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

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Listing Standards for Recovery of Erroneously Awarded Compensation
(Release No. 33-9861)
Commission File No. S7-12-15

Dear Mr. Fields:

Ernst & Young LLP is pleased to comment on the *Listing Standards for Recovery of Erroneously Awarded Compensation* proposal (the Proposal) issued by the Securities and Exchange Commission (SEC or the Commission). The Proposal would implement Section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), which requires the Commission to adopt rules directing the national securities exchanges and national securities associations to prohibit the listing of any security of an issuer that does not have a policy to recover incentive-based compensation from certain officers in the event of an accounting restatement.

We are limiting our comments to recommendations that the Commission consider clarifying certain aspects of the Proposal that could be difficult to interpret or apply or could have unintended consequences. We are not commenting on the merits of Section 954 or the Proposal.

Scope and definition of restatements

The Dodd-Frank Act added Section 10D to the Securities Exchange Act of 1934, which would require listed issuers to implement "clawback" policies to recover excess incentive-based compensation upon a "restatement due to material noncompliance with any financial reporting requirement under the securities laws." Footnote 65 of the Proposal notes that US GAAP defines a restatement as "the process of revising previously issued financial statements to reflect the correction of one or more errors that are material to those financial statements." However, it isn't clear whether the Proposal would apply to certain restatements or all revisions of previously issued financial statements due to an error in those previously issued financial statements.

SAB 108[1] provides guidance for issuers on how to quantify misstatements to assess materiality. The application of SAB 108 could result in a conclusion that the current financial statements have a material misstatement because immaterial errors in prior periods have accumulated to the point where

[1] SEC Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements*

they become too material to correct in the current financial statements (i.e., "Little r" restatements). Because the corrections of such errors are not material to the prior year financial statements, issuers don't have to file amended financial statements to address any inability to rely of those financial statements. Instead, "Little r" restatements may be corrected when the prior annual financial statements are reissued in comparative form. In contrast, issuers must file amended financial statements to restate previously issued financial statements to correct errors that are material to those financial statements (i.e., "Big R" restatements).

The Proposal suggests "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." However, the Proposal does not clearly state that an individual "Little r" restatement should not trigger any clawback. Consistent with the treatment of other revisions to previously issued financial statements discussed in the Proposal (e.g., discontinued operations, segment changes, changes in accounting principles including the adoption of a new standard) that are not material error corrections, we believe the SEC should clarify that an individual "Little r" restatement would not trigger a clawback.

In response to the SEC's request for comment on whether it should require an issuer to disclose its evaluation that errors are immaterial or not the result of material noncompliance, we discourage any such requirement. We understand the scope of any such disclosures would include "Little r" restatements discussed above, immaterial errors that are corrected as "out of period" adjustments and immaterial errors that have not yet been corrected. Such items occur routinely, and companies and their independent auditors evaluate an array of quantitative and qualitative factors (such as those described in SAB 99[2]) to make judgments about their materiality, individually and in the aggregate. It is unclear what would make disclosures about immaterial items material to investors, and explaining SAB 99 analyses regarding a conclusion that such items are immaterial could result in extensive disclosures that we believe would be unnecessary. A SAB 99 analysis of materiality includes consideration of whether an error has the effect of increasing management's compensation. Accordingly, we believe that the involvement of the independent auditors in evaluating management's materiality analyses and concurring (through the audit opinion) with management's conclusion, with oversight from the company's audit committee, provides sufficient protection of investor interests that material errors do not go uncorrected by a company trying to avoid the clawback of incentive compensation.

Triggering a clawback

The Proposal states that a clawback would be triggered by the earlier of two events — "the date the issuer's board of directors, a committee of the board of directors, or the officer or officers of the issuer authorized to take such action if board action is not required, concludes, or reasonably should have concluded, that the issuer's previously issued financial statements contain a material error" or "the date a court, regulator or other legally authorized body directs the issuer to restate its previously issued financial statements to correct a material error." The Proposal also states the trigger date "generally is expected to coincide with the occurrence of the event described under Item 4.02(a) of Exchange Act Form 8-K." In these disclosures, companies state that their financial statements can no longer be relied upon. The SEC should consider whether to include as a trigger the filing of an Item 4.02(b)

[2] SEC Staff Accounting Bulletin No. 99, *Materiality*

of Form 8-K in which companies disclose that their independent accountants have advised them that the financial statements can no longer be relied upon. While Item 4.02(b) disclosures are less common than Item 4.02(a), such communication also would present an objectively identifiable date from which to perform a look back analysis for purposes of recovering compensation, rather than any later date on which management or the board ultimately reaches the same conclusion. This clarification would appear consistent with a trigger based on when management or the board "reasonably should have concluded" as to the existence of a material error.

We also believe it would be helpful for the Commission to perform additional outreach to regulatory bodies and provide more guidance, including examples, on how the trigger involving conclusions by "a court, regulator or other legally authorized body" should be interpreted and applied. For example, it is unclear whether a request from the SEC staff in the Division of Corporation Finance that a company restate previously issued financial statements, made as part of the staff's review process, would be considered a trigger. Companies that receive requests like this from the SEC staff or other regulators may initially disagree with the regulator's position or with the materiality of the position, and the resolution of the issue to the satisfaction of the company and the regulator (potentially including various levels of appeals) may take time. It is unclear at what point the triggering event would have been deemed to occur when a material restatement occurs as the result of an inquiry from the SEC staff or other regulator.

Estimating excess incentive-based compensation

The proposed amendments to Section 10D of the Exchange Act state that when incentive-based compensation is based upon stock price or total shareholder return (TSR), the amount to be recovered "shall be based on a reasonable estimate of the effect of the accounting restatement on the stock price or total shareholder return." We believe the SEC should clarify that certain accounting restatements may not always require a clawback of incentive-based compensation based on stock price or TSR. We and others have observed that certain restatements may not affect stock price or TSR. For example, restatements related to the measurement and recognition of financial assets and liabilities, the measurement of asset impairments and classification errors in the statement of cash flows often have limited if any impact on stock price or TSR. When these types of errors occur, it appears that a company may not be required to recover any incentive compensation that was based on stock price or TSR, provided the issuer reasonably concludes that those metrics would not have been affected (i.e., there was no excess incentive compensation).

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We would be pleased to discuss our comments with the Commission or its staff at your convenience.

Very truly yours,