CFA Institute

560 Ray C. Hunt Drive
Charlottesville, VA
22903-2981 USA

+1 (434) 951 5499 tel
+1 (434) 951 5262 fax
info@cfainstitute.org
www.cfainstitute.org

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

14 September 2015

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

CFA Institute[1] appreciates the opportunity to respond to Securities and Exchange Commission's proposed rule, *Listing Standards for Recovery of Erroneously Awarded Compensation* (the "rule"). CFA Institute represents the views of investment professionals before standard setters, regulatory authorities, and legislative bodies worldwide on issues that affect the practice of financial analysis and investment management, education and licensing requirements for investment professionals, and on issues that affect the efficiency, integrity and accountability of global financial markets.

Summary

The proposed rule and rule amendments would direct the national securities exchanges and national securities associations to establish listing standards that would require each listed securities issuer to develop and implement a policy providing for the recovery, under certain circumstances, of incentive-based compensation paid to current or former executive officers on the basis of reported financial information that is subsequently restated. A listed issuer would be required to file the policy as an exhibit to its annual report.

CFA Institute finds the proposed rule largely reasonable, as it will allow investors to better understand a company's compensation policies regarding the recovery of erroneously granted compensation. We believe the rule as currently drafted can help assure investors that boards and board compensation committees are deploying shareowner assets to the benefit of shareowners.

Specific Comments

A. Issuers and Securities Subject to Proposed Exchange Act Rule 10D-1

1. General

[1] CFA Institute is a global, not-for-profit professional association of more than 130,000 investment analysts, advisers, portfolio managers, and other investment professionals in 146 countries, of whom nearly 115,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 145 member societies in 70 countries and territories

1. Should the listing standards and other requirements of the proposed rule and rule amendments apply generally to all listed issuers, as proposed? If not, what types of issuers should be exempted, and why? Please explain the rationale that justifies exempting any particular category of issuer.

CFA Institute sees no reason to exempt any companies from the proposed rule. The size of a company or its country of domicile should not matter in the case of erroneously awarded compensation.

B. Restatements

1. Restatements Triggering Application of Recovery Policy

12. For purposes of proposed Rule 10D-1, an accounting restatement would be defined as the result of the process of revising previously issued financial statements to correct errors that are material to those financial statements. Rather than including this definition in our proposed rule, should we refer to the definition of "restatement" in GAAP? If we do not refer to the definition in GAAP, is it appropriate to include in the proposed definition the phrase "errors that are material" or might it be confusing or redundant? Is our proposed approach the appropriate means to implement Section 10D, including its "material noncompliance" provision?

We believe the definition as currently stated is adequate. We believe it is fine for the issuers and their boards to have some discretion concerning the definition of materiality, though they must therefore be required to disclose how they determined whether an error was material or not.

13. If an issuer evaluates whether certain errors are material, and concludes that such errors are immaterial or are not the result of material noncompliance, should the issuer disclose its evaluation? If so, what should be disclosed and where should such disclosure be required?

Yes, in the interest of transparency, the issuer should disclose such evaluations, the process and assumptions used to determine whether the error(s) in question were material or immaterial, and why it decided the matter in this way. Such disclosure should be thorough enough for investors to understand the material facts of the case, understand the reasoning behind such a decision, and make appropriate decisions about the board's actions.

2. Date the Issuer Is Required to Prepare an Accounting Restatement

17. Is it appropriate to treat the earlier of the two proposed dates as "the date on which an issuer is required to prepare an accounting restatement" for purposes of triggering the Section 10D recovery

obligation? If not, why not? Would using these dates provide sufficient certainty and transparency for issuers, investors and exchanges to when recovery would be triggered for purposes of compliance with the proposed listing standards? Are there additional triggers we should consider including?

Under the proposed listing standards, the proposed rule would state that the date on which an issuer is required to prepare an accounting restatement is the earlier to occur of:
• 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.

We believe it is reasonable to use the earlier of these dates. We do not feel it is appropriate to use the later date, as a great deal of time can pass between the time an error is detected in financial statements and the time a court or regulator requires a company to take action.

18. Should receipt of a notice from a company's independent auditor that previously issued financial statements contain a material error constitute a date when the issuer "reasonably should have concluded" that such statements contain a material error? Why or why not? What if the issuer disagrees with the auditor's conclusion?

In practice, the release of a statement by the company's independent auditor will only come after a period in which the auditor discusses the matter with the issuer. Technically speaking, therefore, the company will have known that a question exists prior to the release of the auditor's statement. It is at the end of these discussions that the auditor will release its determination. While the issuer may disagree with the conclusion, it is the auditor's opinion that matters most as they have been hired as shareowners' independent monitor on such matters. Therefore, we support the view that the date of notice from the independent auditor should also be seen as a trigger date.

C. Application of Recovery Policy

1. Executive Officers Subject to Recovery Policy

20. Consistent with the Rule 16a-1(f) definition of "officer", should we define "executive officers" to expressly include the principal financial officer and the principal accounting officer (or if there is no such accounting officer, the controller), as proposed?

Yes. As individuals in these positions are often the heads of the teams responsible for a company's accounting policies, practices and the creation of a company's financial statements, it is reasonable to include them as "executive officers".

21. Are there any other officers, such as the chief legal officer, chief information officer, or such other officer, who by virtue of their position should be specifically named as executive officers subject to the issuer's recovery policy? If so, which additional officers should be subject to the issuer's recovery policy and why?

This can be left to the discretion of individual companies, as job titles mean different things at different companies.

2. Incentive-Based Compensation

a. Incentive-Based Compensation Subject to Recovery Policy

26. Is the scope of incentive-based compensation subject to recovery under Section 10D(b) properly defined by reference to compensation that is granted, earned or vested based wholly or in part upon attainment of any measure that is determined or presented in accordance with applicable accounting principles? If not, please explain what other forms of compensation should be covered and why.

Yes, it is reasonable to define incentive-based compensation subject to recovery as that which is granted, earned or vested based wholly or in part upon the attainment of any measure that is determined or presented in accordance with applicable accounting principles.

29. Should compensation that is based upon stock price performance or total shareholder return be considered incentive-based compensation subject to recovery? If not, please explain why not. If compensation that is based on stock price performance or total shareholder return is included as incentive-based compensation subject to recovery, what calculations would need to be made to determine the recoverable amount? What are the costs and technical expertise required to prepare these calculations? Who would make these calculations for issuers? Would the costs be greater than for calculations tied to other financial reporting measures, which would be subject to mathematical recalculation directly from the information in an accounting restatement? Would the exchanges be able to efficiently assess these calculations for purposes of enforcing compliance with their listing standards? Why or why not? Should we require an independent third party to assess management's calculations?

Compensation based on stock price performance can be included, though a link would need to be made that financial reporting errors led to a change in stock price, thus triggering the incentive-based compensation. In cases of fraud that are meant to directly affect stock price, this is more clear-cut. Some discretion can be given to the board and compensation committees in the instances of an error made in good faith. Regardless, the board owes shareowners a full explanation of their decision to clawback the award, or not to do so, and therefore such disclosures should be required.

30. Should incentive-based compensation be defined to include compensation that is based on satisfying one or more subjective standards (such as demonstrated leadership) to the extent that such subjective standards are satisfied in whole or in part by meeting a financial reporting measure

performance goal (such as stock price performance or revenue metrics)? If so, how could this approach be implemented? Is it sufficient that the current proposal encompasses "any compensation that is granted, earned or vested based wholly or in part upon the attainment of a financial reporting measure"? If not, why not?

See answer for 29. Discretion can be given to the board, though an explanation of any decision made should be required.

32. Should the definition of "incentive-based compensation" included in Rule 10D-1 be principles-based, as proposed? Alternatively, should the definition specify performance measures that may be affected by an accounting restatement? If so, please explain which examples should be included and why.

We believe the principles-based rule proposed captures the spirit needed to protect the interests of investors. As long as disclosure is thorough and prompt, we believe it is reasonable to give boards and compensation committees some discretion in following a principles-based rule.

b. Time Period Covered by Recovery Policy

36. Is the proposed approach to determine the three-year look-back period for recovery an appropriate means to implement Section 10D? Does it properly reflect the way in which issuers make their compensation decisions (on a fiscal year-by-fiscal year basis)? Why or why not?

The proposed three-year lookback period is a reasonable period of time. We believe that errors in financial statements would be uncovered within this timeframe and, therefore, it is unlikely that compensation before that time would have been the result of more recent reporting errors.

c. When Incentive-Based Compensation Is "Received"

39. Should incentive-based compensation be deemed "received" for purposes of triggering the recovery policy under Section 10D in the fiscal year during which attainment of the financial reporting measure specified in the incentive-based compensation award, by its terms, causes the incentive-based compensation to be granted, to be earned or to vest, as proposed? If not, when should incentive-based compensation be deemed "received" for purposes of triggering the recovery policy?

We support the proposal's provisions that incentive-based compensation be deemed "received" for purposes of triggering the recovery policy under Section 10D in the fiscal year during which attainment of the financial reporting measure specified in the incentive-based compensation award, by its terms, causes the incentive-based compensation to be granted, earned or vested. Efforts by companies to game the system by simply waiting to grant incentives outside of the period effected by the rule should be addressed by regulators (see response to paragraphs 73 and 74 below) at the time issuers decide to adopt such compensation policies.

3. Recovery Process

b. Board Discretion Regarding Whether to Seek Recovery

51. Is the proposed issuer discretion not to pursue recovery of incentive-based compensation consistent with the purpose of Section 10D? Is the scope of this discretion appropriate? Why or why not?

CFA Institute believes that boards and compensation committees should have the discretion to not pursue recovery if they so choose. However such a decision and the reasoning behind it needs to be transparently communicated to shareowners to help them determine whether the decision is, in their view, appropriate and that the board is working in their interests.

52. Should the standard for exercising discretion not to recover be limited to the extent to which that recovery is impracticable? Should direct costs of recovery be a basis for exercising discretion not to recover? If so, what specific costs of recovery should be considered? For example, should only direct expenditures to third-parties be considered, as proposed? Should we further define what constitutes "direct costs"? Should an issuer be permitted to consider indirect costs, such as opportunity costs or reputational costs? Should the issuer disclose the cost estimates in its Exchange Act annual reports? If the cost estimates are not disclosed in the issuer's annual reports, should those costs be independently verified?

We do not believe that the standard for exercising discretion not to recover should not be limited to the extent to which that recovery is impracticable. A board or compensation committee may have other reasons for not pursuing recovery, such as the severity of the error or reasoning behind the original financial reporting decision. A board or compensation committee would simply need a sound reason for telling shareowners why they chose not to pursue recovery when they had the ability to do so.

56. Are there other circumstances in which a listed issuer should be permitted to not pursue recovery from its former executive officers? If so, please explain the circumstances and what, if any, conditions should apply.

Any such decisions should be made by and communicated clearly by the board's compensation committee.

c. Board Discretion Regarding Manner of Recovery

59. How and under what circumstances, if any, should the board of directors be able to exercise discretion regarding the amount to be recovered? What steps should the board of directors be required to take, if any, before exercising any permitted discretion about the amount to be recovered from individual executive officers? 60. Are there any material tax considerations relevant to whether an issuer should be able to exercise discretion as to the amount of recovery? If so, please explain.

We believe that a board should be allowed discretion in the amount to be recovered, up to the amount awarded in cash or shares. Any such amount should be made public. The board should also

publish its policies for recovery so that investors are well informed about what to expect in the event that a recovery or clawback is required, whether because of fraudulent actions or simple accounting errors.

4. Compliance with Recovery Policy

68. Should Rule 10D-1 specify the time by which the issuer must complete the recovery of excess incentive-based compensation required by the listing standards?

We do not feel there is a need to specify a time by which the issuer must complete recovery of excess incentive-based compensation required by the listing standards. Under the proposed rule and rule amendments, an issuer would be subject to delisting if it does not adopt and comply with its compensation recovery policy. Under the proposed rule an exchange would determine whether the steps an issuer is taking constitute compliance with its recovery policy.

D. Disclosure of Issuer Policy on Incentive-Based Compensation

73. Is the proposed approach of having the listing standard require an issuer to disclose its compensation recovery policy an appropriate means to implement Sections 10D(a) and 10D(b)(1)?

74. Would it be preferable to implement the disclosure requirement only through issuer disclosure requirements? Alternatively, would it be preferable to make the disclosure requirement solely a listing standard requirement? If so, please explain why.

We believe it would be preferable to require issuers to make such disclosures through routine SEC disclosure requirements that would apply to all issuers, not just those with exchange listings. Under this system, exchanges would require issuers to have the policies, and the SEC would require disclosure of the existence of such policies – or non-existence in the case of companies who opt not to list and do not have recovery policies. The SEC would then need to disclose penalties for non-compliance with the disclosure requirements.

90. Our rules permit emerging growth companies and smaller reporting companies to provide scaled disclosure of certain requirements. Should the proposed disclosure rules for incentive-based compensation recovery policies be scaled for these companies? If so, please explain why and in what manner.

CFA Institute does not believe it is appropriate or necessary to scale the proposed disclosures for smaller or emerging growth companies. The disclosures asked for in the proposed rule should not prove excessively onerous to companies and their boards unless there is a financial reporting restatement. And in cases of restatement, investors in all companies need to understand the reasons behind the change, what steps issuers are taking to prevent recurrence, whether or not boards seek to recover remuneration from senior company executives, and how much they seek to recover. These are material issues in the performance, condition and sustainability of a company and events that may be instructive as to the type and quality of managerial oversight. Therefore, we believe it is imperative that such matters be disclosed, regardless of the size of the companies involved.

Concluding Remarks

CFA Institute welcomes the proposed rule addressing the recovery of erroneously awarded compensation. We are happy to discuss these matters further if you wish to contact us.

Yours faithfully,

James Allen, CFA

Head, Capital Markets Policy - Americas

CFA Institute

[redacted]

Matt Orsagh, CFA

Director, Capital Markets Policy

CFA Institute

[redacted]