September 21, 2015

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

Re: Proposed Rules on Listing Standards for Recovery of Erroneously Awarded Compensation (Release Nos. 33-9861, 34-75342, IC-31702; File No. S7-12-15)

Dear Mr. Fields:

The Corporate Governance Coalition for Investor Value (the "Coalition") has been formed to provide a forum for the discussion of issues of common interest among its members to advocate for strong corporate governance policies and the goals of the federal securities laws to promote long-term value creation for investors and the firms in which they invest. Coalition members represent American businesses of all sizes, from every industry sector and geographic region. These businesses produce the goods and services that drive the American economy, employing and creating opportunities for millions of Americans, and serving the countless communities nation-wide in which they operate. The Coalition believes that strong corporate governance policies are important to provide investors with return and businesses with the capital needed to grow and operate.

We appreciate the opportunity to comment on the proposed rules issued by the Securities and Exchange Commission ("Commission" of the "SEC") in the release entitled Listing Standards for Recovery of Erroneously Awarded Compensation (the "Proposal"). The Proposal seeks to implement Section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").

The Coalition is concerned that the Proposal, in its current form, is both overly prescriptive and, in several important respects, simply unworkable. Due to the highly inflexible nature of the Proposal, the individual stock exchanges are left with little

discretion to fashion their own unique listing standards and are likely to propose their own listing standards that closely mirror the format described in the Proposal. The Commission would thus micro-manage the promulgation of stock exchange listing standards and frustrate any private ordering that would ordinarily exist. The many issuers that have previously adopted clawback policies of their own will inevitably be required to synchronize those with the rigid criteria established by the exchanges. We believe advancing a rule that follows this pattern is problematic from both a legal and a public policy perspective. We highlight our specific concerns with the Proposal below.

I. The Commission should not apply any final rules on a retroactive basis.

The Proposal provides that any final rules would apply to any awards granted, earned, or vested on or after the effective date of Rule 10D-1. Because it includes awards that are earned or vested after the effective date, and such awards often have lengthy vesting periods, the Proposal could include awards that were granted before the effective date of a final rule. We do not believe Congress intended for the final rules to have retroactive effect.[1] Thus, the Coalition believes that any final rule should only apply to awards that were granted after the effective date of final rules.

The Proposal also raises a similar issue with respect to pre-existing employment contracts and incentive compensation agreements that may not permit the kind of clawback recovery contemplated by Rule 10D-1. On this point, we respectfully disagree with the Commission's statement that there should be no contradiction between Rule 10D-1 and existing employment contracts, "because issuers can amend those contracts to accommodate recovery." As a matter of contract law, companies cannot make a unilateral amendment to an employment contract; they must, instead, seek consent of the affected employee and offer new consideration for the amendment. That employee may not be willing to agree to an amendment, particularly when the effect would be to disadvantage the employee by permitting a clawback of the type contemplated by the Proposal. For employees outside the

[1] The holding by the Court of Appeals for the District of Columbia Circuit as to the retroactivity of another Dodd-Frank provision enforced by the Commission also calls into question the permissibility of adopting a retroactive rule here. *See Koch v. Commission*, 2015 WL 4216988, at *8 (D.C. Cir. July 14, 2015)(the presumption against retroactive legislation is "deeply rooted in our jurisprudence and embodies a legal doctrine centuries older than our Republic").

United States, where employment laws and standards for employment contracts differ significantly from those in the US, unilateral amendments may present even greater difficulties. And the problem is compounded for former employees who have no incentive of any kind to cooperate with a former employer. Accordingly, to avoid the problem of retroactive effect, we believe the Commission should enforce any final rule on a go-forward basis only so that employment agreements entered into in the future can include appropriate provisions to address these issues.

II. The Commission should refine the definition of "Executive Officer".

Under the Proposal's definition of "executive officer", an executive officer would include the issuer's president; principal financial officer; principal accounting officer (or if there is no such accounting officer, the controller); any vice president of the issuer in charge of a principal business unit, division or function; any other officer who performs a policy-making function; or any other person who performs similar policy-making functions for the issuer. Executive officers of the issuer's parent or subsidiary would be deemed executive officers of the issuer if they perform such policy-making functions for the issuer.[2]

The Proposal's mandatory recovery policy would thus apply to all of an issuer's executive officers, regardless of whether the executive officer's responsibilities include preparing the issuer's financial statements. In the interest of fundamental fairness, proper alignment of incentives and management responsibilities, and legal soundness, the Coalition urges the Commission instead to (1) limit the scope of "executive officer" to those senior executives with direct responsibility for accounting and preparation of financial statements, and (2) require that any officer for whom disgorgement is sought must have scienter and must otherwise have played a significant role in the events leading to a restatement.

We believe the Proposal's no-fault standard for such a large group of employees is problematic from both a policy and legal standpoint. Similar to Section 954 of the Dodd-Frank Act, Section 304 of the Sarbanes-Oxley Act provides that if an issuer is required to prepare an accounting restatement due to the material

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[2] The proposed definition largely tracks the definition of "officer" in Rule 16a-1(f) under the Securities Exchange Act of 1934.

noncompliance of the issuer, as a result of misconduct, with any financial reporting requirement under the securities laws, the issuer's CEO and CFO must reimburse the issuer for certain bonuses and profits on the sale of company stock. The SEC and courts have interpreted Section 304 to be one of strict liability, and the courts have authorized the SEC's enforcement of this provision even when the CEO and CFO were not accused of any wrongdoing. Nevertheless, the SEC's power to seek disgorgement is not limitless.

The Sarbanes-Oxley cases focus on the interplay between Section 304 and the other provisions of Sarbanes-Oxley applicable to the CEO and CFO to justify a no-fault standard. For example, these cases have emphasized the fact that the CEO and CFO are required to certify annual and quarterly reports, including certifying that they are responsible for the design and operation of effective internal controls.[3] Thus, the courts have reasoned, that the absence of any requirement of personal misconduct provides an incentive for the CEO and CFO to be vigilant in ensuring there are adequate controls to prevent misconduct by their subordinates.[4]

Unlike the Sarbanes-Oxley framework for the CEO and CFO, many of the "executive officers" of a company under the Proposal have little to no visibility into the maintenance of internal controls or the preparation and certification of financial statements, and likewise have no control over accounting and finance employees within the company who prepare those financial statements. Senior executives in areas such as human resources, marketing, public relations, information technology, legal and compliance, research and development, and other administrative areas outside of financial reporting could all be subject to the rule. The Coalition believes the Proposal's broad scope of executive officers would be fundamentally unfair to these kinds of employees who, because of the nature of their job duties, have no ability to affect financial reporting in the first place. Disgorgement could create personal hardships for executives where funds or securities are no longer available to the executive because they have been spent or sold. The hardship is made worse when compensation must be disgorged on a pre-tax basis and the executive has already paid income and employment taxes on the amount in controversy.

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[3] *See, e.g., SEC v. Jenkins*, 718 F. Supp. 2d 1070 (D. Ariz. 2010); *SEC v. Baker*, 2012 WL 5499497 (W.D. Tex. Nov. 13, 2012).

[4] *See, e.g., Jenkins*, 718 F. Supp. 2d at 1077; *Baker*, 2012 WL 5499497 at *6.

Moreover, providing a remedial mechanism against employees who have no ability to impact accounting decisions will not improve accounting systems, enhance the quality of a company's financial statements, or guard against future restatements. Such a rule would also serve to discourage many qualified employees from seeking senior positions within companies out of fear that they may be required in future years to disgorge compensation because of a series of events totally outside their control. We do not believe Section 954 of the Dodd-Frank Act requires the Commission to define "executive officer" so broadly.

III. The Commission should streamline the burdensome recovery process.

We believe the Proposal creates a complicated and unduly burdensome process for compelling issuers to seek recovery of erroneously awarded compensation from executive officers. This collection mechanism is both novel and unprecedented. If enacted, this process will present many procedural and practical challenges to issuers and, ultimately, we believe it will prove unworkable in practice.

First, the Proposal's calculation of recoverable amounts, based on what payments would have been made based on the accounting restatement, will be impractical because of common features of issuers' compensation plans. Many issuers' plans include multiple metrics, of which financial measures potentially subject to restatement are only a part. In such cases, the Proposal states that the issuer, "first would determine the portion of the original incentive-based compensation based on or derived from the financial reporting measure that was restated." Given the wide variety of compensation schemes in use by listed companies, however, determining that "portion" may well be impossible. Management and boards of directors frequently exercise considerable discretion in making incentive awards, and attempting to assign a portion of that decision to a financial measure will expose them to extraordinary litigation risk—from affected employees who argue that the financial measure was over-weighted, and potentially from shareholders who argue that it was under-weighted. In addition to introducing this risk, the potential for related additional litigation expenses will make any recovery more likely to be "impracticable," as discussed below.

The Proposal establishes a number of highly restrictive parameters that are

intended to limit severely an issuer's discretion to pursue recovery, in effect compelling an issuer to proceed except in the rare circumstance in which pursuing recovery would be "impracticable". For example, the issuer would first have to make a reasonable attempt to recover the excess incentive-based compensation before concluding that it would be impracticable to recover based on the costs of enforcing recovery. The only permissible criterion for making this determination is whether the direct costs (such as reasonable legal expenses) of enforcing recovery would exceed the recoverable amounts, which is a decision only a company's board of directors can make. The issuer would also be required to document its recovery attempts, provide such documentation to the exchange and disclose why it chose not to pursue recovery. Any determination of impracticability would be subject to review by the stock exchange. Moreover, the Proposal does not allow issuers to settle for less than the full recovery amount unless full recovery is impracticable, in which case the same conditions would apply as those applicable to a determination to forgo recovery.

The Proposal is highly intrusive in the way it seeks to intervene in an issuer's efforts to pursue recovery, from what terms of settlement are permissible to providing a mechanism for the stock exchange to second-guess a board's business judgment. Because the Proposal requires that companies must, in all cases, make an attempt to collect before determining that collection costs are unjustifiable, the Proposal provides no alternative to companies in cases when amounts to be pursued are far outweighed by the cost of collection. The Coalition believes there is no benefit to a company's shareholders in expending huge sums of corporate funds to chase defendants (such as former employees) for which the chance of recovery is remote, or to otherwise seek to recover what will often be nominal or immaterial amounts.

Rather than compelling companies to pursue uneconomical litigation and in effect requiring them to act as the Commission's collection agents, we believe a more straightforward approach would be to permit boards of directors the broad discretion to assign claims to the Commission in the event a current or former executive officer is unwilling to make voluntary disgorgement to the company. Such an assignment would be entirely consistent with Section 954, which only provides that an issuer "will recover" the amounts at issue, but does not prohibit an assignment to the Commission. The Commission could then pursue collection as it sometimes chooses

to do under Section 304 of the Sarbanes-Oxley Act.[5] This alternative properly places responsibility for enforcement of the Commission's regulations with the Commission, and obviates the need for final rules on the mechanics of collection that will surely produce a myriad of unintended consequences. This alternative would also give the Commission greater ability to be included in the development of the case law that will flow from judicial interpretations of the rule.[6]

The Commission must also consider carefully the interplay of the recovery process with other regulatory requirements. For example, if an accounting restatement is not initiated by voluntary action of the issuer's management, but is instead compelled by the action of a regulator having jurisdiction over the issuer, recovery should not commence prior to final resolution of any applicable appeals process, so that the restatement is final. Since some of the accounting policies most in flux are highly relevant to regulated industries, e.g., financial services, the need for such final determinations is critical to the fair implementation of the Dodd-Frank Act requirements.

We also request that the Commission clarify in final rules whether it intends for those final rules to preempt applicable state and federal labor and employment laws. Seeking a clawback of the type contemplated by the Proposal may be inconsistent with state or federal wage and hour laws, and could open employers who are pursuing disgorgement to potential liability for unfair labor practices or other violations of applicable employment law. Given the broad sweep of the current definition of "executive officer," it is also conceivable that an affected employee may be a member of a collective bargaining unit, which raises the potential for conflict with the National Labor Relations Act.[7]

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[5] While the Commission's record of pursuing disgorgement under Section 304 has been inconsistent over the years, the fact that in many cases it chooses not to initiate litigation suggests that the Commission itself is exercising some level of discretion as to whether to pursue uneconomical cases. Yet in doing so the Commission faces none of the procedural hurdles it seeks to impose on issuers under the Proposal.

[6] Surely the Commission would prefer to be involved in cases interpreting its own rules, as opposed to third parties who would have no incentive to advocate in favor of the Commission's preferred positions, and may in fact take positions in adversarial litigation that are contrary to the Commission's preferred approach.

[7] As we highlight below, US corporations seeking disgorgement from employees overseas may also face similar predicaments under foreign law as well.

IV. The Commission should clarify what kind of restatement will trigger a clawback.

The Coalition believes establishing a clear understanding of precisely what kind of accounting restatement will trigger application of a clawback obligation is important. It appears from the Proposal that the clawback obligation is triggered by a requirement to prepare a restatement to correct a material error, which is often understood to mean a restatement of the type that would require an issuer to file a Form 8-K under Item 4.02(a). However, the Commission's statement in the Proposal 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" potentially casts doubt on this interpretation. The Commission staff has previously offered other guidance on the topic of what constitutes a restatement.[8] To avoid ambiguity regarding the type of accounting restatement that will require an issuer to seek recovery, as well as potential uncertainty regarding its timing, the Coalition requests that the Commission confirm the circumstances leading to restatement for purposes of any final rules. In particular, we seek confirmation as to whether a clawback is triggered only if, following the aggregation of a series of immaterial errors, the issuer is required under applicable accounting standards to prepare an accounting restatement to correct a material error of the type required to be reported under Item 4.02(a) of Form 8-K.

V. Final rules should make greater accommodation for foreign law.

The Coalition is concerned that the Proposal subjects foreign private issuers to many of the same challenges as US issuers. The Coalition would typically expect any Commission rule or stock exchange listing standard affecting foreign private issuers to make accommodations for conflicting foreign law. We do not believe the Commission has adequately addressed this situation in the Proposal. If enacted, not only would the Proposal's approach to foreign law serve as a further disincentive for foreign firms to list in the US, it may also accelerate the unfortunate trend of foreign firms delisting from US exchanges. Worse still, it could encourage foreign

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[8] *See* SAB 108*, codified as* SAB Topic 1.N. *See also* Mark Mahar, Associate Chief Accountant, Office of the Chief Accountant, *Remarks Before the 2008 AICPA National Conference on Current SEC and PCAOB Developments* (Dec. 8, 2008), available at https://www.sec.gov/news/speech/2008/spch120808mm.htm.

governments to pass laws that single out or even penalize US corporations.

While the Proposal's exception for impracticability when collection would violate home country law is a good first step, in practice this exception as currently structured would be unnecessarily complicated. Under the Proposal, a foreign private issuer who concludes that recovery is impracticable because it would violate home country law must first obtain an opinion of home country counsel that recovery would result in a violation, which opinion must be acceptable to the exchange. Further, the relevant home country law must have been implemented prior to the date that the final version of Rule 10D-1 is adopted.

Therefore, the Coalition supports a home country law exception, but believes final rules should clarify and expand its scope and allow for substituted compliance. When the Commission looks to adopt final rules here, we encourage it to abandon the Proposal's discriminatory approach towards foreign private issuers by eliminating the requirement for opinions of counsel and the limitation that home country law cannot change after the date final rules are enacted. Doing so would be consistent with numerous precedents in the Commission's integrated reporting system that provide accommodations for foreign private issuers under home country law without the need to seek opinions of counsel or take other extraordinary measures, and without penalizing foreign firms from compliance with home country law. Similarly, the stock exchanges regularly seek to accommodate foreign governance systems when foreign companies seek US listings.

Moreover, the Coalition encourages the Commission to expand the exemption for compliance with foreign law so that it is not limited to foreign private issuers. US corporations operating outside the United States will inevitably face the same obstacles in seeking to enforce a Commission disgorgement rule in a foreign court with respect to foreign employees. In many instances, applicable foreign law will not be the jurisdiction of incorporation or the jurisdiction where a head office is located, but rather the jurisdiction where the employee against whom disgorgement is sought resides. Thus, any issuer—foreign or domestic—should have the ability to defer to foreign law in situations in which foreign law is applicable.[9]

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[9] Although the Proposal is not clear on the point, we believe home country law should be construed broadly enough to include any applicable foreign law.

Finally, the Proposal has the potential to conflict with other regulations, including those issued and to be issued under the Dodd-Frank Act. Of particular concern are forthcoming regulations under Section 956 of the Dodd-Frank Act, originally proposed in 2011, dealing with incentive compensation. The Coalition understands that the Commission and the bank supervisory agencies expect to re-propose regulations in this area in the near future. It would pose a risk of extreme injury, not only to financial institutions and other regulated issuers subject to Section 956, but also to their shareholders, if inconsistencies between final rules under Sections 954 and 956 multiplied issuers' administrative burdens, impaired their ability to manage compensation to compete in the market for management talent, or, worst of all, subjected them to legal requirements so conflicting that compliance was impossible.

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Thank you for considering our views on the Proposal. We would be pleased to discuss our concerns or any other matters that you believe would be helpful.

Sincerely,

American Bankers Association
American Insurance Association
Institute of International Bankers
National Association of Manufacturers
National Association of Real Estate Investment Trusts
National Black Chamber of Commerce
Property Casualty Insurers Association of America
Securities Industry and Financial Markets Association
The U.S. Chamber of Commerce

Cc: The Honorable Mary Jo White
The Honorable Luis A. Aguilar
The Honorable Daniel M. Gallagher
The Honorable Kara M. Stein
The Honorable Michael S. Piwowar