



Occupy the SEC

<http://www.occupythesec.org>

November 22, 2021

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

**Re: Listing Standards for Recovery of Erroneously Awarded Compensation; Reopening of Comment Period
(File Number S7-12-15)**

Dear Sir or Madam:

Occupy the SEC¹ (“OSEC”) submits this comment letter to the Securities and Exchange Commission (“Agency”) in response to the notice of proposed rulemaking² seeking to reopen the earlier proposal³ to implement Section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act’s (“Dodd-Frank Act”).⁴ This statute requires the clawback of ill-gotten bonuses received by managers at public companies based on erroneous information. Section 954 is premised on laudable and vital objectives: reducing perverse incentives for risk-taking and enhancing public disclosure about compensation practices at public companies.

I. Introduction

Rampant speculation played a causative role in producing the financial crisis of 2008. The Financial Crisis Inquiry Council has determined that excessive risk-taking led to the gargantuan economic losses of that crisis, which devastated the economic position of multinational conglomerates and poor individuals alike, and extinguished nearly 40% of U.S. family wealth from 2007 to 2010.⁵ Through the widespread usage of bonuses and other conditional

¹ Occupy the SEC (<http://occupythesec.org>) is a group of concerned citizens, activists, and financial professionals that works to ensure that financial regulators protect the interests of the public, not Wall Street.

² Listing Standards for Recovery of Erroneously Awarded Compensation; Reopening of Comment Period, 86 Fed. Reg. 58,232 (proposed Oct. 21, 2021) [hereinafter Reopened Proposal or NPR].

³ Listing Standards for Recovery of Erroneously Awarded Compensation, 80 Fed. Reg. 41,143 (proposed July 14, 2015) [hereinafter Initial Proposal]

⁴ 15 U.S.C. § 78j-4 (2021).

⁵ Jesse Bricker, et al., Changes in U.S. Family Finances from 2007 to 2010: Evidence from the Survey of Consumer Finances 17, Federal Reserve Bulletin (June 2012).

compensation, public companies have encouraged an executive culture that often promotes short-termism.

Section 954 of the Dodd-Frank Act was passed by Congress as a reflection of the public's anger over the profiteering culture at public companies like Enron and JPMorgan. As the Agency implements Section 954 through the rulemaking process, it must vindicate the American public's interest in a fair and just marketplace that is free of the self-interested profiteering that privileges the select few at the expense of the many.

II. Materiality

We commend the Agency for reopening the Initial Proposal and for considering the expansion of the scope of materiality. We believe that the statutory term “an accounting restatement due to material noncompliance” should be interpreted to include *all* required restatements made to correct an error in previously issued financial statements. There should be no exclusion for errors that were not material to those previously issued financial statements [hereinafter referred to as “materiality carveout”].

There is no statutory basis for the Initial Proposal's materiality carveout. For one thing, it is important to recognize that Congress expected materiality to be interpreted broadly and inclusively. This is evident from the legislative history of the Dodd-Frank Act, wherein Section 954 is described as follows:

“companies will be required to have a policy to recover money erroneously paid to executives based on financials that later have to be restated due to an accounting error.”⁶

The usage of the term “accounting error” suggests that even seemingly innocuous errors should fall within the ambit of Section 954's materiality provision. Moreover, the three-year lookback period in Section 954 reflects an orientation towards correcting present-day errors that derive from the past. The Initial Proposal's materiality carveout manufactures an exclusion without statutory authority, and should therefore be excised.

III. Triggering of the Three-Year Lookback Period

The Initial Proposal would require issuers to prepare accounting restatements if so directed by a regulatory body or court. There seems to be no controversy on this straight-forward requirement. A more controversial issue is when, in the absence of a government order, company management should be expected to release restatements.

The Initial Proposal is correct to impose a reasonableness standard on management's decisions on whether to restate an issuer's erroneous financial statements. The Reopened Proposal

⁶ H.R. Rep. No. 111-517, Joint Explanatory Statement of the Committee of Conference, Title IX, Subtitle E “Accountability and Executive Compensation” 873 (Conf. Rep.) (June 29, 2010).

observes that some industry commenters oppose the reasonableness standard, instead preferring to defer to management’s discretion on the matter.⁷

Aside from being contrary to Congressional intent, this *laissez-faire* approach has shown to be ineffective in the past. Public companies and their risk control procedures cannot be trusted to unearth or correct accounting misstatements. There is no doubt that covered institutions spent billions of dollars on compliance and self-monitoring efforts in the run-up to the 2008 crisis. Yet those efforts at self-regulation seemed to yield little benefit as the global economy teetered on the verge of collapse. It would be highly questionable for the Agency to support the industry view that internal risk management procedures will be more effective this time around.

If internal procedures proved to be ineffective in the runup to 2008, why should we expect them to be more effective now? Admittedly, the Dodd-Frank Act establishes a number of restrictions on executive compensation and other controls that have not existed before, but the mere existence of those restrictions will not serve the purposes that Congress intended in passing Section 954 without meaningful implementation. The elimination of the reasonableness requirement would effectively neuter Section 954, relegating actual enforcement to those rare instances where a court or regulator compels restatement. A recent audit revealed that “[r]eissuance restatements, where prior financial statements are reissued because they can no longer be relied upon, were at their lowest level since the disclosure requirement took effect in 2005.”⁸ There is no rational reason to believe that issuers will adequately release restatements without some level of compulsion, which the reasonableness standard promotes.

IV. Post-Restatement Requirements

The NPR’s proposal to require checkboxes on the cover page of Form 10-K for Section 954 restatements is an excellent idea. Issuers are increasingly prone to deluge investors in a flood of information, concealing key data in a wash of profuse text. Section 954 restatements are highly relevant for investors, and deserve being spotlighted for attention.

Along similar lines, the Agency should require issuers to explicitly disclose not just how Section 954 clawbacks were calculated, but also the identities of officers whose compensation was affected. This is justified by the text of Section 954, which appends a disclosure provision to the claw-back mandate.⁹ The disclosure of such information will provide valuable data to investors, who can utilize it to better assess issuers’ long-term riskiness. At present, the terms of executive compensation at public companies are mostly secret, which deprives investors of the ability to make fully informed investment decisions. While officers might expect some level of privacy over their compensation, such privacy rights should be deemed abrogated when that compensation is deemed to have been illegally procured under Section 954.

⁷ See Reopened Proposal at 58,234-35.

⁸ Maria L. Murphy, *Report: 2019 Restatements at 19-Year Low; Revenue Still Top Issue* (Sep. 8, 2020), <https://www.complianceweek.com/accounting-and-auditing/report-2019-restatements-at-19-year-low-revenue-still-top-issue/29421.article>.

⁹ 15 U.S.C. § 78j-4(a).

Permitting senior employees to keep their compensation secret even when that compensation was based on error creates a serious moral hazard problem. The promise of everlasting secrecy incentivizes officers to play fast-and-loose with financial reporting. In contrast, the robust disclosure of clawback information (including identity and amount) would eliminate this moral hazard and have a disciplining effect on management actions. We suggest that the Agency establish an online, publicly-accessible database (similar to FINRA's BrokerCheck) that lists all employees whose compensation has been clawed back pursuant to Section 954. The disclosure of this information would serve as an additional deterrent against irresponsible risk-taking among employees of public companies.

Similarly, each issuer should be required to report clawed-back compensation by department, sub-department and function. The disclosure of such information will provide shareholders and prospective investors with important data about a company's internal allocation of capital resources. Such information will also make it easier for regulators to monitor compliance with the applicable regulations.

V. Escrow Requirement

One of the chief failings of the NPR is that it does not establish a realistic mechanism whereby financial institutions can claw back ill-gotten gains. By the time a covered institution realizes that it must claw back compensation from a former employee, that employee may:

- a) not have enough money to pay the institution back,
- b) be deceased,
- c) be untraceable or living in another country.

We therefore urge the Agency to require incentive-based compensation to be held in escrow for the duration of the three-year clawback period. This approach would greatly improve the ability of affected institutions to enjoy something more than nominal restitution in cases where clawbacks are needed. Moreover, the usage of an escrow would facilitate the collection of government penalties (if applicable). Even if the Agency declines to apply an escrow requirement to all covered persons, the Agency should at least apply the requirement to top-level executive officers who have far-reaching control over profitability and to others who are able to commit the highest levels of company capital.

VI. Concerns About Effects on Recruitment

Various industry lobbyists have proclaimed that a vigorously enforced Section 954 would impede the ability of issuers to "recruit top talent."¹⁰ The Agencies must disregard these proclamations.

First of all, the implication of this argument is that "top talent" a) seeks out opportunities to exploit issuers and their shareholders based on erroneous disclosures, and b) would decline job openings where such opportunities did not exist. This is a perhaps unduly pessimistic view of

¹⁰ See, e.g., Enesco PLC, Comment Letter on the Initial Proposal (Sep. 14, 2015), available at <https://www.sec.gov/comments/s7-12-15/s71215-34.pdf>.

the ethical constitution of the nation's executive class. In any case, if this perspective held true, then issuers, shareholders and the broader public would actually benefit from the exclusion of such "talent" from the employee rolls at the nation's securities issuers.

Further, there is no evidence that Congress intended the Agency to take potential impacts on recruitment into consideration. For instance, there is no rule of construction listed in the statute mandating that the Agency implement rules that account for any impacts on retention of talent.

In any case, there is no credible evidence that the NPR will actually cause public companies to suffer from a dearth of talented executives. The only "talent" who might flee from American industry by virtue of Section 954 would be those individuals with an outsized appetite for risk. And even if such individuals were to flee, the United States markets would be more stable without them.

Furthermore, the "flight" argument rings hollow when one considers the fact that compensation regulations are actually more burdensome in comparative jurisdictions.¹¹ Unlike those comparative jurisdictions, the United States currently suffers from the absence of meaningful restrictions on risk-promoting compensation. This imbalance creates incentives for dangerous risk-taking in the American financial markets. By failing to meet the stringent compensation standards set in Europe, American regulators risk setting the stage for the next financial disaster.

VII. Conclusion

It should be noted that the SEC was provided with a similar opportunity to punish improper compensation two decades ago, under Section 304 of the Sarbanes-Oxley Act. Unfortunately, history has shown that that section has been rarely enforced.¹² We urge the Agency not to repeat history when it comes to enforcing Section 954.

In crafting regulations implementing Section 954, the Agency has have been given an historic opportunity to reorient the nation's public companies towards stability and growth and away from the kind of self-interested profiteering that produced the Great Recession of 2008. It is vital that the Agency avail of this opportunity by producing tough, bright-line regulations that help restore the public's confidence in the nation's markets.

¹¹ See Press Release, European Commission, Commission Adopts New Standard to Increase Transparency over Bankers' Pay and Risk Profiles (Mar. 4, 2014), available at http://europa.eu/rapid/press-release_IP-14-210_en.htm; Corporations Amendment (Improving Accountability on Director and Executive Remuneration) Act, No. 42 (2011) (Australia); Raphael Minder, *Swiss Voters Approve a Plan to Severely Limit Executive Compensation*, N.Y. Times, Mar. 3, 2013, available at http://www.nytimes.com/2013/03/04/business/global/swiss-voters-tighten-countrys-limits-on-executive-pay.html?_r=0.

¹² See *SEC v. Baker*, 2012 WL 5499497 (WD Tex. Nov. 13, 2012) ("For reasons best known to the SEC, the Commission has been historically reluctant to utilize § 304 in the ten years since Sarbanes-Oxley was enacted.").

Thank you for your attention to this matter of great public interest.

Sincerely,

/s/

Occupy the SEC

Akshat Tewary

Neil Taylor

Josh Snodgrass

et al.