October 2, 2015

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

File Number S7-12-15: Executive Pay Clawbacks
(Under Section 954 of the Dodd–Frank Wall Street Reform and Consumer Protection Act)

Dear Mr. Fields, Chair White, and Commissioners:

Thank you for the opportunity to comment on the newly proposed rule on executive pay clawbacks under Section 954 of the Dodd–Frank Act of 2010 (hereafter cited as "Dodd–Frank"). This comment on the proposed rule represents the perspective of corporate directors who will be charged with overseeing compliance with the new rule.

The National Association of Corporate Directors is the nation's oldest and largest organization for directors and boards—now more than 16,000 members strong. We convene, educate, and inform directors on a wide range of governance issues, including compensation, financial reporting, and legal compliance, the subjects at issue here. Indeed, all of these topics have been central to our mission since NACD's founding in 1977. Over the years our contributions in these areas have included Blue Ribbon Commission reports, handbooks, articles, white papers, webinars, and comment letters, including letters on several proposed Dodd–Frank rules.

In the release proposing "Listing Standards for Recovery of Erroneously Awarded Compensation" (hereafter "release" or "proposing release"), the SEC intends to carry out Section 954 of Dodd–Frank, which requires the SEC to direct stock exchanges to compel listed companies to develop and implement policies providing:

> 1) for disclosure of the policy of the issuer on incentive-based compensation that is based on financial information required to be reported under the securities laws; and
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> 2) that, in the event that the issuer is required to prepare an accounting restatement due to the material noncompliance of the issuer with any financial reporting requirement under the securities laws, the issuer will recover from any current or former executive officer of the issuer who received incentive-based compensation (including stock options awarded as compensation) during the three-year period preceding the date on which the issuer is required to prepare an accounting restate-

> ment, based on the erroneous data, in excess of what would have been paid to the executive officer under the accounting restatement.[1]

This Dodd–Frank provision for mandatory clawbacks is more punitive than the approach taken under the current rule from Section 304 of Sarbanes–Oxley, where the mandated clawback is triggered only if the restatements occurred due to "misconduct"; furthermore, the scope of the period covered by Dodd–Frank is only one year, not three, as in Sarbanes–Oxley.

As noted in the release announcing the proposed clawback rule, restatements are required when there is

> [a]n error in recognition, measurement, presentation, or disclosure in financial statements resulting from mathematical mistakes, mistakes in the application of generally accepted accounting principles (GAAP), or oversight or misuse of facts that existed at the time the financial statements were prepared. A change from an accounting principle that is not generally accepted to one that is generally accepted is a correction of an error.[2]

In other words, Dodd–Frank requires clawbacks for what can be innocent mistakes in accounting.

In addressing clawbacks, moreover, the SEC does not confine its scope to the statutory language of Dodd–Frank but also explores additional triggers. Its 198-page release proposes a rule (10D-1) on "recovery of erroneously awarded compensation" (hereafter "proposed rule") while posing 115 questions in 14 distinct clusters.

In this letter, we will summarize and respond to each question cluster. As we do so, we intend to show that the proposed rule, as well as some of the questions the SEC raises pertaining to it, could make the rule even more punishing than it was originally intended to be. Our responses will reflect NACD's commitment to independence, fairness, link to performance, long-term value, and transparency—the five principles of executive compensation advocated by NACD more than a decade ago in the *Report of the NACD Blue Ribbon Commission on Executive Compensation and the Role of the Compensation Committee* (2003) and reiterated this year in the *Report of the NACD Blue Ribbon Commission on the Compensation Committee* (2015), summarized here.

SEC Questions and NACD Responses

Re: Issuers and Securities Subject to Proposed Exchange Act Rule 10D-1 (questions 1–11)
This section of the release addresses exemptions for issuers that do not have common equity (e.g., those with non-convertible debt or preferred stock) or that are foreign issuers and asks whether there are additional categories of companies that should be exempted.

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[1] Dodd-Frank Wall Street Reform and Consumer Protection Act, § 954, 124 Stat. at 1904.
[2] Release, p. 24 n66, citing ASC Topic 250.

> ***NACD'S response:*** *Due to the onerous nature of the proposed rule (discussed further below), NACD recommends preserving the existing exemptions. In addition, NACD recommends giving a later compliance deadline for emerging growth companies as defined under the JOBS Act of 2012 (currently defined as under $1 billion in revenues).*[3] *The proposed rule notes that accounting restatements are common for these kinds of companies.*[4] *In our view, to the extent that these stem from innocent mistakes, this may be due to lack of resources for internal controls, so granting more time for compliance can be helpful.*

Re: Restatements Triggering Application of Recovery Policy (questions 12–16)
This section of the release asks what events should trigger application of the recovery policy. The release says that 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" (p. 26, emphasis added). The release references the filing of Item 4.02 Form 8-K (Non-Reliance on Previously Issued Financial Statements). To its credit, the rule clearly excludes certain events that are a) not material[5] or b) not corrections of errors.[6] At the same time, the release asks if the SEC should refer to the definition of restatement in GAAP instead of asserting this new definition. The release also asks about disclosing processes that lead to a decision about whether or not to restate. Finally, the proposing release asks if the final rule should include anti-evasion language.

> ***NACD's response:*** *The SEC should make its rule conform with the language of Dodd–Frank, which limits its scope to material errors. While borrowing language from GAAP on restatement might seem like the easier route, doing so would not be wise because, as noted above, the GAAP definition of restatement is very broad and does not make a materiality distinction (much less a fraud distinction). Most restatements under GAAP do not involve amounts that are material.*[7] *As for a re-*

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[3] See the Jumpstart Our Business Startups Act (JOBS Act), Jan. 3, 2012, sec. 101(a) [H. R. 3606–2].
[4] "For example, during 2012 and 2013, U.S. issuers who are not accelerated filers [as defined in Exchange Act Rule 12b-2 [17 CFR 240.12b-2] and including emerging growth companies as defined under the JOBS Act] accounted for approximately 55 percent of total U.S. issuer restatements"; see Audit Analytics Trend Report, "2013 Financial Restatements—A 13-Year Comparison" (New York: Alacra Inc., 2014), and Susan Scholz, "Financial Restatement Trends in the United States: 2003–2012" (Washington, DC: The Center for Audit Quality, 2014).
[5] Regarding nonmaterial error, under GAAP, firms do not need to issue restatements if the accounting error is deemed immaterial by management and the independent auditor.
[6] These would not trigger application of the issuer's recovery policy under the proposed listing standard; there are, however, also cases in which there is an accounting restatement under GAAP that is not based on any kind of error; it is simply retrospective application, revision, or adjustment of some kind. Such non-triggers (identified in the proposing release itself) include retrospective application of a change in accounting principles; retrospective revision to reportable segment information due to a change in the structure of an issuer's internal organization; retrospective reclassification due to a discontinued operation; retrospective application of a change in reporting entity, such as from a reorganization of entities under common control; retrospective adjustment to provisional amounts in connection with a prior business combination; and retrospective revision for stock splits.
[7] "The proportion of corporate financial restatements that had no impact on the bottom line was 59% in 2014" (Maxwell Murphy, "Restatements Affect Bottom Line Less Often," *The CFO Report* [a *Wall Street Journal* blog], Apr. 21, 2015). In a comment on this blog post, S. L. Gray asked: "Why are companies being required to restate financial statements when there is no bottom line effect? Accounting errors which are due to misclassifications

quirement to disclose a non-finding, we believe that such disclosure is unnecessary; if a company conducts an evaluation to determine the possible need for a restatement and determines that no restatement is necessary due to lack of materiality, it should not have to disclose this (for the very reason that the finding is not material). As for adding anti-evasion language, this is not only unnecessary but could be counterproductive, since an honest effort to avoid violating the rule could be misconstrued as an attempt to "evade" the rule.

Re: Date the Issuer Is Required to Prepare an Accounting Restatement (questions 17–19)
In this section, SEC staff asks for views on identifying the date on which an issuer is required to prepare an accounting restatement. The proposed rule says that it should be the earlier of two key dates, namely the date on which that company determined the need vs. the date on which the company learned of the need from a third party. The release notes that the company's decision often does (but need not) coincide with the filing of a Form 8-K (for reporting material events in between quarterly statements).

NACD's response: *Rather than having a two-part construct with an "earlier date," it is best to make the date a single one—namely, whenever the company makes a determination that a restatement is needed. The precise timing of that event would be marked by the 8-K filing, which would be the formal culmination of the various red flags mentioned above. The 8-K linkage puts the timing in the hands of the company, where it belongs. This simpler approach will cause no undue delays, especially considering that the need for restatement is often discovered months and even years after the fact. It is not uncommon for companies to restate three prior years, for example.*

Re: Executive Officers Subject to Recovery Policy (questions 20–25)
This cluster explores how the term *executive officer* should be defined in the rule, which, as proposed, expressly includes not only the named executive officers (as defined under Regulation S-K) but also the principal financial officer and the principal accounting officer. This part of the release also asks for comments on how the three-year rule can work in the case of officers whose service periods are not related to the timing of the recovery. For example, the release asks if an individual who is an executive officer at the time recovery is required should be subject to recovery even if that individual "did not serve as an executive officer of the issuer at any time during the performance period for the affected incentive-based compensation."

NACD's response: *Since the current disclosure rules focus on named executive officers, it might be best to restrict mandatory recovery to this group. However, the rule could include an instruction to listed companies allowing them to tailor their clawback policy to other officers based on the extent and size of the rewards at stake— for example, business unit leaders who were paid in relation to unit performance that in retrospect proved to be erroneously reported and awarded. As for*

(i.e., between 2 assets or between 2 liabilities, overstatement of revenue with a corresponding overstatement of expenses, etc.) should have a much higher threshold for restatement."

timing, the title of the Dodd–Frank section provides guidance: the recovery should be of "erroneously awarded" compensation. If an individual did not serve as an executive officer of the issuer at any time during the performance period being restated, then his or her pay would not normally be affected. In other words, executives are paid to perform during periods when they are present; the final rule and the ultimate listing standards should reflect this fact.

Re: Incentive-Based Compensation Subject to Recovery Policy (questions 26–35)
In this cluster of questions, the agency asks for views on its definition of *incentive-based compensation* as "any compensation that is granted, earned or vested based wholly or in part upon the attainment of any financial reporting measure" (p. 41), defining that broadly to extend beyond GAAP reporting. The SEC here explores the possibility of expanding that definition in a variety of directions so that an even greater clawback might be possible—for example, a clawback of incentive pay awarded on even nonfinancial goals such as "demonstrated leadership."[8]

> ***NACD's response:*** *The definition of incentive-based pay should not be expanded beyond the clear intent of Dodd-Frank, which, as mentioned, references "financial reporting requirement under the securities laws"; rather, the definition should limit itself to pay awarded under a formal, written incentive compensation plan that includes specific GAAP-based measures subject to potential restatement.*

Re: Time Period Covered by Recovery Policy (questions 36–38)
The SEC does not seem to have much latitude concerning the three-year lookback period for recovery, but in this section the SEC asks if an issuer should be permitted to apply its recovery policy to any three-year period in which incentive-based compensation received by executive officers was affected by the accounting error.

> ***NACD's response:*** *Given the variety and complexity of pay plans, it should be up to each company to select the appropriate time period. In some cases, three years may not apply and the company should be able to identify a different time period. Not every incentive plan is a three-year plan. (This may require a technical correction to the law.)*

Re: When Incentive-Based Compensation Is "Received" (questions 39–42)
Questions in this section of the release concern when compensation is received and related issues, such as rewards received on the basis of multiple criteria, including criteria other than those pertaining to achievement of results based on reported financial performance. Such matters clearly go beyond the scope of the Dodd–Frank provisions. This part of the release also asks whether non-listed companies might have to follow these rules, and also whether the ex-

[8] At question 30, the release asks: "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)?" (p. 48).

ecutive officer should be required to obtain a “non-forfeitable entitlement” in order to receive the compensation.

> ***NACD’s Response*****:** *Regarding the timing of receipt, the proposed rule may be too broad in defining this as any compensation received “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.” Just because a reward is granted, earned, or vests does not mean that it is actually received. For a definition of pay actually received, please see our comment letter on the proposed rule on pay versus performance under Section 953(a) of Dodd–Frank.*[9] *In that letter, we questioned the Commission’s proposal that “equity awards be considered actually paid on the date of* ***vesting*** *and valued at fair value on that date, rather than fair value on the date of* ***grant*** *as required in the Summary Compensation Table.”*[10] *The pros and cons of using the vesting date vs. grant date are beyond the scope of this letter, but guidance is available.*[11] *As for relevance of stock exchange listing, since this is posed as a listing rule, it should not extend beyond the boundaries of the time period of listing. Finally, it might be a good idea for companies to explore the legalities of non-forfeitable entitlement as a shield against overreach. If companies can prove that their executives had such an entitlement, this might prevent them from clawing back the pay. The burden should be on companies to write good compensation agreements.*

Re: Determination of Excess Compensation (questions 43–50)
In this part of the letter, the SEC extends well beyond what we believe was the intent of Congress by broadening the scope of Section 954 beyond financial reporting results and into stock performance and records retention. For example, the SEC asks: “For incentive-based compensation based on stock price or total shareholder return, would permitting the recoverable amount to be determined based on a reasonable estimate of the effect of the accounting restatement, as proposed, facilitate administration of the rule by issuers and exchanges?” (At the end of the release, in the economic analysis section, the SEC explains that in order to estimate the effect of the accounting restatement on the financial reporting measure, a reasonable estimate of the ‘but for’ price of the stock [i.e., the stock price that would have existed if financial statements had been presented originally as later restated] must be first determined.”) The SEC also asks about recovery of compensation under “qualitative standards.” Finally, there are questions here about documentation in the case of recovery based on estimated values.

> ***NACD’s Response:*** *We strongly disagree with the inclusion of stock-price-based incentive pay, as well as “qualitative standards,” both of which fall outside the scope of Congress’s intent. As mentioned earlier in the “Restatements Triggering Application of Recovery Policy” section, most restatements do not involve material*

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[9] See NACD, Comment letter Re: File Number S7-07-15, Concerning Pay Versus Performance, posted on www.sec.gov, July 10, 2015.
[10] Ibid.
[11] See Pearl Meyer & Partners, *Client Alert: SEC Proposes Rules on Clawback Policies* (July 7, 2015), p. 5.

> *amounts, which means that the original statements, however flawed, are unlikely to have caused a material difference in stock price and are thus unlikely to have caused erroneous incentive awards. In the original language of Section 954, the required clawback policy is intended to cover "incentive-based compensation that is based on financial information required to be reported under the securities laws," as quoted in the opening of this letter. This is a straightforward calculation that does not involve estimates and documentation beyond a company's normal policies for calculating and documenting incentive pay decisions. What is not at all straightforward—and could be prone to gross error in calculation—is the difference in stock price that would have resulted had the restated financials been issued at the time of the erroneous financial statement. Equity markets judge the value of individual securities on the basis of multiple contemporaneous factors; replicating these for the purpose of determining a clawback would be at best difficult and at worst a "windfall for the plaintiffs' bar," as David Swinford of Pearl Meyer states in his letter of September 14.[12] Indeed, it would be a wasteful distraction that would cost a company far more in dollars and opportunity than it would recoup from some marginal clawback amount. It therefore seems obvious that the second part of Section 954, regarding recovery, also refers to this same type of compensation, based on reported financial results, and does not refer to other parts of an incentive plan that might relate to stock price or more qualitative matters. This said, we believe that the final rule should be flexible enough to permit—but not compel—directors to make and document such recovery (of incentive pay awarded on the basis of stock price or qualitative standards), as detailed in the next section.*

Re: Board Discretion Regarding Whether to Seek Recovery (questions 51–58)
This section of the release declares that an issuer "must recover erroneously awarded compensation in compliance with its recovery policy *except to the extent that pursuit of recovery would be impracticable* because it would impose undue costs on the issuer or its shareholders or would violate home country law and certain conditions are met." The questions in this cluster ask about the scope of the exemption and related issues. For example, the release asks, "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?" It also asks, "Should the determination that recovery would be impracticable need to be made by the issuer's committee of independent directors responsible for executive compensation decisions, or in the absence of such a committee, by a majority of the independent directors serving on the board?" Another important question asks whether a policy could cause a company to "violate any existing statutory or contractual provisions," and, if so, whether these could be resolved through amendment to bylaws.

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[12] "Arriving at this reasonable estimate will necessitate extensive research, testing, and expense to understand how stock price and TSR would have been impacted by a restatement, and there are countless assumptions that go into the 'but for' price of the stock. The Proposal provides almost no guidance or parameters as to how to arrive at such valuations. In fact, the Proposal takes eight pages to discuss the complexities. If adopted as is, the Proposal will be a windfall for the plaintiffs' bar, as any 'reasonable estimate' will be fair game for challenge, and executive officers will also likely dispute these estimates if subject to a clawback" (David Swinford, Comment letter Re: File Number S7-12-15, Executive Pay Clawbacks, posted on www.sec.gov, Sept. 14, 2015).

> ***NACD's response:*** *NACD firmly believes that board should have the maximum discretion to decide whether to pursue recovery. Therefore in answer to the question about practicality (question 52), we would say that the standard should not be limited to cases of impracticality but can be for other reasons, such as concerns for corporate reputation, as mentioned in the release. As for the individuals making the determination (in answer to question 55), this determination should definitely be made by independent directors, as described above. The question of contractual violation is serious and may not be resolved merely through an amendment to bylaws. To solve this problem the rule could apply only to compensation contracts that do not contradict any law, and that are written after the effective date of the clawback rule (with which they must be in compliance). The burden would then be on companies to align their contracts and their policies with existing laws and rules, including the clawback rule. The legal principle of grandfathering is widely accepted and should resolve this issue of contradiction.*

Re: Board Discretion Regarding Manner of Recovery (questions 59–67)
Following the section above regarding board discretion on *whether* to seek recovery, this section focuses on board discretion regarding *how* to make recovery. It does not allow the board to differentiate among officers affected but mandates a single standard, pro-rated by the size of the original reward. This section of the release also says that the board should be able to make exceptions only (as above) when recovery is impractical. This section asks how and under what circumstances the board should be able to exercise discretion on the amount to be rewarded; what material tax situations might be relevant; and what to do when discretion was involved in making the award in the first place, e.g., in a pool plan. The release also asks for comments on the use of board discretion on the means of recovery; the possibility of codification; the issue of netting amount based on both underpayment and overpayment in the same three-year period, as restated; and various timing issues, including the possibility of having a nonqualified deferred compensation plan (e.g., a "holdback plan" or "bonus bank") to aid recovery.

> ***NACD's response:*** *NACD believes that the board as well as its independent compensation committee should have maximum discretion in determining the manner of recovery, including using net amounts with periods of underpayment offsetting periods of overpayment (which would be most fair), as well as the possibility of setting up a nonqualified deferred compensation plan to insure against the possibility of a future clawback. In that way, the money would not need to be retrieved from the bank accounts or wallets of executives, but would be in the custody of the company, making recovery easier. In the case of a pool plan where the board has discretion to exceed the amount paid irrespective of reported financial performance, the extent of recovery would depend on the precise wording of the plan. If the plan approved by shareholders at the say on pay vote does not have a minimum financial performance requirement based on financial reports, then the clawback mandate should not apply. With regard to tax matters, any amount recovered should be the amount the executive was originally paid after taxes, not before taxes.*

Re: Compliance With Recovery Policy (questions 68–72)
This section of the release addresses compliance, asking whether the final rule should give a deadline or any standard for judging compliance, whether objective or subjective. The release also raises the possibility of compliance disclosure and assessment. Finally, the release asks for comments on how the rule could be revised to better ensure compliance.

> ***NACD's response:*** *The rule already requires the company to develop and disclose a policy concerning clawbacks and dictates the basics of what must be in that policy (namely, the recovery of excess compensation paid in the three years prior to the restatement). It would obviously be incumbent upon the board and the independent compensation committee to comply with this requirement. If they did not comply, the usual consequences of shareholder litigation and/or SEC action would follow. There is thus no need to build into the rule any additional mechanisms for assurance of compliance.*

Re: Disclosure of Issuer Policy on Incentive-Based Compensation
The SEC's proposed rule interprets Dodd–Frank as requiring disclosure of the clawback policy as both a listing requirement and an SEC filing requirement under Item 402 of Regulation S-K. The proposed rule makes requirements of what and how to disclose the clawback information in the Compensation Discussion and Analysis and in the Summary Compensation Table in the proxy statement. The release asks for comments on this interpretation.

> ***NACD's response:*** *It seems clear from the rule that Congress intended for the clawback disclosure and recovery mandates to be a listing requirement. However, it is not clear that these mandates should have to trigger disclosure of any specific recoveries in the proxy statement. Disclosure of a clawback policy could be made via the company's website by posting the policy there. The details of any specific clawback could be made public via an 8-K disclosure and would probably follow the sensible format the SEC has outlined in the proposed rules as a matter of course (who, how much, when, etc.).*

Re: Indemnification and Insurance (questions 93–96)
The anti-indemnification provisions of proposed Rule 10D-1 would prohibit "agreements, arrangements, or understandings that directly or indirectly mitigate some or all of the consequences of recovery." The release asks whether exchanges should be able to prohibit listed companies from indemnifying or insuring executive officers against the risk of clawbacks, or the cost of litigation expenses. The release also asks how the exchanges and companies can distinguish between payments made based on indemnifications agreements from other forms of compensation, and asks whether the Commission should define *indemnification* for purposes of the recovery, and, if so, whether this definition should require that any such agreements be made before the event to be indemnified.

> ***NACD's Response:*** *If the clawback provisions of Dodd–Frank were focused (like those of Sarbanes–Oxley before it) on clawing back compensation awarded to executive following restatements necessitated by past fraud, then a prohibition*

against mitigation of the rule's effects through indemnification or insurance would make sense. However, since the Dodd–Frank rule is predicated upon the clawback of any compensation deemed to be excessive, including overpayments made because of an innocent accounting mistake (such as failure to adhere to an accounting rule that had come into effect shortly before the original statement), then companies should be free to manage this risk as they deem appropriate.

Re: Transition and Timing (questions 97–99)
In this part of the release, the SEC gives a proposed 60-day time frame for adopting its clawback policy and asks for comments on that. Furthermore, it asks when day 1 of that time frame should start—on the effective date of the SEC's rule giving direction to the exchanges, or of the exchange listing rule. The SEC also asks if the SEC should consider the date of compensation agreements and the ability of issuers to modify them.

NACD's Response: *Compensation committees will need as much time as possible to comply with the rule. Even if they receive support from full-time members of management, they would still want to meet and consider the policy. NACD research shows that compensation committees normally meet four to six times per year. For this reason we would ask for a mandatory time frame of no less than 90 days and would recommend that the start date be the date of the listing standard.*

Re: Analysis of Potential Economic Effects (questions AP1–AP14)
The release concludes with a cluster of 14 questions. Among other requests, this section asks for comments about the impact of the rules on smaller companies and emerging growth companies. The release requests commentary on whether the proposed rule may spur "higher quality financial reporting." The SEC here also requests comments about possible costs of the stock price studies necessitated by the part of the proposed rule discussed earlier at "Restatements Triggering Application of Recovery Policy." Finally, in this section, the release asks about the effect of the proposed rule on the market for executive officers and the market for public companies.

NACD's Response: *NACD believes that this proposed rule, as drafted, could negatively impact company productivity and value, especially among smaller companies. Furthermore, NACD believes that the proposed rule, like any rule that increases disclosure and compliance burdens unnecessarily, puts an inordinate burden on smaller companies, which cannot always afford the kind of compliance costs entailed by new rules. This is particularly true for the part of the proposed rule that would extend the clawback to overpayments attributed to stock price appreciation. As discussed earlier, this kind of calculation should be entirely unnecessary, since the original clawback provision of Section 954 of Dodd–Frank was limited to financial information in financial statements and did not extend to stock price. Regarding the quality of financial reporting, we don't think the rule will improve it; and even if it were to do so, this improvement would be at the expense of the results reported. As the release itself notes, "the increased allocation of resources to the production of high-quality financial reporting may divert resources*

> *from other activities that may be value enhancing[; it] may also encourage executives to forgo value-enhancing projects if doing so would decrease the likelihood of a financial restatement." We are most concerned about these potentially negative effects, even more than the compliance cost of the proposed rule. In addition, the rule could have an inflationary effect on the market for public company executive officers if they receive higher pay packages just to cover the risk of future loss through clawbacks. Finally, the rule might have a dampening effect on the market for public companies themselves if it and other rules like it influence private companies to remain private or push public companies to go private.*

In closing, we note that this rule—like the Dodd–Frank provision it implements—seems to offer a solution for a non-problem. Most major companies already have clawback policies, according to Equilar.[13] Furthermore, during this past proxy season only 13 of the 250 largest U.S. public companies received proposals from shareholders requesting new or revised clawback policies; and in every case, shareholders rejected these proposals.[14] As for financial reporting, this has never been identified as a major flaw in our economic system. In fact, we would venture to say that U.S. financial reporting has become the world's gold standard, thanks to the SEC and its financial accounting arm, the Financial Accounting Standards Board. The challenge before the nation is not how to improve financial reporting or retrieve pay following restatements. The real challenge is how to create and maintain long-term company value that can reward employees at every level, from hourly workers to senior executives, as well as provide a return to the shareholders who invest in them.

We hope that these observations and recommendations will be helpful to you as you move toward a final rule implementing Section 954 of Dodd–Frank.

Sincerely,

Ken Daly, CEO

Peter R. Gleason, President

Dr. Reatha Clark King, Chair

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[13] Aaron Boyd, Leslie Lau, B.J. Firmacion, and Charlie Pontrelli, *2013 Clawback Policy Report* (Redwood City, CA: Equilar Inc., 2013).

[14] These figures derive from search results for the term *clawbacks* on the Proxymonitor.org website.

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