Electronically Filed

July 14, 2022

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

Re: Reopening of Comment Period for Listing Standards for Recovery of Erroneously Awarded Compensation (File No. S7-12-15)

Dear Ms. Countryman:

Better Markets[1] appreciates the opportunity to provide additional comment on the above-captioned Proposed Rule ("2015 Proposal"), which was published by the Securities and Exchange Commission ("SEC" or "Commission") in the Federal Register on July 14, 2015, initially reopened for comment on October 21, 2021 (the "2021 Proposal"),[2] and now being reopened for comment[3] in light of a memorandum issued by the staff of the SEC's Division of Economic and Risk Analysis ("DERA Staff Memo"), released on June 8, 2022.

The DERA Staff Memo provides additional data relating to two points: First, the number of companies that have voluntarily adopted a compensation recovery policy, and second, the number of additional restatements that would trigger a compensation recovery analysis if, as described in the 2021 Proposal, the rule was extended to *all* required restatements made to correct

1 Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system that protects and promotes Americans' jobs, savings, retirements, and more.

2 Listing Standards for Recovery of Erroneously Awarded Compensation, 80 Fed. Reg. 41,144 (Jul. 14, 2015) (to be codified at 17 C.F.R. pts. 229, 240, 249, and 274); Reopening of Comment Period for Listing Standards for Recovery of Erroneously Awarded Compensation, 86 Fed. Reg. 58,232 (Oct. 21, 2021).

3 87 Fed. Reg. 35,938 (Jun. 14, 2022).

errors in previously issued financial statements. The memo also briefly addresses the potential costs and benefits associated with these two data sets and estimates.[4]

The 2015 Proposal would implement Section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act").[5] Under that provision, the Commission must adopt a rule directing the securities exchanges to establish issuer listing standards providing for the recovery of incentive-based compensation paid to current or former executive officers in excess of what those executives should have received, as shown by an accounting restatement, all without regard to fault. This important reform serves to limit systemic risk by curbing the impulse among executives to pursue short-sighted business strategies for personal gain and by encouraging companies to pursue high quality financial reporting practices. It also vindicates the basic principle that it is wrong for corporate leaders to retain compensation—especially performance-based compensation—that they do not deserve.

As we stated in our original letter[6] in response to the 2015 Proposal, and in our response to the 2021 Proposal,[7] both of which we fully incorporate herein by reference, we believe that the Commission has developed a strong proposal that largely adheres to both the letter and the spirit of Section 954 of the Dodd-Frank Act. Nevertheless, the Commission can and should improve the Proposal in several respects, as detailed in the 2015 Better Markets Letter, to ensure that it fully realizes the Congressional objectives underlying Section 954. In particular, as we explained in our comment letter on the 2021 Proposal, in light of the text of Section 954, and the context in which it was passed, the Commission should define "restatement" broadly so that it captures all types of accounting restatements resulting from "the material noncompliance of the issuer with any financial reporting requirement under the securities laws."[8] This will not only ensure that the final rule is consistent with the statutory text but also prevent evasion of this critical provision, as evidence has demonstrated that, given the opportunity, issuers will misclassify restatements to avoid triggering a compensation recovery analysis. The DERA Staff Memo does not fundamentally alter this analysis, and it actually supports it in significant respects. Accordingly, we again urge the SEC to complete this mandatory rulemaking with an appropriately broad definition of "restatement."

---

4 Memorandum From the SEC Division of Economic and Risk Analysis Re: Supplemental Data and Analysis on the Voluntary Adoption of Compensation Recovery Provisions By Issuers and the Impact of Including "Little R" Restatements as Triggers for a Compensation Recovery Analysis (Jun. 8, 2022), https://www.sec.gov/comments/s7-12-15/s71215-20130560-298718.pdf

5 Section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, *codified at* 15 U.S.C. § 78j-4 (2010).

6 Better Markets Comment Letter to the SEC on Clawbacks (Sept. 14, 2015) ("Better Markets 2015 Letter"), https://bettermarkets.org/wp-content/uploads/2021/07/SEC-CL-Listing-Standards-for-Recovery-of-Erroneously-Awarded-Compensation-9-14-2015.pdf.

7 Better Markets Comment Letter to the SEC on Listing Standards for Recovery of Erroneously Awarded Compensation (Nov. 22, 2021), https://bettermarkets.org/wp-content/uploads/2021/11/Better_Markets_Comment_Letter_on_Clawback_Rule_Reopening.pdf.

8 15 U.S.C. § 78j-4(b)(2).

INTRODUCTION AND BACKGROUND

Major contributors to the financial crisis were misaligned incentives generally and executive compensation policies in particular at many financial institutions that motivated corporate leaders to engage in high-risk activities for short-term profit and lucrative bonuses. Citigroup CEO Chuck Prince's infamous quote captures much of what went so wrong in the suites of the too-big-to-fail banks on Wall Street:

> "When the music stops, in terms of liquidity, things will be complicated. But as long as the music is playing, you've got to get up and dance. We're still dancing,"

These short-sighted policies, fueled by misguided competitiveness and greed rather than principles of sound corporate governance, came at the expense of the long-term viability of those institutions, the entire financial system, and, ultimately, the U.S. economy. As a result, the financial crisis of 2008 will ultimately cost over $20 trillion in lost GDP, in addition to the long-lasting suffering experienced by millions of Americans who lost their jobs, savings, and homes.[9]

A specific problem in the realm of corporate governance was the tendency of some corporate executives to engage in accounting fraud or manipulation and high-risk business strategies to bulk up revenues and attempt to justify inflated compensation awards. As one Congressional study of the crisis concluded:

> "Even before the current crises, many criticized such incentive plans for encouraging excessive focus on the short term at the expense of consideration of the risks involved. This short-term focus led to unsustainable stock buyback programs, accounting manipulations, risky trading and investment strategies, or other unsustainable business practices that merely yield short-term positive financial reports."[10]

To address these abuses, Congress enacted a collection of corporate governance and executive compensation reforms in Subtitle E of Title IX of the Dodd-Frank Act, including the following:

- Section 951, requiring shareholder advisory votes on executive compensation and golden parachutes;

- Section 952, requiring new listing standards that impose enhanced independence requirements for members of issuers' compensation committees;

- Section 953(a), requiring disclosure of executive compensation in relation to company performance;

---

9 *See generally* Better Markets, "The Cost of the Crisis" (July 2015).

10 Congressional Oversight Panel Special Report on Regulatory Reform, *Modernizing the American Financial Regulatory System: Recommendations for Improving Oversight, Protecting Consumers, and Ensuring Stability* (2009).

- Section 953(b), requiring disclosure of the ratio between the CEO's total compensation and the median total compensation for all other company employees; and

- Section 956, mandating the disclosure to regulators of all incentive-based compensation arrangements, and prohibiting incentive-based compensation arrangements that encourage inappropriate risks by providing executives or others with excessive compensation.

Section 954 is part of this collection, and it was specifically designed to ensure that corporate executives are not allowed to retain incentive-based compensation that was awarded based upon materially inaccurate financial statements. Once implemented, it will help curb high risk activities, increase compliance with accounting standards, and promote fairness to shareholders by ensuring that they are not forced to pay executive compensation that was undeserved.[11] It is one of many important reforms that are necessary to help reduce excessive risk-taking by financial market participants and thereby decrease the likelihood of another financial crisis.

The SEC first proposed a rule to implement Section 954 in 2015. It reopened the comment period in 2021. A primary focus of the 2021 Proposal was whether the SEC should define "accounting restatement" narrowly so that it only captures a subset of accounting restatements, i.e. so-called "big R" reissuance restatements that are "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,"[12] or whether the rule should also cover so-called "little r" revision restatements i.e. "restatements that correct errors that are not material to previously issued financial statements, but would result in a material misstatement if (a) the errors were left uncorrected in the current report or (b) the error correction was recognized in the current period."[13]

The SEC is now reopening the comment period in light of the DERA Staff Memo which found that: (1) the number of companies that voluntarily disclose a compensation recovery policy has increased substantially since the 2015 Proposal, and (2) that there have been about 3 times as many "little r" revision restatements as "big R" reissuance restatements in recent years.[14]

COMMENTS

It is certainly a hallmark of good rulemaking and government transparency to disclose new information, and related analysis, that is relevant to a pending rule proposal, and to allow the public to provide comment on how that new information may or may not impact the proposal. In this case, the information and analysis contained in the DERA Staff Memo do not fundamentally alter the approach the SEC should take to implementing Section 954. In some respects, the memo

[11] *See* S. Rep. No. 111-176 (2010).
[12] 2021 Proposal at 58,234.
[13] 2021 Proposal at 58,234.
[14] DERA Staff Memo.

supports the broader classification of restatements that should trigger a compensation recovery analysis.

First, of course, nothing about the new facts or analysis in the DERA Staff Memo alters the mandate Congress set forth in Section 954, which is straightforward in its core provision: If an issuer is required "to prepare an accounting restatement," because of the issuer's "material noncompliance with financial reporting requirements," then it must recover any incentive-based compensation received by current or former executives over the prior three years, in excess of what would have been paid to those executive officers under the accounting restatement. The language of the provision is both **broad** and **mandatory,** by intention, as made clear in the Senate Report discussing the provision, which explained that "it is unfair to shareholders for corporations to allow executives to retain compensation that they were awarded erroneously."[15] The statute covers "accounting restatement[s]," without regard to specific subspecies of restatements. Moreover, nothing in the text of Section 954 or its accompanying history or context suggests the SEC has any discretion to narrow the rule in light of the number of companies that have voluntarily adopted a compensation recovery policy, or in light of the fact that the substantial majority of accounting restatements are of the "little r" type.

Second, the analysis in the DERA Staff Memo regarding the increased voluntary adoption of compensation recovery provisions actually highlights the need for a broad, uniform, and mandatory compensation recovery requirement. The memo observes that "the number and percentage of filers that disclose a compensation recovery policy has roughly doubled relative to the estimates provided in the Proposing Release."[16] It further notes that the costs and benefits of the Proposal may be somewhat reduced to the extent companies have already adopted strong compensation recovery provisions.[17] But it follows that not all issuers have adopted the compensation recovery policies; many have declined to do so and a regulatory requirement is clearly still necessary. Furthermore, a critical observation in the memo is that according to several studies, the policies that have been voluntarily adopted are narrower than the policies required under the Proposal. Specifically, those voluntary provisions, unlike the provisions under the proposed rule, may only be triggered if there is misconduct on the part of the executive; may apply to a smaller set of executives; and/or may have a shorter look-back period.[18] Clearly, then, it is no less important for the Commission to follow-through with a broad and strong rule that requires ***all listed companies*** to have a compensation recovery policy in place and that those policies meet ***minimal, standard criteria***.

In fact, many of the benefits of the SEC adopting a rule mandating compensation recovery policy arise directly from the mandatory nature of an SEC rule. An SEC rule mandating a compensation recovery creates an enforcement mechanism to ensure not only that a company has a compensation recovery policy that meets certain requirements, but also that it is actually applying that policy and recovering compensation as appropriate. A purely voluntary regime leaves entirely up to the self-interested discretion of the issuer (1) whether to have a compensation recovery policy

---

15 S. Rep. No. 111-176 (2010).
16 DERA Staff Memo at 1.
17 DERA Staff Memo at 2.
18 DERA Staff Memo at 1.

at all, (2) when the compensation recovery policy will be triggered; (3) the scope of that policy; and (4) whether to attempt to claw back compensation in any particular situation. An SEC rule, by contrast, will limit the ability of issuers to abuse their discretion in clawing back erroneously awarded compensation.

Finally, the prevalence of "little r" restatements, relative to big R restatements, actually affirms the need to encompass them under any final rule. Plainly, including little r restatements is necessary and appropriate to achieve the objectives underlying Section 954 to the greatest extent possible: recovering erroneously awarded incentive-based compensation when an accounting restatement—of any kind—has become necessary. It is in fact highly implausible to suggest that Congress would be satisfied with a claw back rule that failed to capture the majority of accounting restatements as triggers for recovery.

The analysis in the DERA Memo bolsters the point, highlighting the numerous benefits that would accrue with the broader framing of the rule: To the extent little r restatements trigger the recovery of erroneously awarded compensation, companies will benefit from the availability of those additional funds for other productive corporate uses; the incentive to pursue high quality financial reporting will increase; and the incentive to engage in more "value-enhancing business practices" will also increase.[19] The DERA Staff Memo notes that little r restatements may be "less likely" than big R restatements to trigger a potential recovery of compensation.[20] But that by itself is no reason to exclude them from the ambit of the rule; even if that premise is true, establishing them as triggers will still serve the purposes underlying the claw back mandate because a significant number of the little r restatements can be expected to result in some compensation recovery.

Finally, including little r restatements is necessary as an anti-evasion measure. There is substantial evidence that issuers are misclassifying reissuance restatements as revision or little r restatements specifically to avoid having to engage in a compensation recovery analysis.[21] The DERA Staff Memo implicitly acknowledges the point, observing that including little r restatements would mitigate the incentive for managers "to report misstatements as 'little r' restatements rather than 'Big R' restatements."[22] In other words, a substantial reason that revision restatements make up the bulk of restatements is the desire among some listed companies specifically to avoid engaging in a claw back analysis. Thus, if the SEC does not define "accounting restatement" broadly so that it includes all accounting restatements, including revision restatements, it will be handing issuers a roadmap for evasion of a Congressionally mandated rule.

CONCLUSION

We hope these comments are helpful as the Commission finalizes the Proposal.

---

19 DERA Staff Memo at 3.
20 DERA Staff Memo at 3.
21 Rachel Thompson, Reporting Misstatements as Revisions: An Evaluation of Managers' Use of Materiality Discretion at 2 (Sept. 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3450828.
22 DERA Staff Memo at 3.

Sincerely,

Stephen W. Hall
Legal Director and Securities Specialist

Scott Farnin
Legal Counsel

Better Markets, Inc.
1825 K Street, NW
Suite 1080
Washington, DC 20006
(202) 618-6464

shall@bettermarkets.org
sfarnin@bettermarkets.org

http://www.bettermarkets.org/