the clawback rule.

FSR believes that the Commission's final clawback rule should subject only that portion of incentive-based compensation that is derived from a material misstatement of the company's financial performance. We note that achievement of certain non-financial measures (*e.g.*, market share and customer satisfaction) are not derived from the company's financial performance and would not be impacted by any material restatement of financial statements. These "non-financial" measures are not subject to financial reporting under GAAP, and do not implicate the type of incentive-based compensation arrangements that Congress sought to regulate in section 954. FSR urges the Commission to exclude from the final clawback rule any incentive-based compensation that is awarded, earned or vested based on non-financial measures.

Similarly, FSR urges the Commission to exclude from the final clawback rule incentive-based compensation that is awarded, earned, or vested based on the exercise of discretion rather than the attainment of specific financial or other metrics. In our view, applying the clawback rule to incentive-based compensation arrangements that are based solely or principally on discretionary factors seems too complex and burdensome, and not within the letter or spirit of section 954(a) of the Dodd-Frank Act.

VIII. FSR requests interpretative guidance concerning the application of the clawback rule to nonqualified deferred compensation and retirement plan arrangements.

We note that the Proposal would require the company to reduce the account balance or recover distributions under a nonqualified deferred compensation plan by the amount attributable to the erroneously awarded incentive-based compensation. Thus, to the extent that erroneously awarded incentive-based compensation formed the basis for calculating an executive's accrued pension plan benefit, the Commission noted that the accrued benefit could be reduced or the distributions could be recovered.[39]

However, the Proposal fails to address the potential for exposure under either section 409A of the Internal Revenue Code or the Employee Retirement Income Security Act in connection with the recovery of nonqualified deferred compensation and/or pension plan accruals.[40] FSR believes the Proposal would subject companies to unintended and adverse tax consequences. We urge the Commission to address these consequences in the final clawback rules.

IX. The definition of "financial reporting measures" should exclude incentive-based compensation based on a total shareholder return or stock-price performance goal.

The proposed rule includes total shareholder return ("TSR") and stock price in its definition of the "financial reporting measures" on which incentive-based compensation subject to recovery under the clawback rule may be based. In the Proposing Release, the Commission acknowledges the difficulty of determining what the stock price or TSR would have been but for a material misstatement in the financial statements. The Commission also notes that companies may need to engage third parties to conduct complicated analyses or event studies to determine the recoverable amount. Thus, the proposed rule allows companies to calculate the recoverable amount 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.

The inclusion of TSR and stock price as financial reporting measures for purposes of the clawback rule is inappropriate because of the impossibility of determining what these measures would have been in the absence of misstated financial statements and, thus, the inability to establish with any degree of accuracy or fairness the actual amount of erroneously awarded compensation. The Commission's allowance of the use of reasonable estimates to calculate the

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39 *See*, Proposing Release at note 167.

40 *See*, LATHAM & WATKINS LLP, White Paper #1862 (Aug. 6, 2015).

effect of an accounting error on TSR and stock price is a concession of this impossibility, particularly in its current form where the Proposal does not specify the process that companies should follow in calculating such estimates. Nor does the Proposing Release provides guidance as to what forms of "reasonable estimates" will be deemed adequate.

As a result, a company's determinations related to TSR and stock price would be particularly subject to challenge, whether by individual executives if the amount is considered too high or by shareholders in a derivative action if the amount is considered too low. These factors could cause companies to avoid using TSR or stock price metrics for purposes of determining incentive-based compensation, which for TSR may be problematic in view of the requirement under the recently proposed "pay-versus-performance" rules[41] to disclose the relationship between company performance as reflected by TSR and the compensation paid to certain executive officers.

Accordingly, we recommend that the Commission exclude TSR and stock price as financial reporting measures in the final clawback rule. Alternatively, if TSR and stock price are included as financial reporting measures, FSR urges the Commission to provide specific guidance in the final clawback rule on the objective parameters within which "reasonable estimates" of the effect of an accounting restatement on these non-GAAP measures should be determined.

X. FSR asks the Commission to address certain interpretative issues concerning recovery of incentive-based compensation.

a. The final rule should provide discretion to the company regarding the method of recovery.

The Proposal generally gives companies discretion regarding the means of recovery and the Commission seeks comment on whether this grant of discretion would be appropriate. FSR agrees with the Commission that the appropriate means of recovery may vary by company and by type of compensation arrangement, and further by individual executive officer. FSR urges the Commission to include in the final clawback rule authority for the company to exercise discretion on how to accomplish recovery under its clawback policy in the final rule.

b. The company should have discretion to recover the cash value of any shares acquired from equity awards subject to recovery.

As proposed, the company is directed to recover the excess shares still held by the executive or, if no longer held, the proceeds of the sale of the excess share awards granted, earned, or vested based on satisfaction of specific financial reporting measures. The Commission seeks comment on whether companies should instead have the choice to recover the cash value of the excess shares, and (in the case of a partial sale of excess shares) whether recovery should be required to be applied first to shares that were sold so as not to erode company stock holding policies.

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[41] Section 953(a) of the Dodd-Frank Act.

We recommend that the Commission grant discretion to companies in the final clawback rule to recover the cash value of any excess shares acquired from equity awards that are impacted by the issuer's clawback policy. To avoid manipulation of the recoverable amount, FSR further recommends that the Commission provide in the final clawback rule that the cash amount should be based on the value of the shares as of the date on which the issuer is required to prepare an accounting restatement, as defined in proposed rule 10D-1(c)(1).

c. The amount subject to recovery should be pro-rated based on the period each covered individual served as an "officer" within the meaning of section 16 during the performance period.

The Proposal provides for recovery of erroneously awarded incentive-based compensation from anyone who served as an executive officer within the meaning of section 16 of the Exchange Act at any point during the performance period for the relevant compensation to be recovered. As a result, the scope of the recovery requirement is very broad and will capture all of the individual executive's "excess" incentive-based compensation for which the financial measure was attained in any of the three completed fiscal years prior to the date the obligation to restate was triggered, regardless of whether the individual served as an executive officer for only a portion of the relevant performance period. The Commission solicits comment on whether an individual should be subject to recovery only for incentive-based compensation earned during the portion of the performance period during which the individual was serving as an executive officer.

Given the language of the section 954(a) and the Commission's acknowledgement that the statute was designed to require recovery of excess incentive-based compensation provided "for service as an executive officer," FSR strongly believes that the final rule should require proration of the recoverable amount so that only compensation earned while serving as an executive officer will be subject to recovery. Particularly in view of the "no fault" nature of section 954(a), from a fairness perspective, it is important that the final rule include this limitation with respect to the recoverable amount.

XI. The clawback obligation should first apply to incentive-based compensation for which the financial measure is attained in the fiscal period in which the final clawback rule becomes effective—not when the Commission adopts the final rule.

Under the proposed rule, recovery is required of any incentive compensation based on financial reporting measures for any fiscal period ending on or after the effective date of the Commission's final clawback rules. Companies, however, are not required to adopt their clawback policy until 60 days after issuance of final listing standards by the applicable national securities market, which may occur up to one (1) year after the Commission publishes its final clawback rules. We further note that disclosure regarding a required clawback is not required until the first proxy statement filed after the effective date of the listing standards.

FSR is concerned that this timeline creates potential implementation difficulties because it means that a company that discovers a need to restate its financial statements during the one-year period between the Commission's publication of the final clawback rules and the effective date of the national securities market's final listing standards could be required to enforce the clawback before the effective date of the listing standards, and before it has adopted the clawback policy pursuant to which enforcement must be made. Further, it could also result in the situation whereby the company's obligation to disclose details regarding its clawback requirement under new Item 402(w) of Regulation S-K would not be effective at the time it files its proxy statement for the fiscal year in which the clawback was triggered.

FSR urges the Commission to avoid these implementation difficulties and state in the final clawback rule that the clawback obligation should apply to incentive-based compensation that has been approved or granted after the effective date of the national securities markets' final listing rules, rather than when the Commission publishes its final rules. We believe this approach would reduce the extent to which the clawback obligation would apply to compensation arrangements already in existence. It also would reduce the potential for the clawback provisions to apply to agreements entered into before the effective time of the final clawback rules. We note that it may prove difficult to enforce the clawback in practice if the Commission does not adopt these recommended revisions in the final clawback rule.

XII. FSR does not believe presenting the required disclosures in XBRL format would provide any material benefit for investors.

The Commission proposes that the company use interactive data ("XBRL") to disclose information concerning the company's action to recover erroneously awarded incentive-based compensation (*e.g.*, the date a restatement was required to be prepared, aggregate dollar amount of excess incentive-based compensation attributable to the restatement, *etc.*).[42] In the Commission's view, the presentation of this information in XBRL format would provide a cost-effective way for investors and others to collect and analyze the data, as compared with disclosures that are not provided in machine-readable format.

However, FSR does not believe that presenting this information in XBRL format would provide any material benefit for investors. Prior to requiring companies to incur the expense to prepare this data in XBRL format, we believe the Commission ought to demonstrate that a material number of investors are using disclosures prepared in XBRL format for their investment decisions.

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[42] *See*, Proposed Item 402(w).

FSR appreciates the opportunity to submit comments on the Proposal. If it would be helpful to discuss FSR's specific comments or general views on this issue, please contact [redacted], or Felicia Smith, Vice President and Senior Counsel for Regulatory Affairs at [redacted].

Sincerely yours,

Richard Foster
Senior Vice President and Senior Counsel
for Regulatory and Legal Affairs
Financial Services Roundtable

With a copy to:

The Honorable Mary Jo White, Chair
The Honorable Luis A. Aguilar, Commissioner
The Honorable Daniel M. Gallagher, Commissioner
The Honorable Kara M. Stein, Commissioner
The Honorable Michael S. Piwowar, Commissioner

Keith F. Higgins, Director
Anne Krauskopf, Senior Special Counsel, Office of Chief Counsel
Carolyn Sherman, Special Counsel, Office of Chief Counsel
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United States Securities and Exchange Commission